

European Employment Observatory

Article on Undeclared Work from SYSDÉM Correspondent (Update of EEO Review: Autumn 2004)

Malta

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1. Introduction

While undeclared work has occasionally attracted the attention of politicians, economists and other researchers, it has rarely been a topical issue on the public agenda. Indeed there has hardly been an increase in public awareness about it over the past years. Apart from sporadic references, trade unions, employers associations and civil society associations tend to sideline this issue and focus their energies on other matters. Underground economy is a more topical issue than undeclared work. This may be due to the fact that the former topic is wider and includes not only paid activities that are lawful in nature and undeclared to public authorities, but also unlawful ones.

Since the launch of the new Lisbon Strategy in 2005, the government drafted a number of policies and measures that directly and indirectly tackle the issue of undeclared employment. These efforts are referred to in several official documents released over the last two and a half years, including the National Reform Programme (NRP), the NRP Annual Progress Report 2006, the National Strategic Reference Framework (NSRF) 2007-2013, and the recent Government Budget documents.

The political debate related to undeclared work in Malta has tended to focus on the abusers of the social benefit system, on illegal immigrants and on the indirectly linked theme of female employment. The importance of the first two issues is probably due to other circumstances beyond the Lisbon Strategy. Over the past years, government has been trying to reduce the burden of public spending through various measures, including the reduction of public sector workers and the better utilisation of existing resources. A major driver towards such efforts has been Government's target to adopt the Euro by January 2008. The measure taken to reduce fraud, which government claims to have been successful, is perceived as a positive step in this regard.

On the other hand, in recent years, the issue of illegal immigration has exacerbated due to the increasing numbers of illegal immigrants landing in Malta. A sizeable number of these immigrants are doing undeclared work especially in the construction and tourism sectors. The third major issue, namely that of female employment, is probably the one which is most directly attributable to the agenda of the Lisbon Strategy. Malta suffers from the lowest female employment rate among EU member states. It is believed that part of the formally inactive women do undeclared work (National Council of Women, 2006). The issue of female employment has, over the past two decades, been put high on the government's agenda and has featured prominently in public debate.

2. Prevalence of undeclared work in the economy

2.1 General assessment of recent trends

Over the last few years there has hardly been any effort to gauge in quantifiable terms the real extent of undeclared work in Malta. There is still no official direct measurement of the extent of undeclared work in the country's economy. The latest attempts at quantifying the Maltese underground economy in speculative terms include those carried out by Briguglio (1989) and Cassar (2001) referred to in a previous report submitted by Cordina (2004). Briguglio's study estimates the underground economy at around 25% of the Gross Domestic Product (GDP). On his part, Cassar (2001) attributed a rise in underground economy between 1971 and 1997 to a

lack of confidence in the government's policy, lack of fiscal morality, and a pervading culture of strong family-oriented entrepreneurial businesses where the informality that prevails is conducive to undeclared work. There are no clear indications of any shift of paradigm in any of these directions. The issue of fiscal morality that was popularized by the previous finance minister has ceased to be topical nowadays. Opinion polls and local elections indicate that confidence in the current government, if anything, has decreased. Besides, the prevailing family model of small entrepreneurial ventures is still dominant. If these criteria are useful indicators for the extent of undeclared work, one can assume that it is still widespread. On similar lines, Zammit (2005) argues that "the high level of consumption, when compared to household disposable income and the increase in savings or financial instruments that represent savings like bonds, shares and collective investment schemes, makes one doubt whether it is possible to achieve such a level of consumption and such a level of saving unless a significant part of income is remaining undeclared."

Undeclared work seems to be more prevalent in particular sectors such as construction, personal services and in domestic related trades (NSRF 2006). There appears to be a significant gender division in the type of undeclared employment. Whereas undeclared male employment tends to be mostly associated with the construction industry, undeclared female employment appears to be more rampant in personal and domestic services. There also seems to be similar prevalence of men and women doing undeclared jobs in the hospitality industry, which, due to its seasonality, becomes higher in summer when a number of youths, students or new job seekers join the bandwagon.

One can attempt to estimate the quantity and trends of undeclared work by comparing the Labour Force Survey, which is based on figures derived from the supply side of the labour market with Administrative data representing demand-side information supplied by employers through engagement and termination forms. The discrepancy between the two sources of data indicates that there is a consistent amount of undeclared work in the economy (see Table 1). The phenomenon is more prevalent among females than males. However, in the past years, the ratio of men in undeclared occupations seems to have increased significantly. As often highlighted by Employment and Training Corporation (ETC) officials and women's organizations, the high levels of female undeclared work is influenced by the rigidity of employment laws and organizational cultures which do not facilitate the integration of women in the formal labour market. Government's effort to increase the lawful female employment was probably instrumental for the apparent containment of female undeclared activity between 2003 and 2006.

Table 1. Employment in Labour Force Survey and Administrative data

	Males	Females	Total
LFS Fourth Quarter 2006	104,133	48,610	152,743
Administrative Data November 2006	97,015	42,441	139,456
Discrepancy %	6.8	12.7	8.7
LFS December 2003	101,159	45,883	147,042
Administrative Data December 2003	96,245	39,989	136,234
Discrepancy %	4.9	12.8	7.4

Adapted from National Statistics Office, News Releases 53/2004, 93/2004, 51/2007, 55/2007

As can be seen in Table 2, the number of employment infringements identified by the ETC increased considerably in the last five years. The number of persons found working and registering in the period 2005-2006 is one of the lowest in recent years. However, the number of foreigners caught working illegally increased threefold in the past year. A parliamentary

question (No.19106) concerning the first four months of 2006 gives an indication of the distribution of migrants caught working without a legal permit; 56% were working in construction, 25% in catering, 8% in commerce, 6% in industry and 5% in cleaning.

Table 2 also shows that the number of persons found working without the necessary documentation, which is by far the most common type of infringement reported by the ETC, increased by 54% in the last five years. These figures must be interpreted with caution as they are based on the number of inspections carried out every year. Despite this, there seems to be a consistent increase of undeclared work over the last years.

Table 2. Employment Infringements

	2001-2	2002-3	2003-4	2004-5	2005-6
Unreported employment	1,191	1,316	814	1,643	1,831
Working while registering	373	215	408	334	219
Employment of foreigners	46	96	70	71	195
Employment of minors	6	11	10	30	20
Total	1,616	1,638	1,302	2,078	2,265
<i>Number of inspections</i>	<i>5,623</i>	<i>4,359</i>	<i>2,790</i>	<i>3,850</i>	<i>5,144</i>

ETC Annual Report 2005-6

2.2 Social Security and undeclared work

Malta's National minimum wage forms part of the numerous laws designed to provide security and decent working conditions for employees. It is difficult to conclude whether the minimum wage, currently at Lm59.63 (139 Euros) (Legal Notice 331, 2006) per week, is causing undeclared work to increase. Employers blame the annual increase of the minimum wage based on the rising cost of living for a reduction in competitiveness. Many employers seem to be discouraged by such restriction and prefer to use undeclared employment to cut their expenses. On the other hand, the difference between the minimum wage and unemployment benefits, which is marginal, does not motivate the unemployed to take up a job in the formal economy. The problem might be more related to an inefficient social security system rather than the low minimum wage. Employers associations have often remarked that the existing unemployment benefits demotivate the unemployed to seek employment in the formal economy.

Micallef (2006) remarked that if one has a child, unless one earns Lm 400 (930 Euros) per month, it pays more not to work. The calculations are based on the unemployment benefits and other allowances (including free medicines, subsidized electricity and others) on one hand, and the financial burdens of childcare, transport etc on the other. The situation seems to be particularly problematic in the case of unskilled or semi-skilled persons whose income may be very close to the minimum wage. They find it more lucrative to register as unemployed in order to get the benefits and engage in undeclared work to supplement the benefits.

The Department of Social Security (DSS) is currently evaluating the existing social benefit schemes in order to determine whether these can be improved. The schemes are being evaluated in the light of the need to encourage more people to join workforce legally.

2.3 Taxation system and undeclared work

Malta has a strongly progressive income tax system. In the last years, the percentage of tax paid on income earned has decreased, as the average gross annual salary for employees increased by Lm 361 (840 Euros) from 2003 to 2006 while the income tax bands remained the same. The average tax rate compares favourably with other EU countries.

In the last Budget, government revised the tax bands and removed the 20% tax rate by increasing the 15% tax bracket. This measure should decrease undeclared work among middle income workers. However, at 35%, the highest marginal tax rate is a high one when compared to other EU countries. Such rate tends to encourage middle and high earners, such as technical persons and professionals to do undeclared work. Indeed, according to the Director General of the DSS, the most common cases of abuse to the social security system involve persons not declaring their full income. Certain employers prefer to declare only part of the pay of their high-salaried workers in order to keep them motivated.

It is believed that there is a widespread abuse of the VAT system (standard rate of 18%) by self-employed persons who give their clients the option to pay VAT or not. While government has strived to reduce this phenomenon in various ways including through awareness campaigns among the general public, the efforts have not been completely successful. A few years back, the government carried out an exercise to benchmark the average earnings within the medical profession in order to be better able to examine doctors who declare to earn less than expected. It is unclear whether such exercise was also carried out with other professions.

Corporate tax in Malta is charged at a burdensome rate of 35%. Employers' associations have often voiced their concern that such tax level stifles economic growth and deters foreign direct investment. However, the link between this tax and undeclared work is unclear. One should note that among others, the Business Promotion Act (BPA) provides reduced tax rates (available up to the end of 2008) for companies in particular sectors.

3. Measures taken to combat undeclared work

3.1 Links with the debate on immigration, flexicurity and social security reform

There is an ongoing debate on the principal components of flexicurity, namely that of improving the flexibility of the workforce through lifelong education and better employment legislation while enhancing the social security system. The issue of undeclared work tends to be closely associated with the issue of social security. It is acknowledged that there exists a considerable abuse of the social security system including persons doing undeclared work while making use of government social security benefits. While such abuse has been condemned by government and social partners alike, many believe that efforts to curb undeclared work should be intensified. Nevertheless, it is reassuring to note that the government put such issue on its agenda and is taking initiatives aimed at reducing social benefit frauds. In particular, the cooperation between ETC, the DSS, the Tax Compliance Unit, the VAT Department and the Police Force are yielding positive results.

In Malta, there is an ongoing debate about illegal migrants which has, in recent years increased to unsustainable levels. While only 24 illegal migrants were reported in 2000, the figure reached 1,388 in 2004. This issue has evidenced the different perspectives of workers

and employers' representatives. The former stress that the work being done by illegal immigrants is, among others, reducing the unions' bargaining power and undermining the core labour standards. On the other hand, going against public sentiment, employers' representatives are urging government to legalize the status of these immigrants. The employers contend that these immigrants are reducing the gap between the supply and demand for labour in some sectors especially in the construction industry and the hospitality sector. The debate on the undeclared work of illegal immigrants has become more salient due to an increasing racial hostility appearing among the Maltese population.

3.2 Measures taken in recent years to combat undeclared work

The Maltese government is carrying out various measures which directly or indirectly combat undeclared work. The following is a list with the most important recent measures.

Measures focusing directly on undeclared work

- In 2005, the government announced a new law aiming at regulating foreign workers and controlling illegal employment. Contractors caught employing foreign workers without work permit will be blacklisted from any government contracts for three years (DOI 2005).
- The government embarked on a review of the policy in the field of employment of third countries nationals to better manage economic migration and to minimise illegal employment (NRP Annual Progress Report 2006).
- The ETC is setting up a campaign to raise awareness of the benefits of working within the formal economy, as well as outlining the penalties if one is caught in undeclared employment.
- In 2003, the ETC Law Compliance Unit launched a free phone service for reporting illegal employment both Maltese and foreigners. In 2006, it was reported that ETC receives an average of 111 calls every month reporting illegal employment (DOI 2006).
- The ETC bound itself to conduct skills profiles of all unemployed to be able to refer them to suitable courses and jobs (NRP Annual Progress Report 2006).

Measures aimed at reducing the abuse of social benefits

- In 2005, as part of government's campaign to intensify its fight against social benefits abuse, such as unemployment registration while in employment, an Anti-Fraud and Investigation Directorate was set up within the DSS.
- According to the new policy adopted by ETC, those registering for work have to attend training and employment schemes depending on the needs of the labour market as well as participate in community work (Budget 2005). Upon refusal of such services the registrants are struck off the register.
- Persons found registering for work while in employment will not be permitted to continue registering before producing evidence of having been in gainful employment for six

months since registering after they had been made redundant from their job (Budget 2005).

- A reform of invalidity pensions was announced in the 200 Budget. Tighter conditions were being imposed on certification of the medical condition of applicants applying for invalidity pensions.

Measures aimed at improving the taxation system

- Whereas before, only persons in full-time or in self-employment were eligible for a fixed rate of 15% on secondary employment, up to a maximum of Lm3,000 (6977 Euros), as from January 2005 a couple opting for joint taxation also started enjoying the right to benefit from this rate (Budget 2005).
- In the 2006 Budget, the government pledged to strengthen the Anti Fraud Department to make sure that every person meets one's tax obligations (Budget 2006). Among others, the Revenue and Customs unit of the UK provided technical assistance under a twinning agreement with the VAT Department (DOI 2005).
- In 2005, the government started providing tax credits to promote particular operations such as back office services, re-investment of profits by SMEs and others. In 2005, government also launched a loan guarantee scheme to support start-ups (NRP Annual Progress Report 2006).
- In 2005, the government also launched a system of fiscal incentives relating to the taking up of ICT, Sciences or Engineering qualifications at university level.
- Amendments were made to the existing tax legislation to enable the sharing of tax and social benefits information between the Tax Compliance Unit and the Social Benefit Fraud Directorate to strengthen their investigative powers (Budget 2006).
- Government declared it would start implementing a mechanism to protect consumers against VAT receipt abuse and facilitate the reporting of such abuse. (Budget 2006).
- The government announced legal changes to enable persons working in a family business to register as employees of the same family business for fiscal purposes. Thus all family members were given the opportunity to enjoy all social benefits which include entitlement to a pension. The measure also includes a tax reduction for the family business (Budget 2007).
- Those persons working on a part-time basis for more than 8 hours a week but whose part-time is their main employment, started paying 10% of their remuneration instead of paying the minimum contribution of LM5.79 (13 Euros) per week. Furthermore, they also became entitled to social benefits on a pro rata basis (Budget 2007).

3.3 Policies supporting transition from undeclared to declared economy

Apart from creating measures to combat undeclared employment the government also set up policies that focus more on the active support of firms and workers in the transition from undeclared to declared economy. The following subsections will focus on two of the most visible aspects of such effort, namely that of increasing female employment and that of reducing the number of registering unemployed.

Increasing the female labour market participation rate

It is acknowledged that there is a significant female participation in the underground economy (National Council of Women, 2006). The following are some of the main measures the government introduced in recent years aimed at increasing the female participation in the formal labour market:

- Women being absent from the labour market for more than five years started receiving a tax credit of Lm688 (1,600 Euros) for two consecutive years when they return to work (Budget 2005)
- The government amended the Income Tax Act to extend the applicability of lower tax on part-time work to spouses working only part-time when their spouse is in full-time employment (2005).
- Parents making use of a licensed childcare provider are entitled to a deduction of Lm400 (930 Euros) from their chargeable income (Budget 2007). The ETC also assists single parents who are registered unemployed and wish to follow training or seek employment by helping them obtain child care provision through the payment of a child care allowance.
- The government provided more family friendly working conditions for employees in the civil service and announced its intention of extending them to the entire public sector.
- The ETC is currently implementing that offer training for women that were absent from the labour market (NRP Annual Progress Report 2006).

ETC's active labour market measures

ETC plays a key role in aiding the transition from undeclared to declared work, by among others, offering a variety of training courses to the registered unemployed. Apart from running training courses, the ETC seeks to remove the barriers to employment through measures including:

- *Training and Employment Exposure Scheme* facilitates the re-training of unemployed workers over 40 years of age in areas where they can be re-integrated in the labour market.
- *Job Experience Scheme* targets school leavers who lack work experience. This scheme aims to improve their chances of employability and ensure a smoother integration into the labour market, whilst simultaneously boosting their self-confidence.

- *Active Youth Scheme* involves young adults in projects for Non-Governmental Organisations in order to help participants discover and enhance their hidden abilities.
- *Job Clubs* provide participants with the opportunity to infiltrate and experience diverse working environments, whilst also offering them the possibility of making contacts with employers.
- *Work Start Scheme* targets individuals lacking apt working experience by providing them with an opportunity to work and in house-training. Eligible candidates include adults who have been absent from the labour market for at least five years and persons who possess academic or vocational qualifications but do not work in the area that they desire.
- *Supported Employment Scheme (SES)* is aimed at persons with special needs who are registered unemployed. Its primary objective is to enhance the involvement of this specific group in open employment.

4. Conclusions

While there is acknowledgement of the prevalence of undeclared work, more concrete measures are needed to address the issue and curb abuses. It can hardly be denied that a shift from undeclared to declared work would bring about numerous benefits to Malta's competitiveness and the overall business environment, while at same time reinforce the social cohesion and the sustainability of public finances. Several direct and indirect measures have already been implemented in this direction. Others, such as lowering taxation levels would raise the incentive to declare income (Cordina, 2004). Public information campaigns should also become louder and wider to change people's perception of undeclared work.

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