

Factsheet on Undeclared Work - CYPRUS

1.1 Nature and Estimated Scale of Undeclared Work

1.1.1 Definition of undeclared work

The Commission's definition of undeclared work (UDW) is paid, legal, work that is not declared and not reported. In Cyprus, there is a grey area surrounding the term 'legal' in the Commission's definition which should be brought out. An activity could be publicly legal but may violate individual contractual commitments in the terms of employment. For example, publicly employed teachers are not allowed to tutor their own students under a private account, yet private schools employing their own teachers and providing tutoring are perfectly legal. We will refer to this situation as an individually illegal activity. The basic problem is not whether such an activity is reported, but rather that it is not allowed under an individual contract. In the case of public servants, a second employment is prohibited by law.

In Cyprus, there is no official and immutable definition of UDW. Officials from the Ministry of Labour, Welfare, and Social Insurance (MLSI) tend to favour a pragmatic definition which revolves around whether "contributions (to) the Social Insurance Fund are not paid or are paid (for) a lower wage"¹ Some of the discussions that have recently taken place have clearly referred to privately illegal activities, and several widely publicised raids on private homes where tutoring was taking place by publicly employed teachers have occurred over the years. Other examples of privately illegal and undeclared activities include those by publicly employed doctors who may work on their own account, and illegal immigrants and refugee claimants who engage in paid legal activities when they are not supposed to (refugee claimants are not allowed to work in the first six months of presence in Cyprus; after six months, they may work legally in certain pre-specified areas of work).

Most official concern has been about the employment of workers such as illegal immigrants, refugee claimants who engage in paid legal activities when they should not, and the non-declaration of legal work carried out by Cypriot or other legal workers in a paid or self-employed capacity. Abuses of the terms of employment (e.g. requiring workers to work for longer hours than they should) are, in principle, monitored by officials from the MLSI.

Since there is no universal definition of UDW, different organisations with diverse remits will have a different focus. The dominant player involved in monitoring UDW is MLSI; this occurs through the regular supervision of the workplace – see below. Other organisations are also involved and will have a different focus. The Ministry of the Interior deals with work permits, nationality issues, identity cards etc. The Ministry of Finance may shape tax and other policy which may impact on the incidence of UDW, but its focus will be a macroeconomic one. The newly unified tax authorities will be interested in the collection of income and indirect taxes, and their focus will be primarily on the collection of assessed but as yet unpaid tax liabilities by individuals and companies.

1.1.2 Characteristics of undeclared work

The main types of workers engaged in UDW include: Illegal immigrants who are employed in legal work, such as construction, and receive envelope wages; the self-employed (including a wide range of professions and vocations) whose work is not reported or is underreported, some of which may be in second jobs that are individually illegal; legal paid workers who hold jobs that are not declared and for which no social security contributions are made; and those receiving unemployment benefit and social security who hold jobs that are not declared. The first three groups are likely to account

¹ This quote was contained in the validation review of the draft sent to the 'nominated representatives of Cyprus'.

for most of the UDW in Cyprus, but no real evidence is available on the total or their relative ranking in importance.

The main sectors where UDW is likely to be found include home services, construction, the food and restaurant sectors, the hospitality business, agriculture, retail trade and across a diverse range of vocational and professional services.

The Commission's (2014) *Undeclared work in the EU, Special Eurobarometer* reports (QE6) that home renovations (25% of respondents), car repairs (22%), home cleaning (35%), farm products (11%), other services (24%), and other goods (20%), are the areas where much of UDW is believed by respondents (according to the percentages shown in brackets) to be found.

There is no hard evidence available on how UDW is distributed by employer size. It is possible that large companies are more professionally run and careful about UDW. To the extent that some abuses occur (e.g. reducing the effective wage rate by requiring longer hours of work or flexible forms of employment), these may be engineered by 'consensus' between the employer and the employees. Abuses may be more likely in the case of individual employers or very small companies where the two parties can come to a mutually acceptable arrangement which reduces costs for the employer but also preserves the worker's job. It should be noted that some of the penalties for UDW (e.g. the exclusion from bidding on government contracts) will concern large firms, so there is an additional incentive for compliance in their case.

There are motives for UDW from both sides of the market. For employers, UDW 'pays' because, until the crisis, there was a shortage of unskilled labour; now, it pays because the decline in demand has necessitated a decrease in costs. Illegal workers offer flexibility in terms of when and for how long they are employed, are paid less than unionized labour, and their social security and other contributions are not made. From the point of view of the worker involved in UDW, the motives include securing work and tax-free income at terms which are preferable to unemployment or legal work elsewhere. In the case of Cypriot workers engaged in UDW, the motives may include adding to their income through flexible forms of employment which are not widely available and are generally not sanctioned by unions. Thus, each category of UDW carries its own special context and forces at work.

The Commission's (2014) *Undeclared work in the EU, Special Eurobarometer* reports ((QE4T) as reasons for UDW that 26% of respondents believe that regular salaries are too low, 15% say that there are no regular jobs and 14% assert that social security contributions are too high.

1.1.3 Estimated scale of undeclared work

Any estimate of the scale of UDW is fraught with difficulties, both definitional and conceptual. The discussion below should, therefore, be read with this caveat in mind.

As noted in section 1.1.2, there are three large sources of UDW. Illegal immigrants are thought to be of the order of 25-35,000, or between 7-9% of the gainfully employed in Cyprus (currently approximately 370,000 persons). So a very rough estimate of the share of GDP (meaningful only under special assumptions about the production function and likely an overstatement) due to this particular type of UDW might be of the same order, namely around 7%.

A second large source of UDW concerns underreporting by the self-employed. The rate of self-employment has been declining over time and is now of the order of 12% (for 2015 Q3, CYPSTAT report 43,410 self-employed individuals out of a total of 370,203 persons employed). Self-employment includes not only tradesmen (electricians, plumbers, mechanics painters, construction and repair people and others), some of whom may employ the illegal immigrants referred to above, but also professionals such as lawyers, doctors, private tutors and other service providers. Some of the self-employment may occur in dual job holding by employees in the public sector who

generally work only until 3pm. The size of the tutoring and medical services activities was estimated by AKEL (2003)² to be approximately CYP 27 million in 2000, most of this being due to tutoring rather than medical services. This equates to about 0.5% of GDP.

Using data drawn from the Family Expenditure Survey (FES, 2004), Pashardes and Polycarpou (2008)³ investigated the extent to which households underreport self-employment income, capital income, and income from agriculture. They concluded that a conservative estimate of the size of the black economy in this particular context is of the order of 6.7% to 8.1% of GDP, with this range including capital income underreporting. Note that their estimate includes the AKEL effects (below).

Some of the UDW by legal workers may be in paid work, the third category mentioned in section 1.1.2. A variety of payment schemes may be in force, including envelope wages; and by definition such work does not involve the payment of social security contributions. This UDW would result in increased household income that would not be reported but would be captured by the Pashardes and Polycarpou (2008)⁴ study.

Abuses of unemployment insurance and welfare schemes may also exist. However, the scale of these abuses is thought to be limited relative to the work carried out by illegal workers, the self-employed and paid workers.

The AKEL (2003) study estimates the total size of the 'para-economy' (defined to include some unpaid and some illegal work) as 9.2% of GDP in 2000. This figure is broadly in line with the estimate of 8.8% of GNP during the 1980s by Georgiou and Syrighas (1994)⁵; they rely on the Tanzi method which uses the demand for currency as a proxy for 'underground' activity, and their methodology is broadly consistent with the definitions in AKEL (2003). Adding the rough estimate of UDW of 7% of GDP due to illegal workers (category 1 above) and the Pashardes and Polycarpou (2008) estimate of about 8% for underreporting (categories 2 and 3 above) would produce an overall estimate of the order of 15% of GDP. Williams and Renooy (2013)⁶ note that the scale of UDW in the EU has been decreasing recently, and this is probably also true in Cyprus. For Cyprus, they report a figure from Schneider (2012)⁷ of 25.6% of GDP in 2012 (down from 29% in 2003). This, however, appears implausibly high.

One issue worth noting relates to possible UDW differences between the government controlled area in the south and the occupied north. Besim and Jenkins (2006)⁸ examined the situation in the north and estimated the number of unregistered workers by (i) comparing the work force with those registered in various insurance funds, and by (ii) counting the number of unregistered immigrants. They concluded that the number

² AKEL (2003) *E Paraoikonomia sten Kypro: Melete* (Nicosia, Grafeio Oikonomikon kai Koinonikon Meleton, AKEL).

³ Pashardes, P. and A. Polycarpou, (2008), 'Income tax evasion, inequality and poverty', *Cyprus Economic Policy Review*, Vol. 2, No. 2, pp. 37-49.

⁴ Ibid

⁵ Georgiou G. M. and G. L. Syrighas (1994) 'The "Underground Economy": An Overview and Estimates for Cyprus', *Cyprus Journal of Economics*, Vol 7. No. 2, December, pp. 125-143.

⁶ Williams C.C. and P. Renooy (2013) *Tackling undeclared work in 27 European Union Member States and Norway: Approaches and measures since 2008*, Eurofound, Dublin. <http://www.eurofound.europa.eu/publications/report/2013/labour-market/tackling-undeclared-work-in-27-eu-member-states-and-norway-approaches-and-measures-since-2008>

⁷ Schneider, F. (2012), *Size and development of the shadow economy of 31 European and 5 other OECD countries from 2003 to 2012: some new facts*, available at http://www.econ.jku.at/members/Schneider/files/publications/2012/ShadEcEurope31_March%202012.pdf.

⁸ Besim, M. and G. P. Jenkins (2006), 'Informal but not Insignificant: Unregistered Workers in North Cyprus', unpublished mimeograph.

of workers in the informal sector was in the region of 35-40% of the total labour force, whose contribution to GNP was of the order of 12-17% of GNP. They also noted (p. 3) that the official statistics for income considerably understate this and that '... the gap in the incomes of permanent residents of north and south Cyprus could be significantly smaller than what was reported in the official statistics for north Cyprus'.

All this work suggests that UDW in the government-controlled areas, where UDW is less prevalent than in the north, is probably of the order of 15% and may have declined during the crisis as illegal workers departed.

1.2 Institutional Framework

1.2.1 Responsibilities for addressing undeclared work

The main governmental organisation with an interest in UDW is MLSI. Other organisations with an interest in UDW include the Ministry of the Interior, tax collection authorities, the Ministry of Finance, and the Police Force. In a Presidential System, the Executive Branch and the House of Representatives also have a major role to play. Social partner organisations, such as trade unions and employer organisations, also play a role in monitoring and dealing with UDW.

The MLSI is responsible for monitoring all labour market and employment developments, supervising the collective bargaining process, facilitating the resolution of industrial relations disputes, monitoring the implementation of labour legislation, administering the social insurance programme as well as the new Guaranteed Minimum Income (GMI) programme, running the Public Employment Offices, and interacting with social partners through the Tripartite Process.

During the last 10 years, tackling UDW has been a priority for Governments in Cyprus. In 2009 Joint Inspection Units (JIUs) commenced fighting UDW. Four JIUs operate on a daily basis, mainly inspecting construction sites, hotels, restaurants and manufacturing enterprises. Inspectors from the Department of Labour Relations, the Department of Labour and the Social Insurance Services take part in these units. The coordination of the JIUs is done by the Department of Labour Relations in MLSI.

Recently, the Council of Ministers decided to reorganise the Joint Inspection Units into a centralised inspections inspectorate. The inspectorate, among other mechanisms, will use advanced information systems and risk assessment methods in its work. Draft law will be forwarded to the Parliament in Summer 2017.

The Ministry of the Interior is responsible for issues relating to migration, issuing identity cards and work permits, citizenship applications, refugee/asylum claims, and the implementation of all legislation covering this broad set of issues. The legality of the work status of an individual would come under its remit, and so it has a direct role in the determination of UDW.

Tax collection authorities are now integrated and responsible for issues relating to both direct and indirect taxation, and are involved in the monitoring of social insurance payments along with MLSI and the Ministry of the Interior.

The Police Force, under the Ministry of the Interior, is responsible for executing court orders and resolving cases of illegal entry. They also have a special unit dealing with human trafficking, some of which is for illegal work purposes.

The Ministry of Finance is responsible for the broad macroeconomic and fiscal policy that shapes the environment within which UDW exists.

The Executive Branch (President and Council of Ministers) sets policy in the context of advice received from the relevant Ministries. When legislation is required, it must work with the House of Representatives to secure sufficient political consensus to implement new measures.

The Tripartite System involves the government (executive and legislative parts), unions and employer organisations. It manifests itself in a number of institutionally defined bodies and helps shape social consensus.

1.2.2 Characteristics of the responsible organisations

The MLSI, the Ministry of the Interior and the Ministry of Finance are large, highly professional bodies employing many well-qualified specialists who, among many other responsibilities, monitor UDW and try to deal with it in the context of the policy environment and the available resources.

1.2.3 Cooperation and collaboration between authorities and cross-border authorities

The nature of cooperation and data exchange, and their effectiveness, are described collectively: Most of the organisations involved in monitoring UDW are ministries which come under the political supervision of the Executive Branch and so must operate within the parameters set by the legal system. A lot of co-operation occurs informally or as a result of ministerial committees appointed by the Council of Ministers. The exchange of information has been improved considerably during the years (2012-2016) when Cyprus was under the programme of financial support by the Commission, the European Central Bank and the International Monetary Fund. Many administrative data sets have been integrated, and the new GMI programme will involve individualised counselling and activation, thus limiting the ability of individuals to collect benefits beyond the allowable amounts while they work.

As a result of measures taken during the recent crisis, much higher monitoring of financial transactions is now carried out by banks. These efforts have required increased co-operation between Member States, the ECB and the Commission. In consequence, it has become more difficult to process transactions involving UDW through the banking system. This may, of course, just increase the demand for currency in circulation.

MLSI, in cooperation with the Support Group and the EU Commission, has proceeded to a study in order to evaluate the existing information system and the existing procedures regarding UDW. The final report will be ready at the end of 2016.

1.3 Policy Focus and Measures

1.3.1 Policy approach

The recent initiatives by the EU with regard to UDW have come in the middle of a deep crisis, and policies in the Memorandum of Understanding do not give UDW centre-stage. As a result, the issue has received relatively modest attention and no major policy initiatives have been undertaken. Nevertheless, efforts are being made on both the deterrence and compliance fronts; however, the resources available to deal with UDW are modest. MLSI and the Minister in charge are spearheading a campaign of public awareness of the problems involved.

Interestingly, the Commission's (2014) *Undeclared work in the EU, Special Eurobarometer* reports that Cypriots disapprove of UDW and have not made or received such payments to any noticeable extent. Yet, 16% reported (QE5) that, when buying goods or services, UDW may have been involved because there was no invoice or VAT receipt. Also, 39% reported (QE1) that they personally know someone whom they suspect of not declaring all their income. They attribute this to a low risk of apprehension (QE3); 56% of the respondents believed that there was 'lack of control' by the authorities ((QE4).

1.3.2 Measures to tackle UDW

Legislation prohibiting UDW is in place. Inspections of workplaces are carried out by officials from MLSI. Government contracts may not be awarded to firms convicted of employing workers illegally and this may provide incentives to avoid UDW and possible

apprehension. Public information campaigns have been carried out and the Minister of Labour makes repeated reference to efforts to combat UDW.

Information from the JIUs suggests that, in 2016, 6,469 inspections took place (1,173 for self-employed persons). During these inspections, 14,434 employees were checked and 15.4% of them found to be undeclared. The main problem seems to be concentrated in the restaurant/café area (with the percentage of undeclared work reaching 22.4%) and in construction (where this percentage was 16.65%). Among EU citizens inspected, 19.4% were undeclared, while this percentage for Cypriot employees was 10.32%.

There is very little information available on the effectiveness of measures to tackle UDW, or on the apprehensions, convictions and the effects of measures to combat UDW. Some rudimentary information is contained in Pashardes (2010)⁹. He reports that, in 2009, 1,208 employers were accused of illegally employing aliens and 1,617 aliens were found to work without a licence. No information is provided on the outcomes of these cases.

A relatively new law now requires employers to issue a Certificate of Commencement of Employment upon hiring a new employee (copies are issued for the employer, the employee and the Social Insurance Service). An extra-judicial fine of EUR 200 per undeclared employee is imposed if this is not done. In 2015, 1593 such fines were imposed.

1.3.3 Good practice

Impressionistic evidence suggests that inspections and convictions appear to be powerful tools, but there is very little publicly available information on these matters.

1.3.4 Challenges and barriers

Several problems make it difficult to deal with UDW. First, Cyprus is in the midst of an unprecedented crisis with high levels of unemployment. In this context, UDW may provide an option for employers whose businesses would not otherwise survive and employees who would not otherwise be employed. Second, the political problem continues to absorb mental and other resources which might have been devoted to other important issues, including UDW. Third, a number of government services are not being provided to a sufficiently high standard; as a result, private schooling and private health care are thriving. Individuals feel that their taxes are not well-spent, corroding the moral and efficiency foundation of the fight against UDW. Efforts are, of course, being made to remove all these obstacles.

⁹ Pashardes, P. (2010) In-work poverty and labour market segmentation A Study of National Policies European Commission DG Employment, Social Affairs and Equal Opportunities. (Assisted by S. Andreou)