

Factsheet on Undeclared Work – CZECH REPUBLIC

1.1 Nature and Estimated Scale of Undeclared Work

1.1.1 Definition of undeclared work

In the Czech Republic, there is no local legal definition of undeclared work (UDW). The Employment Act (§5.e) defines illegal work as dependent work¹ performed outside of an employment contract or performed by a foreigner without a valid work or residence permit. (A pervasive form of illegal work, referred to as "Švarcsystém" (eponymously named after the entrepreneur Miroslav Švarc, its "inventor") consists of using self-employment contracts in place of employer-employee contracts in work relations that fundamentally constitute an employer-employee relationship and ought to be covered by an employment contract.) The Czech Republic therefore formally adopted the UDW definition from the Decision of the European Parliament and Council of 9 March 2016 as any paid work that is legal, but is not reported to public administration. The implementation of this recent adoption remains to be developed and we thus focus in most of this factsheet on the closely related agenda of dealing with illegal work.

The State Labour Inspection Office (SLIO), the Foreign Police, the District Labour Offices (DLO), as well as members of the tripartite all apply the current state of the legislation when considering illegal work and UDW. There has been a gradual clarification of how and when to best apply the specifics of the Employment Act outlined in the preceding paragraph. The different positions of the trade unions and of the employer associations on what constitutes a useful definition of illegal work play out in the legislative process as either party attempts to affect one of the frequent updates of the Labour Code or the Employment Act.

1.1.2 Characteristics of undeclared work

According to SLIO, the main types of practices targeted by the Labour Inspection authorities are the presence of effective employer-employee relations without written employment contracts (also including those working illegally while registered unemployed), the absence of appropriate permits for the employment of foreign workers, and the "Švarcsystém" disguising salaried employment as self-employment. In 2016, Švarcsystém cases represented about 20%² of uncovered instances of illegal employment, whereas its share in 2010 was 10%. Foreign workers also frequently work based on a trade licence, as independent contractors, when their employment relations at least border on regular long-term employer-employee relations.

According to ad hoc surveys³ the highest incidence of UDW and illegal work in the Czech Republic is among workers holding multiple jobs and among self-employed. The most

¹ Dependent work is performed in a relationship of a supervisor-employer with a supervisee-employee, work that deserves a salary, and is performed within specified work hours.

² There were 247 SLIO inspections that uncovered Švarcsystém, with the total of 256 persons involved in this type of arrangements: 122 citizens of the Czech Republic, 29 citizens of EU Member States, and 105 Third-Country nationals.

³ See the following studies:

Kux, J., Kroupa, A. (2006): Undeclared Labour in the Construction Industry. CLR, European Institute for Construction Labour Research. Country Report – CR, RILSA. Internet: <http://www.rilsa.cz/an205.html> World Bank (2015); Horáková, M., Kux, J. (2003): Country Study on Informal Economy in the CR. Prague, Research Institute of Labour and Social Affairs. Internet: http://www.vupsv.cz/INFORMAL_ECONOMY.pdf; Fassmann, M. (2006): Shadow economy – III, Undeclared Work (Stínová ekonomika – III, Práce na černo. Pohledy č. 3), Praha, Českomoravská konfederace odborových svazů.; Drbohlav, D. et al. (2009): Illegal economic activities of immigrants: Czech Republic in broader European context. (Nelegální ekonomické aktivity migrantů: Česko v evropském kontextu) Čermák Zdeněk - Lachmanová Lenka - Fassmann Martin - Drbohlav Dušan, Karolinum, Praguem, ISBN 9788024615523.

common practices consists of tax evasion in small companies (paying the minimum wage and the rest in an envelope), undeclared earnings from secondary jobs or overtime hours, and undeclared work activities of the registered unemployed. During the economic boom preceding the great recession, many foreign workers had at least one UDW activity since their arrival in the country and the highest incidence of UDW appeared at the time of arrival. About a half of those involved in UDW are low skilled workers. There is also an indication of an intensive overlap of declared and undeclared work with about two thirds of the self-employed who engage in UDW generating significant benefits from tax evasion.

According to evidence and the experience of SLIO, supported by a recent study⁴, UDW is most prevalent in construction (accounting for 20% of the total number of identified illegally employed persons), processing/manufacturing (14%), wholesale/retail and motor vehicles repairs/maintenance sector (11%) in particular. In 2016, consistent with this evidence, SLIO inspections targeted the following sectors: wholesale/retail trade and repairs/maintenance of motor vehicles (24%), construction (17.7%), the HORECA⁵ sector (16.7%), and the processing/manufacturing sector (15.9%).

There is no systematic evidence on the distribution of UDW by employer size, although both existing ad hoc surveys⁶ and SLIO inspection practice are consistent with the majority of illegal employment and UDW cases being concentrated among small (under 10 workers) or medium sized companies (10-49 workers), and the self-employed. However, it is possible that some large employers under-report actual hours worked (in the services sector in particular). This trend is more or less stable over time. In 2016 approximately 52% of SLIO inspections targetted employers with 0-9 employees, 16% with employers with 10-49 employees, and employers without any registered employees.

One of the two main incentives which may motivate the existence of UDW is the high tax wedge on low-wage earners through social security contributions. Equally importantly, the Czech tax wedge gap between self-employed and employees continues to be one of the largest in the EU. Correspondingly, an unusually high proportion of workers in the Czech Republic are self-employed, i.e., work in job types more prone towards UDW. The administrative burden imposed on employers by the three systems of tax collection (income tax, social security, health insurance) could represent another contributing factor (Doing Business, The World Bank⁷ reports high workload in terms of hours related to this agenda in an average Czech company).

A less discussed issue is that the bureaucracy of the Czech system of work and residency permits for foreign workers may have pushed law-abiding immigrants into illegal work. However, since June 2014, administrative costs may have declined thanks to the 'dual card' approach where one card (based on one application) contains both the residence and work permit.⁸ In the same spirit, inefficient business regulation may force workers into self-employment arrangements. There is little empirical evidence evaluating the success in terms of UDW reduction of recent reforms in this area.

⁴ CETA (2015): Shadow economy in the Czech Republic: A study [Studie: Stínová ekonomika v České republice] Internet: <http://eceta.cz/studie-stinova-ekonomika-v-ceske-republice/>
http://eceta.cz/wp-content/uploads/2015/11/SE_01_2015_web.pdf

⁵ Hotels, restaurants, and catering sector

⁶ Filipec, P. 2011. "The Shadow Economy Analysis in the Czech Republic". Charles University in Prague, Faculty of Social Sciences. Internet: <https://is.cuni.cz/webapps/zpp/detail/95977>
Also, CETA (2015).

⁷ World Bank Group. 2014. *Doing Business Economy Profile 2015 : Czech Republic*. Washington, DC. © World Bank. Internet: <https://openknowledge.worldbank.org/handle/10986/21267>
License: CC BY 3.0 IGO.

⁸ Asylum seekers are effectively not allowed to work for extended periods of time. However, this issue affects only a small number (under 1000) of individuals.

1.1.3 Estimated scale of undeclared work

In 2016, SLIO performed about 9,300⁹ inspections that targeted illegal employment practices. These inspections of employers uncovered 5,815 violations of labour legislation (in terms of the following areas: undeclared/illegal work, but also labour relations/conditions and occupational safety and health which are also identified by legality of employment inspectors), in which 2,290¹⁰ workers were illegally employed. A large proportion of the foreign workers involved in some form of violation did not have a valid work permit, and the second largest group of foreigners had all the necessary permits but worked without proper contractual arrangements. Within the foreign-worker group, Ukrainian and Vietnamese workers continue to represent the largest groups. Similar results are reported for earlier years. In 2016, inspections involved both legal entities and physical persons as employers, with 30% of the inspected workplaces being subject to some form of formal employment or work safety issues. It is difficult to generalise these numbers into an estimate of the country-wide extent of UDW, as SLIO inspections target workplaces that are the most likely to be in breach of employment legislation. It is clear that in a country of 5 million employees and 450,000 foreigners with a long-term presence, 2,290 illegally employed workers constitute a very small group.

On the other hand, a qualitative difficulty with these numbers is that even careful inspections are unable to deal with certain forms of UDW. When both parties to an employment relationship claim to be collaborating based on a verbal agreement or a short-term under-EUR 350-per-month contract (under the arrangement known as Agreement to Complete a Job, "Dohoda o provedení práce"), such relations are not subject to reporting to the sickness insurance system and effectively prevent the examination of actual hours worked. In the Czech Republic small employers are avoiding long-term contracts (allowing for less flexibility) and favouring short-term contracts (for definite period) to such an extent that regular employer-employee long-term contracts are becoming the exception with small employers.

According to 2015 studies by A.T. Kearney and VISA and by the CETA¹¹ think tank, the shadow economy adds up to about 15 % of the Czech GDP. For the purposes of cross-country comparisons of such estimates, it is crucial to account for the qualitative differences in methodologies involved in generating such estimates. According to the CETA study, the Czech Republic features a relatively high share in an EU comparison of purchases of services and products from friends, colleagues, and acquaintances (esp. in home improvement and car maintenance activities) in small municipalities. The CETA study also cites estimates that almost 200 000 workers (i.e., over 3 % of the labour force) was involved in illegal work activities in 2013.

1.2 Institutional Framework

1.2.1 Responsibilities for addressing Undeclared Work

SLIO, which is supervised by the Ministry of Labour and Social Affairs (MoLSA), is entitled to perform inspections with all employers and self-employed with regard to workplace safety and the formal aspects of employment, including illegal employment. A key issue is that employers must have available written employee contracts on site, until they register their employees for the purpose of pension insurance. Following a legislative change, the obligation to have the contracts available in the place of work also applies for posted workers (from 1st April 2017). In addition to a regular programme of annual

⁹ The annual target for 2016 was set to 7,000 inspections; SLIO inspected 3,518 physical persons and 4,538 legal entities.

¹⁰ 1,367 Third-Country nationals, 760 Czech citizens, and 163 citizens of EU Member States.

¹¹ Ceta, 2015

inspections¹², SLIO occasionally organises unexpected nation-wide actions focused on specific issues (e.g. Christmas markets). It is also worth noting that between 2012 and 2015, much of SLIO activity was covered by ESF funding (OP LZZ¹³).

In 2000, the Czech government established an 'Inter-ministry coordination board for curbing illegal employment of foreigners', which also features representatives of the tripartite bodies, the Czech Statistical Office, SLIO, etc. (the bylaws of the board were updated in 2014). A corresponding Action Plan for fighting illegal migration was approved in 2004 and involves actions by the Ministry of Interior, MoLSA, Ministry of Foreign Affairs, Ministry of Finance and other public administration bodies. The board participates on annual reports that compile policy information in this area from all involved ministries.¹⁴ The board clearly improves information flows between ministries; it is less clear (given the absence of corresponding recent documents) that it plays an important role in coordinating legislative work or targeting inspections.

1.2.2 Characteristics of the responsible organisations

SLIO is divided into a Head Office and 8 Regional Labour Inspectorates, with about 190 labour inspectors focusing on employment issues and following a centralised inspection methodology. Some of the inspectors received special training for detecting illegal employment of foreign workers and human trafficking practices. Some 45 company cars, laptop computers and mobile internet routers were provided to the employment inspectors several years ago to speed up the performance of accounting checks at the inspected workplace.

1.2.3 Cooperation and collaboration between authorities within the Czech Republic and cross-border authorities

When inspecting a workplace, SLIO naturally cooperates with the Czech Social Security Administration and Trade Licencing Offices when checking formal aspects of inspected documents. A key collaboration is between SLIO and DLOs, as some of the illegally employed workers are registered as unemployed. The labour inspectorates also frequently coordinate with the state, municipal and/or foreign police, as needed.¹⁵

Since October 2014, SLIO uses an integrated information system with access to the so called Common Database of the MoLSA department, through which inspectors may verify, for example, whether a certain employee was duly registered for the purpose of social insurance. We suspect, however, that progress is slow in the area of integration of various databases employed by the tax, social security, and health insurance authorities and by welfare and labour offices, and by the foreign police. However it is clear that, in specific individual inspection cases, SLIO receives information from other state organisations, as outlined above, and that cooperation with respect to UDW is on the increase – including national and regional cooperation between the Police, Foreign Police and Customs Offices. Furthermore, the 'Inter-ministry coordination board for curbing illegal employment of foreigners', which meets bi-annually, also sets up ad hoc sub-committees and supports information flows, at least at the aggregate level.

In terms of UDW, the closest cooperation has traditionally been between DLOs and SLIO authorities. In 2015 and 2016, SLIO reacted to extensive suggestions from the LO when targeting inspections to employment agencies. SLIO also regularly receives support from the Police of the Czech Republic, Foreign Police and the Customs Administration. Other

¹² Target for 2016: 7000 inspections; 2017: 8500 inspections

¹³ OP LZZ stands for Operation Program for Human resources and Employment [Operační program Lidské zdroje a zaměstnanost].

¹⁴ The 2012 report can be found here:

<http://www.psp.cz/sqw/text/orig2.sqw?idd=65146>

¹⁵ Inspectors are not armed, unlike members of the Police of the Czech Republic. The Foreign Police has specialists trained to identify falsified documents and other specialists trained in the regulation of employment relations for foreign workers.

than support provided for inspections, we know of no direct active cooperation between authorities in this policy area.

The Czech Republic collaborates with other Member States within the IMI¹⁶ system on the posting of workers, which enables any individual Member State to share and request information from authorities in a different Member State. Since April 2017, following the implementation of the Enforcement Directive 2014/67/EU, the scope of administrative cooperation through the IMI system has been widened. Apart from requests for information on specific posting arrangements, both the system and the Czech legislative framework allows for the exchange of administrative data and decisions to service providers, as well as cross-border enforcement of financial administrative penalties imposed in the context of the posting of workers.

1.3 Policy Focus and Measures

1.3.1 Policy approach

The recommendations featured in the Czech policy debate as of the writing of our 2007 UDW report (and well represented in Fassmann, 2006, for example) included (i) strengthening the analytical capacity at the Ministry of Finance, (ii) simplifying tax legislation and collection, (iii) introducing measures to eliminate room for disguising regular employee-employer relationships as self-employment, (iv) strengthening monitoring, enforcement, and sanctions of UDW, (v) launching a public media campaign against UDW. The actual policy course focused on approaches (iii) and (iv).

Repression is the main tool of UDW policy as Czech policymakers focus on parameters of the relevant legislation. The continuous updates of the Employment Act and of the Labour Code introduced since 2004 with an eye towards reducing illegal employment practices include more stringent conditions for unemployment registration, stricter conditions on temporary employment agencies and on the type of jobs to be performed by self-employed instead of regular employee-employer contracts, and extended powers of DLOs as an inspection authority together with increased penalties for UDW of an increasing variety.¹⁷ In recent years, SLIO has become the main authority addressing UDW and its inspection efforts (and penalties) were magnified.

1.3.2 Measures to tackle UDW

The chief measure used in the Czech Republic is Labour Inspection. During 2016, SLIO imposed penalties of approximately EUR 2 million in connection with illegal employment practices.

The stricter regulation of temporary employment agencies, which increased the price of labour they offer, led to a partial replacement of the flexible labour they supplied by equally flexible quasi-legal arrangements.

For several years now the government has been increasing the statutory minimum wage from very low levels. The effect of this policy on the share of self-employed in the total employment and on UDW has not yet been analysed.

It is not clear how effective labour inspections are. First, many of the inspection cases transform into legal proceedings that tend to be extended and involve several instances of appeals. Second, there are no studies attempting to estimate the causal effect of changes in maximum penalties, number of inspections, etc.

¹⁶ The Internal Market Information system of the European Commission.

¹⁷ The very high level of penalties was recently decreased: the *minimum* penalty for employers enabling illegal employment declined from under EUR 10,000 to under EUR 2,000 as of January 2016. The practices leading to employer being penalised when uncovered include employers not having proper employment documentation on site and exceeding the annual limit for Agreements to Complete a Job.

1.3.3 Good practice

Good practice examples identified in recent years have been included in the unified methodology for inspecting the legality of employment.

1.3.4 Challenges and barriers

We believe that the lack of data management across various state authorities is a major obstacle to identifying targets for labour or financial (tax authority) inspections.

Most of the discussion in the country focuses on updating the Labour Code and the Employment Act to foster the practice of labour inspections in the field. Looking forward, further data sharing (mainly within the practice of SLIO) will take a key role.

The country could benefit from a transfer of good practices from other MSs. An important incentivising factor is the high tax wedge on low-wage earners through social security contributions. Equally importantly seems to be the notable tax wedge gap between self-employed and employees.

Additional References

Annual Summary Report on Work Inspections [Roční souhrnné zprávy o výsledcích kontrolních akcí provedených inspekcí práce za rok 2014] Internet:
<http://www.suip.cz/rocní-zpravy/>

Paying Taxes 2016: The Global Picture, Internet:
<http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Special-Reports/Paying-Taxes-2016.pdf>