

## **Factsheet on Undeclared Work – HUNGARY**

### **1.1 Nature and Estimated Scale of Undeclared Work**

#### **1.1.1 Definition of undeclared work**

The Hungarian government's employment strategy for 2014-2020<sup>1</sup>, refers to undeclared work as employment that is not reported to the national authorities. It also mentions envelope wages as a common form of the grey economy.

The Department of Labour Inspections (Employment) focuses on the enforcement of obligations concerning labour contract, such as reporting the beginning and end of the employment relationship or observing working time rules. Therefore the Department does not include envelope wages in their definition of undeclared work (as the employment relationship is duly reported to the authorities). By contrast, the Tax Authority is concerned with all forms of tax fraud, thus covering envelope wages as well.<sup>2</sup>

#### **1.1.2 Characteristics of undeclared work**

There are three main types of undeclared work in Hungary: employees who are not fully declared to the authorities by their employers, self-employed individuals who fail to declare some or all of their income, and bogus employment.

Within both of the two basic types we can distinguish between fully (black) and partly (grey) unreported employment. Data is limited on the issue but one source suggests that at most 15% of the employees receive higher wages than their declared salary<sup>3</sup>, while the share of undeclared employment is estimated around 17%. According to other estimates, 0.6-0.7% of GDP goes unreported due to grey employment<sup>4</sup>. Please note: this data does not necessarily reflect the views of the Hungarian government.

Socially embedded undeclared work or illegal immigrant work does not seem to be significant. According to the yearly report of the Department of Labour Inspections (Employment) of the Ministry for National Economy (DLIE) undeclared work of third country workers is below 2% of the all reported undeclared work cases in 2015 in Hungary.<sup>5</sup>

According to Elek-Köllő (2015), between 2001 and 2006 agriculture, transportation, construction and personal services exhibited higher probabilities of undeclared work (8-16 pp, 14-25 pp and 3 pp higher than industry respectively).<sup>6</sup> Elek et al. (2012)<sup>7</sup> find

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<sup>1</sup> Proposal for the Hungarian Government's Employment Strategy for 2014-2020. Internet: [http://2010-2014.kormany.hu/download/8/4c/01000/Fogl\\_Strat\\_14-20.pdf](http://2010-2014.kormany.hu/download/8/4c/01000/Fogl_Strat_14-20.pdf)

<sup>2</sup> Cf the relevant section of the law on taxation (2003. évi XCII. törvény az adózás rendjéről, 86. § (1) "Az adóhatóság az adóbevétel megrövidítésének, a költségvetési támogatás, adó-visszaigénylés jogosulatlan igénybevételének megakadályozása érdekében rendszeresen ellenőrzi az adózókat és az adózásban részt vevő más személyeket. Az ellenőrzés célja az adótörvényekben és más jogszabályokban előírt kötelezettségek teljesítésének vagy megsértésének megállapítása.")

<sup>3</sup> Benedek et al (2012), p. 174.

<sup>4</sup> Ibid, p. 177.

<sup>5</sup> Annual Report on Labour Inspections, 2015. Department of Labour Inspections (Employment), Ministry for National Economy. Internet: [http://www.ommf.gov.hu/letoltes.php?d\\_id=6675](http://www.ommf.gov.hu/letoltes.php?d_id=6675)

<sup>6</sup> Elek, P., Köllő, J.: Undeclared employment in permanent jobs – estimates from matched administrative and survey data. 2015. Paper presented at the Annual Conference of Hungarian Economics Association.

<sup>7</sup> Péter Elek, János Köllő, Balázs Reizer, Péter A. Szabó: Detecting Wage Under-Reporting Using a Double-Hurdle Model. *Research in Labor Economics*, Volume 34, 2012, pp.135 - 166.

that the proportion of employees paid envelope wages was higher than average in construction, trade and catering (around 12%, 10% and 9%, respectively).

According to the 2016 Report of the DLIE<sup>8</sup>, which reviews the outcome of inspections carried out annually, among the cases where undeclared work was detected 69% involved undeclared employees and 12% involved the lack of an employment contract. Other causes included undeclared casual work<sup>9</sup> (14%), a full-time employee being declared as a part-time employee (2%), bogus contracts (artificial agreements, 2%), and various other reasons (1%). According to the results of the inspections carried out in 2016, 38% of the undeclared employees worked in the construction sector. 7% of undeclared workers were employed in the agricultural sector, 9% in the manufacturing industry, 11% by private security firms, 9% in retail and 12% in catering. However, these numbers are influenced by the number of inspections in the respective sectors: 20% of the inspections were carried out in the construction sector, 12% in the manufacturing industry, 12% in private security firms, 22% in retail and 16% in catering.

Undeclared work tends to vary inversely with employer size. Elek-Köllő (2015) find that unregistered employment was 15% more likely in micro firms between 2001 and 2006.<sup>10</sup> Envelope wages were also more common in micro (19%) and small firms (12%) in 2006 (Elek et. al 2012).

As also admitted by the Government Employment Strategy, the main motivation is to gain a competitive advantage by avoiding the payment of taxes and social security contributions (SSC). It must be noted that employees are not always aware of the fact that they are not registered by their employer.

### **1.1.3 Estimated scale of undeclared work**

As detailed above, the estimated size of completely unreported employment was 10-17% of total employment in the period 2001-2006.

According to one 2013 study on the black and grey economy, in 2004 more than 40% of the self-employed were not reported<sup>11</sup>, while for formal enterprises the share of undeclared work was between 10% and 17%, based on a comparison of the Labour Force Survey data and Pension Insurance records (16-17% between 2001 and 2005, Elek et al 2009)<sup>12</sup>. Most recently, Elek – Köllő (2015)<sup>13</sup> show that among employees with stable jobs (with more than one year tenure), between 2001-2006 on average 10% of

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<sup>8</sup> Annual Report on Labour Inspections, 2016. Department of Labour Inspections (Employment), Ministry for National Economy. Internet: [http://www.ommf.gov.hu/letoltes.php?d\\_id=7190](http://www.ommf.gov.hu/letoltes.php?d_id=7190)

<sup>9</sup> Casual workers can be employed on simplified terms (called simplified employment) in some branches of the economy, such as seasonal agricultural work

<sup>10</sup> Ibid.

<sup>11</sup> Benedek, D, Elek, P and Köllő, J (2013): A Tax avoidance, tax evasion, black and grey employment. In: Fazekas, K., Benczúr, P. and Teledgy, Á. (eds.) The Hungarian Labour Market, 2013. CERS, HAS, Budapest. pp. 161-178.

<sup>12</sup> Elek, P., et al (2009): A feketefoglalkoztatás mértéke Magyarországon. (Measuring undeclared employment in Hungary [in Hungarian].) In: Semjén, A. and Tóth, I. J. (eds.), Rejtett gazdaság. Be nem jelentett foglalkoztatás és jövedelemeltitkolás – kormányzati lépések és a gazdasági szereplők válaszai KTI Könyvek 11., p. 84-102.

<sup>13</sup> Elek, P., Köllő, J.: Undeclared employment in permanent jobs – estimates from matched administrative and survey data. 2015. Paper presented at the Annual Conference of Hungarian Economics Association.

employment went unreported<sup>14 15</sup>. Again, please note: this data does not necessarily reflect the views of the Hungarian government.

Estimates of the extent of partly unreported employment (envelope wages) vary substantially. According to Semjén et al (2008)<sup>16</sup>, in a 2008 survey of 1,000 respondents aged 15-60, 15% reported to have received 'envelope wages' at least once in the preceding two years. Elek et al. (2012)<sup>17</sup> found that about 6% of all private sector employees received 'envelope wages' in 2006.

## **1.2 Institutional Framework**

### **1.2.1 Responsibilities for addressing undeclared work**

There are two key bodies:

**Labour Authorities (LAs) within District Offices of County Government Offices:** Inspections of labour authorities (LAs) are focused on all the work related legal relations. The directive of the Ministry for National Economy for labour inspections in 2016 focus on prevention by informing employers of employment rules<sup>18</sup>. LAs do not examine the reporting or payment of taxes or SSC.

**National Tax and Customs Administration of Hungary (NTCA):** this is the general tax authority in Hungary that is responsible for collecting taxes and SSC and inspecting tax compliance.

### **1.2.2 Characteristics of the responsible organisations**

**LAs** - The Labour Authority was restructured in 2015 (along with the PES). Before 2011 the Hungarian Labour Inspectorate (OMMF) had seven regional offices.

The Labour Authority has currently two levels: (1) the Minister for National Economy who is responsible for the professional guidance of lower levels. At the district level the role of the former territorial offices of the OMMF was gradually transferred to (2) the District Offices of the General Government Offices at the district level, and executed by

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<sup>14</sup> This paper relies on matching employment histories as reported in the Hungarian Labour Force Survey with data from the Hungarian Pension Directorate. The figure above relates to the discrepancy between the self-reported and officially recorded number of years work for a given employer.

<sup>15</sup> Similar results are obtained by survey-based using self-reported undeclared work data. For the time period of 2001-2009 Semjén et al. (2009) found that the extent of UDW is 15 %, while Czibik-Medgyesi (2007) estimated 10%. See: Czibik Ágnes-Medgyesi Márton (2007): A lakosság nyugdíjjal kapcsolatos megtakarítási tudatossága és hajlandósága. Egy lakossági kérdőíves felvétel elemzése. MKIK GVI, Budapest.; Semjén A., Tóth, I. J., Medgyesi, M. and Czibik, Á. (2009): Adócsalás és korrupció – lakossági érintettség és elfogadottság. In: Semjén András-Tóth István János (eds.): Rejtett gazdaság. Be nem jelentett foglalkoztatás és jövedelemeltitkolás – kormányzati lépések és a gazdasági szereplők válaszai. KTI Könyvek, 11.

<sup>16</sup> Semjén, A, Tóth, I. J, Medgyesi, M., Czibik Á. (2008): Adócsalás és korrupció: lakossági érintettség és elfogadottság. Discussion Papers MT-DP – 2008/13. Budapest: Institute of Economics, Hungarian Academy of Sciences. Internet: [http://www.econ.core.hu/file/download/mtdp/MTDP\\_0813.pdf](http://www.econ.core.hu/file/download/mtdp/MTDP_0813.pdf)

<sup>17</sup> Péter Elek, János Köllő, Balázs Reizer, Péter A. Szabó: Detecting Wage Under-Reporting Using a Double-Hurdle Model. *Research in Labor Economics*, Volume 34, 2012, pp.135 - 166.

<sup>18</sup> LXXV of 1996 Act on Labour Inspection and Announcement of the State Secretary for the Labour Market on guidelines on labour inspections in 2016.

their departments of 'Labour Inspection and Supervision'. The operational and professional activities of these district level departments are guided by the DLIE.<sup>19</sup>

The remits and powers of LAs are set out by the Act LXXV of 1996 on Labour Inspection. LAs are responsible for checking compliance with the statutory requirements at any enterprise in Hungary regardless of nationality and can take measures against employers in cases of breach of law. In particular, LAs inspect the registration of employment, the mandatory substantial elements of the employment contract, working and resting time, the payment of wages, observing minimum wage regulations, special employment conditions, posting and assignment of workers and temporary agency work, and the employment of third-country nationals in Hungary.<sup>20</sup> During their inspections LAs target sectors in which infringements are frequently detected and which were not under inspection in the previous year.<sup>21</sup>

**NTCA** - The tax authority has three organisational levels. At the local level there are the 22 offices of NTCA; the second level is the central office of NTCA; while on the top is the Minister of National Economy. The central office of NTCA guides its county offices in all issues, while the Minister is responsible for the supervision of the whole NTCA and acts as the appellate authority.<sup>22</sup>

NTCA must conduct inspection in the following cases: voluntary liquidation is ordered at a company; at the call of the Court of Audit; at the instruction of the Minister of National Economy; and in cases of the decision of the city council at local authorities. In each year NTCA inspects 10 % of the newly established firms based on its risk analysis system. Otherwise, the priorities are set by the president of NTCA.<sup>23</sup> According to the announcement of the head of NTCA in 2015, NTCA especially targeted to detect unregistered employees by inspecting companies that reported large revenues and few employees. In addition it targets companies using manpower leasing and services to households (private doctors, vets, hairdresser, electricians, plumbers, etc.) and sectors with a low share of material costs (insurance agents, real estate agents, designers, etc.).

### **1.2.3 Cooperation and collaboration between authorities and cross-border authorities**

**LAs** - According to Section 8 of the Act LXXV of 1996 on Labour Inspection, during their proceedings LAs cooperate with other authorities. In this cooperation LAs provide information ex officio to the public employment service (PES) about the infringements of the employment rules on a monthly basis. To meet this requirement LAs maintain an electronic database and record of the personal data of affected employees.

For inspections in other fields LAs maintain a database of employers against whom legally binding decisions have stated infringement.<sup>24</sup>

**NTCA** - Based on the Annual Report of NTCA cooperation is mainly between tax and custom authorities.<sup>25</sup> There is no available information on cooperation regarding employment contracts.

In terms of data exchange and cooperation between national authorities other Member States, activities are as follows:

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<sup>19</sup> Government Decree No. 320/2014. (XII. 13.)

<sup>20</sup> Internet: [http://www.ommf.gov.hu/?akt\\_menu=547&set\\_lang=123](http://www.ommf.gov.hu/?akt_menu=547&set_lang=123)

<sup>21</sup> Act LXXV of 1996 on Labour Inspection

<sup>22</sup> Act XCII of 2013 on the Rules of Taxation 10. §

<sup>23</sup> Act XCII of 2013 on the Rules of Taxation 86-89. §

<sup>24</sup> Act LXXV of 1996 on Labour Inspection

<sup>25</sup> Annual Report of National Tax and Customs Administration of Hungary, 2014.

**LAs** - According to the Act LXXV of 1996 on Labour Inspection DLIE cooperates with all the employment related authorities of the EU. In this cooperation DLIE provides all the information about the findings of its inspection activity and the related legislation.<sup>26</sup>

**NTCA** - The collaboration between NTCA and other Member States (MSs) is described in the Directive 2011/16/EU which aims to facilitate the information exchange and inspections by MSs.<sup>27</sup> In 2014 NTCA exchanged information in 18 000 cases of which 90 % were between MSs. NTCA cooperates most frequently with Germany, Slovakia, Czech Republic and Romania. There is no data on employment related cooperation at NTCA.<sup>28</sup>

### **1.3 Policy Focus and Measures**

#### **1.3.1 Policy approach**

According to the Government's Employment Strategy for 2014-2020, Hungary needs to combine deterrence and motivation.

Motivating measures include further cuts in the Personal Income Tax, targeted reductions of SSC in the Job Protection Action Plan and targeted information campaigns in industries that are most affected by undeclared work.

Deterrence measures include more frequent controls and stricter penalties, with an emphasis on their frequency. Firms are expected to accept these changes more easily as the cost of employment has decreased in recent years.

The strategy also aims to improve compliance with health and safety regulations and to enable social dialogue by strengthening the representation of the interests of various stakeholders, including those of employees, as this could further decrease undeclared employment.

#### **1.3.2 Measures to tackle UDW**

Investigations are carried out regularly by the DLIE and by the NTCA. For 2016, the following target values were set by the Minister for National Economy for LAs: at least 10 % of the inspections must be carried out in the sector of private security firms, at least 10 % in the manufacturing industry. At least in 80 % of the cases where undeclared work was detected, inspection authorities shall investigate if the employer has rectified the situation by reporting the employees affected.<sup>29</sup>

A major project, TÁMOP 2.4.8<sup>30</sup> was launched in 2012 to increase the effectiveness of labour inspections. The goals of the project include the development of the system and processes of inspections, increasing the quality, targeting and depth of inspections, and the provision of more information to employees and employers.

A new project that has been announced recently also aims to further enhance the effectiveness of labour inspections.<sup>31</sup>

#### **1.3.3 Good practice**

The EU co-funded project TÁMOP 5.2.3.B established 116 JOGPONT+ (Legal point +) Mini offices in Hungarian cities throughout the country, providing employers and employees with free services and information on the legal framework of employment.

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<sup>26</sup> Act LXXV of 1996 on Labour Inspection

<sup>27</sup> Directive 2011/16/EU. Internet : <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011L0016&from=en>

<sup>28</sup> Annual Report of NTCA (2014).

<sup>29</sup> Announcement of the State Secretary for the Labour Market on directives on labour inspections in 2016. Internet: [http://www.ommf.gov.hu/letoltes.php?d\\_id=6447](http://www.ommf.gov.hu/letoltes.php?d_id=6447)

<sup>30</sup> Internet: <http://tamop248.hu/2/>

<sup>31</sup> <https://www.palyazat.gov.hu/megjelent-a-jogszer-foglalkoztats-fejleszts-felhvs>

By making participants of the labour market more aware of their rights and obligations, this national network of offices is expected to contribute to the decrease of undeclared work, although impact assessments are not yet available.

The database of the cases addressed in the JOGPONT+ offices provides information on the number of cases and the typical nature of issues in each specific region. Reports on these data are published at the project's website.

#### **1.3.4 Challenges and barriers**

The main challenge to decreasing undeclared work in Hungary is that taxes and SSC on employment are high, especially in the case of low-skilled workers (excluding casual workers). This implies that firms that do not comply with regulations have a significant cost advantage.

The government aims to tackle this by decreasing taxes on employment along with increasing the efficiency and frequency of inspections.

In the newly reorganised system, the Minister for National Economy has more direct control over the targeting of inspections. The restructuring also created new challenges, as the former OMMF had seven regional offices, but the new structure is integrated into the District Offices of the Government Offices at the district-level (one department at each county seat in the 19 counties and Budapest). Officers need to adapt to the new structure.