

Factsheet on Undeclared Work – LATVIA

1.1 Nature and Estimated Scale of Undeclared Work

1.1.1 Definition of undeclared work

There is no definition of undeclared work in Latvian legislation.

The Ministry of Welfare, State Labour Inspectorate (SLI) and State Revenue Service, key institutions in the area of UDW in Latvia, use the definition: *Work that is legal in its nature but work without a written employment agreement and/or without notification (registration) to the State Revenue Service.*

1.1.2 Characteristics of undeclared work

The main types of undeclared work in Latvia are envelope wages and unreported employees. According to the SLI there is a shift from classic work without labour contract and without any registration of workers with the State Revenue Service to that of concluding labour contracts for part time work while in practice workers work full time and maybe even overtime.

According the study by Sauka and Putniņš¹, which is the main local source of data on the shadow economy in Latvia², in 2016 the shadow economy was estimated at 20.3% of GDP, and envelope wages made up 40.2% of this total while 17.7% could be attributed to unreported employees³.

The main sectors where undeclared work is found in Latvia are as follows: (the figures in brackets show the number of employees found working illegally in the 2015 and 2016 inspections of workplaces). In 2015 these were: construction (361), hotels and catering (202), agriculture, fishery and forestry (185), wholesale and retail (178) and manufacturing (168). The numbers of 2016 were: construction (357), hotels and catering (191), manufacturing (183), agriculture, fishery and forestry (155) and wholesale and retail (154).

Data for the shadow economy is available distributed by employer size. The average 2014-2016 figures are as follows:

- 1-5 (employees): 26.7% (shadow economy in the company)
- 6-10: 27.0%
- 11-20: 18.2%
- 21-50: 22.0%
- 51-200: 21.2%
- 200+: 22.7%

This data is also from the study by Sauka and Putniņš on the size of the shadow economy in the Baltics. In conformity with general practice in Latvia their definition of the shadow economy excludes illegal activity such as contraband, drugs trade, weapons trade, etc.

¹ Putniņš, T., Sauka, A. (2017). SSE Riga Shadow Economy Index 2009-2016.

Internet: <http://www.sseriga.edu/en/centres/csb/shadow-economy-index-for-baltics/>

² Estimates of the shadow economy in European countries by Friedrich Schneider yield similar results for Latvia i.e. in 2014 the estimate for Latvia was 24.7 % of GDP and in 2015 23.6 % of GDP. See Schneider 'Size and development of the shadow economy of 31 European countries and 5 other OECD countries from 2003 to 2015: different developments' Internet:

<http://www.econ.jku.at/members/Schneider/files/publications/2015/ShadEcEurope31.pdf>

³ Unreported business income formed the biggest share at 42,1%.

A key motivator for UDW in Latvia is low tax morale. However, the only data available is from the research Sauka and Putniņš' report on the shadow economy who find that the statistically significant factors are:

- Balance of costs and benefit associated with tax evasion;
- Discontent is associated with more shadow activity;
- Discontent with business legislation (strongest effect), State Revenue Service work, tax policy, government support for business (weakest effect);
- Higher tolerance of involvement in the shadow economy is associated with higher involvement in the shadow economy;
- Smaller firms tend to be more involved in the shadow as economy compared with large ones; and
- Russian speakers are more inclined to be involved with shadow activity.

No evidence is available for other types of UDW.

1.1.3 Estimated scale of undeclared work

The main form of UDW is envelope wages where a worker has a legal work agreement but a significant share of remuneration is undeclared. The Putnins and Sauka estimate of the shadow economy in 2016 is 20.3% of GDP and, if we take their estimates of the importance of envelope wages and undisclosed workers in the shadow economy, then UDW, broadly defined, corresponds to about 11.8% of GDP.

The SLI conducts work place inspections to detect undeclared work and workers. In 2016 the SLI conducted 3,026 inspections with aim of detecting UDW, of which 431 were repeat inspections. The number of undeclared workers revealed was 1,371, 881 of whom were without a labour contract and without registration, 342 had a labour contract that was not registered, and 148 had no labour contract but were registered with the SRS. As a result 846 fines were imposed totalling EUR 609,497.

1.2 Institutional Framework

1.2.1 Responsibilities for addressing Undeclared Work

The main institutions responsible for identifying, tackling and preventing UDW are:

- the Ministry of Finance,
- the Ministry of Welfare,
- the State Labour Inspectorate,
- the State Revenue Service, and
- the Shadow Economy Combating Board (consisting of the Prime Minister, the Minister of Economics, the Minister of Finance, the Minister of Internal Affairs, the Minister of Welfare, the Minister of Transport, the Minister of Justice, the Minister of Health, the Minister of Agriculture, the Solicitor General, the Head of the Corruption Prevention and Combating Bureau, the Head of the State Labour Inspectorate, the Head of the State Revenue Service, the Head of the State Police Department, the Head of the State Health Inspectorate, the President the Employer's Federation of Latvia, the Chairman of the Municipality Association of Latvia, the Chairman of the Free Unions of Latvia, and the President of the Trade and Industry Chamber of Latvia). In addition there is a Consultative Board for Reduction of Shadow Economy operating under the Ministry of Finance.

However, in practice many other institutions may play a part in tackling and preventing UDW, including various police forces or the Border Guard. In the new draft "Action Plan for the Reduction of the Shadow Economy 2016-2020" 30 different institutions are listed as being involved.

The Ministry of Finance in association with the Ministry of Welfare and other ministries is responsible for development of legislation regarding UDW especially with respect to tax compliance.

The State Labour Inspectorate supervises and controls the enforcement and the general compliance of labour market practice with labour law.

The State Revenue Service collects taxes, it registers and enumerates tax payers, as well as controlling for the compliance of tax payers' documents with the law, prevents and detects criminal activity associated with state taxes, fees, and other obligatory state payments, and customs duties;

The Shadow Economy Combating Board co-ordinates the organisations involved in measures aimed at preventing shadow economy activities.

1.2.2 Characteristics of the responsible organisations

The Ministry of Finance (MoF) is responsible for (i) the formation of financial policy of the state including the state budget; (ii) organisation and coordination of tax policy; as well as (iii) performing various statutory regulatory functions. The MoF is interested in all sectors of the Latvian economy. The MoF is part of the central government and its coverage is national, it operates from its office in Riga.

The Ministry of Welfare (MoW) is responsible for (i) the formation of policies on employment and the labour market, social security, child and family rights, as well as equal opportunities for handicapped persons, and gender equality; (ii) organising and co-ordinating implementation of the above policies (iii) liaising with other labour market related institutions such as the State Employment Agency and the SLI. The MoW is concerned with all sectors of the Latvian economy. The MoW is part of the central government and its coverage is national, it operates from its office in Riga.

The State Revenue Service (SRS) collects taxes, registers and enumerates tax payers. It controls for the compliance of tax payers' documents with the law, and seeks to prevent and detect criminal activity associated with state taxes, fees, and other mandatory state payments, and customs duties. The SRS is interested in all sectors of the Latvian economy, is a sub-body of the MoF and covers the whole state. It operates from its office in Riga and has approximately 4 100 employees.

The State Labour Inspectorate (SLI) supervises and controls the enforcement of labour legislation including labour protection and health and safety at work. The SLI is interested in all sectors of the Latvian economy, is a sub body of MoW, and it covers the whole state. It operates from its main office in Riga, as well as its 5 regional inspectorate centres (there are structural SLI units in 13 different cities in Latvia). In 2016 the SLI employed an average of 165 persons.

The Shadow Economy Combating Board is a government body whose function is to coordinate all organisations involved in combatting the shadow economy. It consists of 19 board members, operates nationally and with interest in all sectors. Board meetings are organised in Riga.

1.2.3 Cooperation and collaboration between authorities and cross-border authorities

Although each of the executive authorities (SLI and SRS) operate separately, they can request data from other authorities (Article 12, paragraph 4 of SLI regulations and Article 4, paragraph 17 of SRS regulations ensure co-operation in the form of data sharing – *the general director of SRS can authorize the SRS officials to acquire and share information*).

In practice there are number of institutions (SRS, State Employment Agency, State Social Insurance Agency, Register of Enterprises, Road Traffic Safety Directorate, State Police, Border Guard, Municipal Police, State Fire and Rescue Service, Office of Citizenship and Migration Affairs, State Building Control Bureau, State Land Service, Fines Register, and the Rural Support Service) that SLI cooperates with in the terms of information sharing to help identify violations of the Labour Law (including undeclared work).

While the largest exchange of information is with the SRS the State Police and the Municipality Police also provide much information and administrative protocols to work on. Moreover, quite frequently joint inspections are practiced with the State Police, the State Border Guard and then Municipality Police. This is done for two reasons – the safety of SLI inspectors (to prevent aggression from violators) and for cases where there might be obstacles to entering the premises

As described above and the MoW claims that this data sharing is very fast and highly efficient. Information is shared between SRS and SLI using an FTPS server where both institutions frequently put relevant information regarding companies where UDW has been discovered by any of the participant institutions.

There are no external evaluations of effectiveness but internally the SLI evaluates its co-operation with the SRS and other institutions involved as fairly effective.

In 2014, 38 Latvian labour inspectors participated in experience-exchange programmes in Slovakia, Finland, Estonia, and Lithuania which focussed on the monitoring and control of undeclared work.

There is an annual meeting of all three Baltic State SLIs where the agenda includes exchange of information and practices on UDW issues.

There has also been practical cooperation in the form of cases when information about violation performed in one Baltic country by a company from another country is then given to the neighbouring SLI to prosecute the case.

Also SLI are taking part and contributing to the European Platform tackling undeclared work, which enhances cooperation between EU countries. It brings together relevant authorities and actors involved in fighting undeclared work, to tackle this issue more effectively and efficiently, while fully respecting national competences and procedures.

1.3 Policy Focus and Measures

1.3.1 Policy approach

Apart from policy implemented by the SLI, policy on UDW is seen as one aspect of policy on the shadow economy and a rather limited part at that since the main concern regarding the shadow economy is the lost revenue it represents rather than the economic distortions it generates.

The main instruments for addressing UDW are aimed at making the controlling mechanisms more effective i.e. deterrence. There have also been attempts at informing society of the negative consequences of UDW i.e. with the aim of improving tax morale. These have included: promotional campaigns and press conferences.

A new 'Shadow economy control strategy for 2016-2020'⁴ was adopted in January 2016 and as usual improving revenue collection is the main aim of the plan and a mix of compliance and tax morale issues are noted to be addressed. However, from the point of view of UDW there is an important innovation: it is proposed that the payment of envelope wages be criminalised and employers who use them be subject to fines.

1.3.2 Measures to tackle UDW

The SLI conducts inspections of workplaces in order to check for the presence of undeclared workers and other violations of labour legislation. Employers found employing undeclared workers are liable to fines.

For the period 2014-2016, there have been 3,998, 3,081, and 3,026 inspections conducted respectively, that revealed 1,586, 1,454, and 1,371 undeclared employed persons. The declining trend in undeclared employed persons is seen as a sign that

⁴ Internet: <http://www.slideshare.net/FinMin/nu-ekonomikas-ierobeoanas-stratija-unvalsts-iestu-darba-plns-nu-ekonomikas-ierobeoanai-20162020gadam>

policies are working, and is consistent with the evidence that the shadow economy itself appears to be declining.

1.3.3 Good practice

In terms of the SLI definition of UDW, what has been found to work is more inspections and more targeted inspections as well as higher fines for violations.

Other practices that appear to work are:

- Changes in the regulations requiring the registration of a worker in the SRS at least 1 hour prior to employment, possibilities for the SLI to check this information and also impose a fine for non-compliance. This has probably contributed to decreasing the prevalence of UDW but this is difficult to prove;
- Access to the data bases of the SRS and other institutions as well as increased cooperation between the SLI and other institutions involved in combating UDW. Nevertheless, the truth is that the main form of UDW in Latvia – envelope wages – has hardly been addressed so good practice in this area is hard to find.

1.3.4 Challenges and barriers

Latvia's main challenge is systemic: both tax morale and tax compliance are low leading to a bad equilibrium where envelope wages are paid in one enterprise because most other enterprises are paying them. The challenge is to achieve a good equilibrium with high tax morale and high compliance as in the Nordic countries. It is unlikely that this can be done piecemeal and perhaps with existing institutions e.g. it has recently been revealed that a number of SRS employees have been involved in tax avoidance/evasion schemes. In the Latvia Competitiveness Report it was suggested that the SRS should be outsourced to an efficient tax administration such as the Danish one in the same way that the City of Stockholm has outsourced the management of its metro to the Hong Kong Mass Transit System.

There have been informational campaigns, the latest one being 'Work contract – safer tomorrow'⁵, which addressed specifically the costs of not having a work contract. There have also been numerous changes made to the tax policy in order to reduce the tax burden (e.g., increasing non-taxable income; increasing the minimum wage). However, all of these have been piecemeal and have not generated systemic momentum. The current 'Shadow economy control strategy for 2016-2020' looks quite promising on paper but the details have yet to be revealed (June 1st) and then implemented.

The key challenge remains systemic change. More specific challenges include: co-operation of workers in revealing undeclared work practices and tackling the causes of undeclared work rather than simply the consequences.

⁵ Internet: <http://www.vdi.gov.lv/lv/kampanas/sabiedribas-informesana/darba-ligums-drosaka-ritdiena/>