



**European Employment Observatory**

**Undeclared Work**

**Malta**

**Update 2012**

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This report is divided into four main sections. First it starts by defining undeclared work and the related concept of the shadow economy. Subsequently it examines the extent of the shadow economy and undeclared work in Malta. The third section deals with some of the more recent measures being carried out by the Government in order to reduce the phenomenon. The report concludes by proposing some suggestions on how to tackle undeclared work and the shadow economy. The report does not claim to capture all the aspects of the phenomenon and its management, but discusses some salient issues that have been raised over the past few years.

## **1. Defining undeclared work and the shadow economy**

The European Union defines undeclared work as "any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account differences in the regulatory system between Member States" (European Union). This definition excludes criminal activities (unlike the term 'illegal work') and activities that do not need to be declared to the Government.

According to the European Union, one can categorise four major types of undeclared workers, namely, persons with two or more jobs; "economically inactive" persons (students, housewives, early retired persons); the unemployed; and illegal immigrants. In the Maltese context, one can also include service providers (such as skilled workers and professionals who do not declare all their work) to the above categories. Labour intensive sectors and sectors where there is a high demand and low supply of human resources are fertile grounds for undeclared work.

Undeclared work is often examined as part of the wider concept of the shadow economy. The shadow economy can be broadly defined as "those economic activities and the income derived from them that circumvent or otherwise avoid Government regulation or taxation or observation" (This definition is based on the work of several authors and is quoted in Schneider and Buehn, 2007). The definition suggests that in order to understand and to tackle the shadow economy, one may focus on either the activities as such or the revenue they generate.

Schneider and Buehn (2007) give a narrower definition of the shadow economy comprising "all market-based legal production of goods and services that are deliberately concealed from public authorities for the following reasons:

- (1) to avoid payment of income, value added or other taxes,
- (2) to avoid payment of social security contributions,
- (3) to avoid having to meet certain legal labour market standards, such as minimum wages, maximum working hours, safety standards, etc., and
- (4) to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms" (p.2).

This definition highlights the complexity of the shadow economy that may be directed not only to avoid the payment of taxes and social security contributions, but also to lower working conditions and avoid Government bureaucracy. Indeed, there are various contributors to undeclared work and the shadow economy, such as tax legislation, level of bureaucratisation, trust in the Government, cultural factors, the overall economy and illegal

immigration, among others. The contributors of the shadow economy differ from country to country, and particular contributors might be more prevalent in Malta than in other countries.

Undeclared work has negative implications for public finances, social protection systems and the economy in general. Undeclared work results in a negative spiral whereas in order to make up for the loss of tax revenue, governments increase taxes, thus increasing the drive to do undeclared work. Undeclared income undermines the government's ability to raise revenue efficiently and results in an inequitable distribution of the tax burden. Individual workers in the shadow economy forgo the benefits associated with formal employment, such as training and social insurance coverage. Besides, consumers (or clients) may also suffer negative consequences from undeclared work, due for instance, to the inability to claim compensation for poor services or products.

Despite all these negative aspects associated with undeclared work, the phenomenon is visibly present in the Maltese society. The population tends to be acquiescent towards this widespread phenomenon, which is often socially accepted as a way of making ends meet. Having said that, social partners do now and again mention the need to reduce the shadow economy. For example, a few months ago, the Malta Chamber of Commerce urged the Government "to address tax evasion through a structured programme of initiatives", something which it argued was not properly tackled in the 2012 Budget (Maltastar, 2011). Indeed the 2012 Budget does not set clear targets to address tax evasion.

## 2. Prevalence of the shadow economy and undeclared work in Malta

### 2.1 Foreign studies

Schneider (2011) wrote a report entitled "The Shadow Economy in Europe, 2011" in which he linked the use of electronic payment systems to the reduction of the shadow economy. In line with some previous local studies, he estimated Malta's shadow economy as comprising about a fourth (25.8%) of the GDP when compared to the much lower average of 19.2% among the EU27. As can be seen in the table below, in 2011, the shadow economy in Malta was estimated to amount to some €1,665 million. Schneider's (2011) study estimates that the shadow economy in Malta increased from 2008 to 2009, but shrunk again in 2011 to the 2008 figure. In this study, Malta's shadow economy is among the largest among the EU27 members, with only the eastern countries Bulgaria, Cyprus, Estonia, Latvia, Lithuania, and Romania doing worse. It is striking that Malta has a larger shadow economy than other southern EU member states like Italy, Greece and Spain, which have a reputation of having a low tax conscience. The study shows that the undeclared economy in EU member states ranges from about 8% in Austria to about 32.3% in Bulgaria.

**Table 1. Malta's shadow economy according to Schneider (2011)**

Country	2008		2009		2010		2011 (estimate)	
	Share of shadow economy	Shadow economy (€ millions)	Share of shadow economy	Shadow economy (€ millions)	Share of shadow economy	Shadow economy (€ millions)	Share of shadow economy	Shadow economy (€ millions)
Malta	25.8%	1,507	25.9%	1,510	26.0%	1,603	25.8%	1,665
EU27	19.3%	1,890,165	19.8%	1,849,020	/	1,885,194	19.2%	1,906,619

The European Commission used Schneider's data for Malta in a report entitled "Tax Reforms in EU member states", and declared that while it is difficult to calculate precisely a country's shadow economy, these estimates are on the conservative side (Camilleri, 2011a).

The Government reportedly played down the European Commission's report based on Schneider's findings, stating that the study's methodologies and assumptions did not consider Malta's specific "social, cultural, economic and political factors" (Sansone, 2011). As an example, the Government mentioned that the study did not delve into "issues such as tax credits and other deductions that legitimately reduced the Government's actual tax intake" (Sansone, 2011).

In 2012, the leader of the Group of the Progressive Alliance of Socialists & Democrats in the European Parliament (S&D Group) urged EU leaders to adopt strong measures to enhance job creation and economic growth. He asked for a strong commitment to reduce tax evasion in the EU by half by 2020. The S&D Group proposed "the immediate introduction of a financial transaction tax, a clear commitment to halve tax evasion by 2020, the creation of a redemption fund to ease the debt burden, and the extension of the credit line for the European Investment Bank" (S&D Website). The S&D Group argued that while many budgetary cuts have been proposed in EU countries to fix the economic problems, insufficient attention has been paid to tax evasion, which may amount to an annual loss of some €1 trillion in potential tax revenue in the EU. According to the S&D Group, a firm stand against tax evasion could resolve the EU countries' public debt within 8 to 9 years (S&D Website).

The S&D Group's proposals are based on a report entitled "Closing the European Tax Gap" (Murphy, 2012). In line with Schneider (2011), Murphy (2012) also estimates Malta's shadow economy to be about a quarter of the GDP. Indeed, at 27.2% (see the table below), the estimate is even higher than Schneider's. According to this report, Malta (together with Poland) is the 8<sup>th</sup> country with the largest shadow economy. This compares somewhat better than the 7<sup>th</sup> position of the Schneider report.

**Table 2. Malta's shadow economy according to Murphy (2012)**

Country	GDP 2009 (€ millions)	Size of Shadow Economy (%)	Tax burden - 2009 (%)	Size of Shadow Economy (€ millions)	Tax lost as a result of Shadow Economy (€ millions)
Malta	6,200	27.2	34.2	1,686	577
EU27	12,271,200	22.1	35.9	2,258,223	864,282

According to Murphy's (2012) study, larger economies tend to have relatively smaller shadow economies. However, this should not be an excuse for acquiescence. Murphy gives some indications of the extent of the loss of tax due to the shadow economy. For instance, tax lost on shadow economy is estimated to amount to 20.8% of Government spending or more than half (56.4%) of the spending of healthcare in Malta. The study also calculated that in theory, it would take Malta only 7.4 years to clear its annual deficit if all tax evasion were to be eliminated. Whereas this scenario is not possible, a reduction of 10% of the shadow economy would already result in an addition of over 50 million in annual Government revenue.

While it is true that the above international reports are only indicative, it is of concern that the Government appears not to acknowledge the extent of the problem, a necessary step needed to refocus the Government's energies on undeclared work and the shadow economy.

## 2.2 Infringements found by the Employment and Training Corporation

The Employment and Training Corporation (ETC) tackles undeclared work in various ways, including through its Law Compliance Unit. The Unit cooperates with other Government entities such as the Department of Social Security, the Tax Compliance Unit, the Vat Department and the Police Force.

As can be seen in the table below, the total number of employment infringements identified by the ETC has decreased from 2,265 to 1,754 (by 23%) between 2005 and 2010 (ETC, 2011). This is mostly due to the fact 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, decreased substantially (by 32%) between 2005 and 2010. These figures must be interpreted with caution as they are based on the number of inspections carried out every year. Indeed, one should note that the number of inspections throughout the years under examination varied considerably, as did the percentage of infringements found in relation to the number of inspections carried out.

The count of persons found working and registering continued to decrease and reached its lowest in Jan-Dec 2010, with only 118 persons. This might indicate that it is becoming more difficult for ETC to clamp down on those who abuse the benefit system, and/ or that the number of persons who do so, is decreasing substantially. Employment of minors has also remained small, indicating that it is probably not a significant problem in Malta. On the other hand, the number of foreigners caught working illegally continued to increase every year, reaching a substantial 373 persons in 2010 (ETC, 2011).

In 2010, 36% of all infringements were found in the hospitality industry, while another 30% derived from the construction and general service sectors (ETC, 2010). These sectors appear to be among those that attract most undeclared work, normally in unskilled and low paid jobs. In recent years, ETC officials have also found undeclared workers in gaming, refuse collection, cleaning and retailing.

**Table 3. Employment Infringements (ETC, 2011)**

	<b>Oct-Sep 2005-6</b>	<b>Oct-Sep 2006-7</b>	<b>Oct-Dec 2007-8</b>	<b>Jan-Dec 2009</b>	<b>Jan-Dec 2010</b>
Working while registering	219	197	145	171	118
Employment of minors	20	26	12	15	20
Employment of foreigners	195	302	291	365	373
Employment not reported to ETC	1,831	1,589	1,727	1,498	1,243
<b>Total infringements</b>	<b>2,265</b>	<b>2,114</b>	<b>2,175</b>	<b>2,049</b>	<b>1,754</b>
<i>Number of inspections</i>	<i>5,144</i>	<i>3,484</i>	<i>4,119</i>	<i>3,553</i>	<i>3,745</i>
<i>Infringements as a % of inspections</i>	44.0	60.7	52.8	57.7	46.8

## 2.3 Corruption, perceptions and the quality of life

It is acknowledged that perceived corruption levels are related to the shadow economy. Thus, it is worth noting how Malta fares with regards to the phenomenon of corruption. Malta scored 5.6 out of 10 (where 0 means that a country is perceived as highly corrupt) in the 2011 Corruption Perception Index developed by Transparency International. Malta is perceived as

the 39th least corrupt country in the world (out of 183 countries) and the 17th within the EU (Camilleri, 2011b). Malta's score is of concern - as nearly all of the "old" member states (apart from Greece and Italy) together with Cyprus, Estonia and Slovenia are perceived as less corrupt than Malta.

So on the one hand, the perception of corruption in Malta indicates potentially high levels of the shadow economy. On the other hand, according to a Eurobarometer survey published in 2007, only 1% of Maltese admitted to having engaged in undeclared work during the previous year. This figure is very unrealistic. Indeed, a third of the participants in the Eurobarometer survey stated to know persons who are involved in undeclared work. The participants who admitted to buying services or goods that probably involved undeclared work, mostly purchased such services or goods from the construction industry (22%), the personal services industry (37%) and retail (30%). The main motivation for these purchases was declared to be their lower price. It is worthwhile noting that 65% of the survey participants felt that the risk of being caught in undeclared work was small (Lindsay, 2007), a figure that sheds light on one of the reasons why the Maltese population engages in undeclared work.

Without going into complicated econometric models, one might try to get a glimpse of the size of undeclared economy by matching GDP and indicators of living conditions. In 2010, Malta's GDP was equivalent to 83% of the EU average (See table below). Despite this, fewer Maltese persons when compared to the EU average could not afford durables such as computers, telephones, cars and so on. While Maltese persons complain more that they cannot make ends meet and while they are less able to afford holidays outside their house (probably stemming from the fact that since Malta is an island, it is more expensive to travel abroad), fewer persons in Malta live in overcrowded households and are unable to face unexpected financial expenses. Considering such statistics, it comes as no surprise that a study by the European Foundation (2009) found that in Malta there is very little tension between the rich and the poor when compared to other EU Countries.

**Table 4. Some quality of life indicators (Eurostat data)**

<b>Data for 2010</b>	<b>EU27 %</b>	<b>Euro area 17 %</b>	<b>Malta %</b>
GDP per capita	100	108	83
Annual net earnings (€)	18,456	20,882	9.652
Enforced lack of a computer	6	4.4	1.8
Enforced lack of a telephone	0.7	0.4	0.2
Enforced lack of a colour tv	0.4	0.3	0.1
Enforced lack of a washing machine	1.4	0.6	0.3
Enforced lack of a car	8.1	4.9	2.4
Population living in an overcrowded household	17.6	11.5	4.1
Inability to afford a one week annual holiday away from home	36.9	32.7	60.1
Inability to afford a meal with meat, chicken, fish (or vegetarian equivalent) every second day	8.7	6.5	10.1
Inability to face unexpected financial expenses	36.2	32.7	26.9
Arrears on utility bills	8.9	7.0	6.4
Inability to make ends meet	10.3	9.3	19.3

## 2.4 Undeclared work, recession and utility bills

The economist and Labour Party MEP Edward Scicluna (2010) asked whether in Malta, undeclared work has taken the brunt of the recession. The question is very relevant, especially since the 2008-2009 global recession only resulted in mild negative effects on the formal labour market in Malta, with few jobs being lost and wages not being strongly affected. At the same time, the attitudes of the Maltese population towards their finances, as measured in national surveys, took a plunge, which has not yet recovered. In line with Scicluna's (2010) thoughts, one can mention the claim by a local newspaper that the increased utility bills in 2009 probably resulted in the shedding of considerable undeclared jobs in the hotel industry, since it was easier for employers to sack workers who could not contest their dismissal. As an example, the article mentioned the case of a hotel that allegedly made redundant 35 undeclared part-timers (Business Today, 2009).

## 3. Recent measures taken to combat undeclared work and the shadow economy

### 3.1 Measures aimed at improving the taxation system

#### Amalgamation of tax-collecting departments

In November 2011, the Parliament approved a Bill that will eventually place four revenue gathering bodies, namely the Inland Revenue, VAT, and Customs departments, and the Tax Compliance Unit, under one regime headed by a Commissioner for Revenue (Times of Malta, 2011a). The move is meant to strengthen the Government's administration of taxes and curtail abuse. The Government asserted that the reform will be carried out gradually in order not to jeopardize the national income. The new Commissioner for Revenue will be responsible for the restructuring that needs to be carried out. The decision whether or not to achieve full integration will be taken in 2013 or 2014. The idea of amalgamating the four bodies was a radical one, and it remains to be seen whether or not it will reap the desired result of reducing the shadow economy. While such move can result in a better rationalization of resources, it will require strong leadership and coordination in order to be more effective than the present system.

#### Commissioner of Inland Revenue's new powers

The total revenue of the Inland Revenue Department increased by 8.6% between 2008 and 2010 (Office of the Prime Minister, 2011). According to the Commissioner of Inland Revenue, between 2009 and 2010, tax audits and investigations performed by the Inland Revenue Department resulted in €34 million increase in tax over 2008 (Conti, 2011). In 2011, the Commissioner of Inland Revenue was given "the power to request information of taxpayers' and their families' property and income, in cases of suspected tax evasion" (Vella, 2011). Such information needs to be given to him within 30 days, with hefty fines for those who give incorrect information. This new power should further decrease the abuse of the system and increase Government revenue.

#### VAT Department

The VAT Department, which collects about a third of the Government revenue, has been under attack due to a VAT fraud scandal. Its public image was severely tainted when in 2009, a group of workers connived with some businessmen to fraud the department a sum amounting to millions of Euros. There exists a widespread impression that there is lack of

accountability in the VAT Department and that this can result in fraud. Indeed, “a board set up to conduct a systems audit of the VAT Department has found a lack of accountability and risk awareness in the management of the department at all levels” (Times of Malta, 2011b).

Having said this, the Government’s income from VAT between 2005 and 2008 has increased every year. A marginal drop of 0.28% occurred in 2009 due to the international financial crisis, but the situation recovered in 2010 (Times of Malta, 2011c), when the Department collected 7.6% more revenue than the previous year (Office of the Prime Minister, 2011). Some observers have attributed the recent increases in VAT revenue to the tighter controls introduced after the VAT corruption scandal. Indeed, the VAT Department made several changes in the way it operates, among others by forming a risk committee to analyse and assess risk assessments (Times of Malta, 2011d). An Analysis and Control Unit was set up in order to monitor the effectiveness of the department (Office of the Prime Minister, 2011). A task force comprising members from the VAT Department, Customs Department and the Police was also set up to cut back illegal trading (Office of the Prime Minister, 2010). The Director-General of VAT stated that in the past two years, the department recruited several new workers, but it still has 21 vacancies for inspectors. Such job is not attractive and posts tend to remain unfilled (Times of Malta, 2011c). (Indeed, a similar problem is faced to find employment inspectors in the Department of Industrial and Employment Relations).

#### Other measures relating to tax

In recent years, several other adjustments relating to the taxation system and its administration were implemented. These include the lowering of taxes for particular working groups in order to make declared work more attractive and the revision of “omission tax to encourage citizens to regularize their position and declare all their income” (Ministry of Finance, the Economy and Investment (2009).

### **3.2 Measures focusing directly on undeclared work**

#### Regulations against the illegal employment of third country nationals

Immigrants from Sub-Saharan Africa have over the past years fuelled Malta’s shadow economy by being used as a cheap and easily disposable type of labour. The collapse of the Libyan regime resulted in a substantial drop in irregular immigration to Malta. While in the first half of 2011, about 1,530 irregular migrants reached Malta from Libya, no arrivals were registered from July to February 2012 (Camilleri, 2012). It is known that Gaddafi has used such immigrants as means of getting funds from the EU.

In 2011, the Maltese Parliament transposed the Directive 2009/52/EC of the European Parliament and of the Council of 18 June 2009 providing for minimum standards on sanctions and measures against employers of illegally staying third country nationals. The new regulations, entitled “Minimum Standards on Sanctions and Measures against Employers of Illegally Staying Third-Country Nationals Regulations, 2011” list harsh penalties for employers found guilty of the offence, including fines, disqualification from public funds and public contracts and even the possible revocation of their trade licence or the closure of their commercial activity. The proper enforcement of these sanctions coupled by more awareness among all employers should result in a drastic reduction of illegal employment of third country nationals.



### **3.3 Measures aimed at reducing the abuse of social benefits**

#### Frequency of registration

The Government is considering the possibility of increasing the frequency of registration of jobseekers in line with the length of their unemployment in a bid to further curb the abuse of the benefit system. The registering unemployed persons will also be provided with greater contact with their employment adviser. The system will use the technology of fingerprint based registration, which is in the process of being set up (Ministry of Finance, the Economy and Investment, 2012).

#### Public awareness campaign

The Government is in the process of launching a three-month inter-departmental campaign promoting the advantages of declared work over undeclared work. The campaign will target different groups of persons including employers, self-employed, and employees, and will also encourage persons to report undeclared work. The campaign will make use of adverts on TV, magazines, and newspapers (Ministry of Finance, the Economy and Investment, 2012).

One should note that the ETC has in the past asked for help from the general public to report undeclared work, and its website already has a law compliance page through which the public may report abuse.

#### Working methods at the ETC

The ETC introduced new working methods in order to intensify its efforts to ensure that persons on the unemployment register abide by the law (Ministry of Finance, the Economy and Investment, 2012).

#### Activation measures and abuse

Mandatory schemes for the registering unemployed persons, such as the Community Work Scheme (CWS), contribute to containing the abuse of the unemployment register as they force the registering unemployed persons to spend a substantial time doing declared activities. The CWS also enables unemployed persons to gain further skills and get closer to the formal world of work through the 30 weekly hours of community work. Those who refuse work without a valid reason are struck off from the register and lose their entitlement to unemployment benefits. A significant number of 441 persons were placed through the CWS scheme in 2011 (Ministry of Finance, the Economy and Investment, 2012). The scheme which in 2010 only targeted persons who had been registering for more than five years, is now including persons who have been registering for a shorter period of time.

A Legal Notice currently awaiting publication will extend the penalty period for those registering unemployed persons who fail to participate in activation measures without just cause for three or more times. They will be struck off from the unemployment register and will only be readmitted after a year, thus doubling the current penalty period (Ministry of Finance, the Economy and Investment, 2012).

### **3.4 Policies and measures supporting transition from undeclared to declared economy**

During the Budget Speech for 2012, the Government announced that a long-term Labour Market Policy will be developed through consultation with the social partners (Ministry of Finance, the Economy and Investment, 2011). The Government is also currently promoting many measures aimed at increasing the participation rate in the formal economy of specific

groups, including females, older workers, and other groups who are not fully integrated in the labour market. These labour market initiatives, to different extents, also contribute (or can contribute) to decreasing the undeclared economy. An analysis of such measures will not be carried out in this report.

#### **4. Some recommendations**

##### Fiscal consolidation through the elimination of tax evasion

The Government is currently juggling with two apparently opposing needs, namely that of aiding the economy to continue growing in a difficult international economic climate and trying to achieve fiscal consolidation. Social partners are adamant that the Government should avoid increasing taxes in order to reduce its debts. Rather, it should embark on a determined programme to reduce the shadow economy. Other Mediterranean countries like Greece and Italy who tolerated a culture of tax evasion, are now in serious difficulties. It is interesting to note that answering a Parliamentary Question, the Minister of Finance recently stated that the Government is determined to continue creating measures that reduce tax evasion in a “gradual manner”. This phrase indicates that the Government is particularly careful when targeting potential abuse. This may stem from controversies that have arisen in the implementation of certain measures meant to reduce the shadow economy. For example, there has been substantial resistance from the social partners, including the Malta Chamber of Small and Medium Enterprises (GRTU), against ‘forward tax agreements’. The GRTU (2006) has strongly criticized the Government on the agreements with hairdressers, who were felt pushed to accept forward tax agreements for three years as they were threatened with long investigations and very harsh penalties. Indeed the GRTU defined the system as anti-business and anti-employment.

##### Stronger administration and fairer penalties

As was argued earlier in this report, the administrative set up to curb abuse needs to be strengthened. The economist and Labour Party MEP Edward Scicluna reportedly stated that "Tax evasion is one of the main challenges for a new government. Tax should not be looked at as a thief. But on the other hand you should not have exorbitant penalties and interest rates. These measures should be in place but they must be proportional to the crime. If somebody makes a mistake in good faith it should be penalised in the same manner as a traffic contravention. It is outrageous that a €50 fine becomes a €3,000 fine in three months. Tax administration must be reasonable and tax collection must be more efficient" (Balzan, 2012).

On the other hand, sanctions against continued and more serious violations need to be strengthened. The “Minimum Standards on Sanctions and Measures against Employers of Illegally Staying Third-Country Nationals Regulations” (Government of Malta, 2011) discussed earlier are an important step in the right direction.

The Government needs to better target potential abusers. Tax evasion appears to be strongly linked to the self-employed. The Chamber of Commerce indicated that a major problem tends to lie with part-timers who tend not to keep any formal records, do not operate from permanent premises and promote their work by word of mouth (Vassallo, 2011). These underground operators are difficult to identify since there might not be any records about them. Another major target group for the Tax Compliance Unit needs to be well-established self-employed persons who make heavily understated declarations. Vassallo (2011) argues that the best way to target these abusers, who also make use of social security provisions

meant for low earners, is through the use of sectoral benchmarks (which have already been controversially implemented for some occupations). One might add that an examination of high spenders (such as those with expensive houses, sports cars and yachts) compared to their annual declarations would give a good idea of where a major part of the problem might lie.

#### Reduction in Government's fuelling of the shadow economy

The Government has often been accused that by awarding contracts to the lowest bidders, it has inadvertently been financing undeclared work on its structural projects, and fuelling the abuse of workers by contractors. Back in 2007, the Employment and Training Corporation itself alerted the Government's Contracts Department to be on the lookout for abuse, especially when the quoted prices are unrealistically low (Times of Malta, 2007). When contractors lower down prices by giving less than the minimum working conditions laid down by law, they not only harm their employees but also offer unfair competition to contractors who abide by the law. As a reaction to these concerns, the Government has improved the procedures guiding the award of contracts.

However, another issue has recently become more prominent, namely the time frames of major projects. At the moment, the Government is pushing forward several large projects (such as major road works in Malta and Gozo, the building of the new Valletta entrance and others) with short time frames. Such time frames are often dictated by EU deadlines relating to funding and political motives such as the need to finish off projects before the election. When several large projects are carried out at once, as is the case at the moment, bottlenecks are created in the economy, where demand for labour is larger than its supply. This lack of equilibrium inevitably fosters undeclared work.

#### Integration of immigrants in the labour market

The problem of Sub-Saharan African irregular immigration was discussed earlier on in this report. The harsh sanctions imposed on persons who illegally employ third country nationals may help to reduce such phenomenon. However, they will not solve the needs of employers for more human resources and the needs of immigrants for money. The Government has shied away from developing a comprehensive integration policy that facilitates the absorption of third country nationals into our society. The Today Public Policy Institute (TPPI, 2008) suggests that a proper policy in this regard would be useful among others to fill selective labour shortages. The Institute argues that the informal economy existing in Malta at present might indeed be attracting immigrants to Malta. The Institute corroborates its assertion by claiming that there is evidence of a growing number of undocumented immigrants who come to Malta as their intended destination, rather than just use the country as a stepping stone to go to Europe. In line with the TPPI, an older report by the Centre for Labour Studies of the University of Malta has also suggested the need to regularise the immigrants' position by issuing them with temporary work permits, or by letting them register as guest workers.

#### Awareness raising

In Malta, there exists a widespread culture that accepts undeclared work. Indeed, many people argue that the black economy is a positive phenomenon, as the formal economy is helped through the spending of money deriving from undeclared practices. There also exists the perception that the Government knows about those who evade the formal economy and does not want to do anything about it. Indeed, as was previously mentioned in this report, the perception of corruption in Malta is relatively high. Reports (sometimes unverified) such as the one claiming that the Tax Compliance Unit and the Tax Audit Department were forced to stop their investigations about cases involving millions of Euros in of taxes (Catania, 2009),

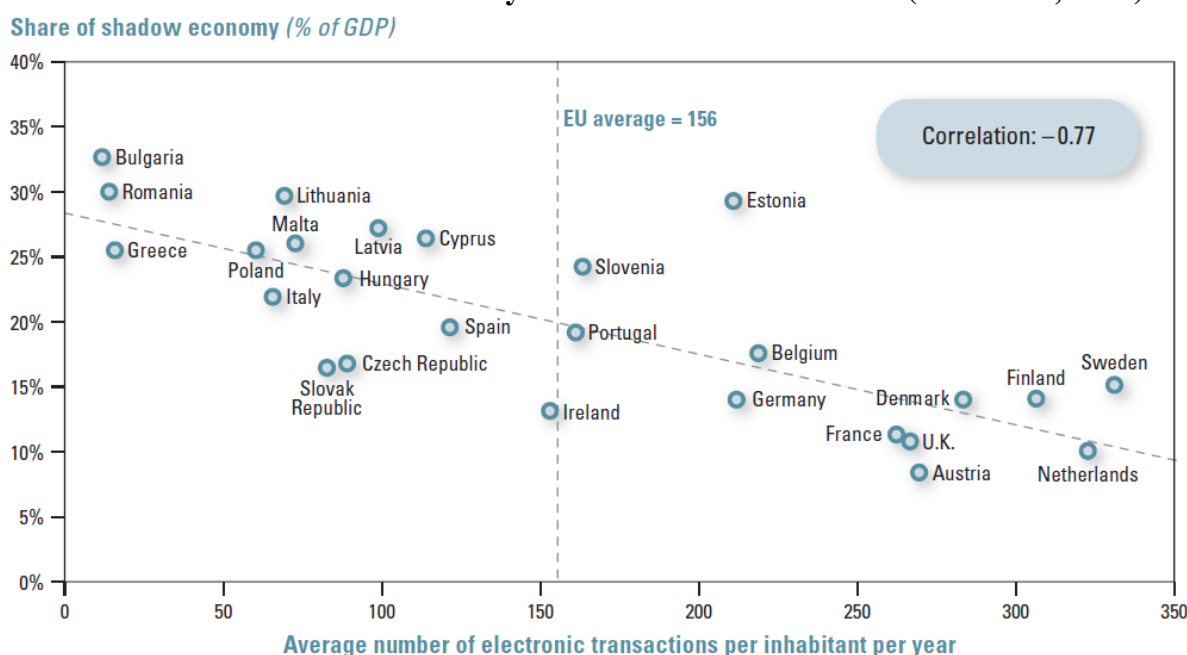
do not help. Neither has the aforementioned corruption scandal in the VAT department. Besides, the Government’s public relations blunder of significantly increasing the cabinet’s wages during a time of austerity has contributed to reducing the Government’s ability to claim the high moral ground when speaking about taxes. “The repeated cases of mismanagement verging on corruption in the Local Councils sector... [also] gave much room for thought to the honest taxpayer” (Vassallo, 2011).

Trust needs to be restored in the system. However, it takes time and effort to establish trust which leads to fiscal morality. Thus, while the three-month campaign being planned is very important, the effort needs to be sustained through a longer-term approach, including education in schools and collaboration with the social partners. The General Workers’ Union’s long-standing campaign against precarious employment is a step in the right direction. The message needs to be clear that declared work is more attractive than undeclared work. Efforts to curb undeclared work require more publicity – there needs to be more information about the performance of the tax gathering departments in order to boost the public confidence in the institutions. Ways need to be found to heighten the social stigma of tax evasion.

Increase the use of electronic payments

Schneider (2011) found a strong correlation of -0.77 between the use of electronic payments and the size of the shadow economy in Europe. In other words, as one might have expected, the smaller the use of electronic payments, the greater the amount of contribution that people make to the shadow economy. Indeed, Malta is one of the lowest users of electronic transactions and has one of the largest shadow economies in the European Union (See Chart below). This data indicates that increasing the culture of electronic transactions might help to significantly reduce the shadow economy.

**Chart 1. Share of the shadow economy and electronic transactions (Schneider, 2011)**



In conclusion and as stated earlier, this report did not aim to analyse the phenomenon of undeclared work and the shadow economy in a comprehensive way. However, it served to highlight some main facets of the problem and some potential ways of managing it. This

report also highlighted the gravity of the problem of undeclared work in Malta. Despite the Government's positive measures, much more needs to be done in order to reduce the phenomenon to an acceptable level.

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