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**EVALUATING THE EXTENT AND NATURE OF ‘ENVELOPE
WAGES’ IN THE EUROPEAN UNION:
A GEOGRAPHICAL ANALYSIS**

Abstract: To evaluate the spatialities of the illegal wage practice where employers pay their declared employees both an official declared wage and an undeclared ‘envelope’ wage so as to avoid tax liabilities, a 2007 survey conducted in 27 European Union (EU) member states is reported. The finding is that 5% of employees received envelope wages which amount on average to some two-fifths of their wage packet. Revealing how, although heavily concentrated in a small group of East-Central European nations, this wage practice is nonetheless ubiquitous, the paper concludes by discussing how this practice might be tackled.

Key words: illegal work, informal economy, envelope wages, tax evasion, European Union.

1. INTRODUCTION

Since the start of the new millennium, a small but growing tributary of thought has begun to unravel the existence of an illegal wage practice in which employers pay their declared employees two wages, an official wage which is declared to the state for tax and social security purposes and an unofficial ‘envelope’ wage that is not declared (Karpuskiene, 2007; Neef, 2002; Sedlenieks, 2003; Williams, 2007; Woolfson, 2007; Žabko and Rajevska, 2007). In this paper, the aim is to provide for the first time a cross-national evaluation of the prevalence and nature of this wage arrangement in the European Union (EU).

To do this, firstly, the previous research on envelope wages in Europe will be reviewed. Revealing that past studies have been small-scale, resulting in a lack

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of knowledge on the prevalence of envelope wages in Europe, the second section then introduces a cross-national survey of envelope wages conducted in 2007 involving 26,659 face-to-face interviews in the 27 European Union (EU) member states. The third section will then report the findings. Revealing that a significant minority of declared employees in the EU receive envelope wages and that it is ubiquitous even if it is heavily concentrated in particular regions of the EU, the final section will then call for greater attention to be paid to both evaluating the impacts of this wage practice and how it might be tackled.

2. PREVIOUS RESEARCH ON ENVELOPE WAGES IN EUROPE

There are a number of ways in which wages might not be declared. On the one hand, there are wholly undeclared wages, or what is variously referred to as the 'cash-in-hand', 'hidden', 'informal', 'off-the-books', 'shadow' or 'underground' economy or sector (see Williams, 2006). Here, the work contract between the employer and employee is in its entirety hidden from, or unregistered by, the state for tax, social security or labour law purposes. There is no formal contract between the employer and employee and none of the income from the work is declared to the state for tax, social security or labour law purposes. Indeed, a vast body of literature exists on this type of undeclared work in which a worker is paid entirely cash-in-hand both in Europe (e.g., Arrowsmith *et al.*, 2003; European Industrial Relations Observatory, 2005; Neef, 2002; Pavlovskaya, 2004; Ram *et al.*, 2002a, b, 2003; Round and Williams, 2008; Smith and Stenning, 2006; Wallace and Haerpfer, 2002; Wallace and Latcheva, 2006; Williams, 2006, 2007; Williams and Round, 2007, 2008) and beyond (e.g., Bajada and Schneider, 2005; Fernandez-Kelly and Shefner, 2006; Kirchler, 2007; Schneider, 2008).

On the other hand, however, and less discussed, are those undeclared wages paid by employers to their declared employees as 'envelope' wages which are paid in addition to the official declared salary. These undeclared 'envelope' wages paid by employers to declared employees have been perhaps ignored, overlooked or simply forgotten because a belief has persisted that formal and informal jobs are separate and discrete. The idea that declared employees working for legitimate employers could be receiving undeclared wages, and that a job might be neither purely formal nor informal, is not considered.

A small but growing stream of literature, however, has started to highlight the wage practice where declared employees receive from their employer two wages, an official wage declared to the state for tax and social security purposes and an unofficial 'envelope' wage which is not declared (Karpuskiene, 2007;

Neef, 2002; Sedlenieks, 2003; Williams and Round, 2007; Woolfson, 2007; Žabko and Rajevska, 2007). So far, nevertheless, most have been small-scale, often qualitative, studies conducted almost entirely in East-Central European nations, namely Latvia (OECD, 2003; Sedlenieks, 2003; Žabko and Rajevska, 2007), Lithuania (Karpuskiene, 2007; Woolfson, 2007), Romania (Neef, 2002) and Russia (Williams and Round, 2007).

The study in Lithuania by Woolfson (2007), for instance, is an in-depth case study of one person, albeit a *cause celebre*, whilst the Latvian study by Sedlenieks (2003) reports 15 face-to-face interviews conducted in Riga. Although the evidence from Ukraine is based on interviews with 600 households, these were conducted in four starkly contrasting localities (Williams, 2007; Williams and Round, 2008), whilst the evidence from Russia is based on interviews with 313 households in three districts of Moscow (Williams and Round, 2007). Until now, therefore, there have been no extensive surveys of the prevalence of envelope wages. The result is that little is known about the pervasiveness of envelope wages in Europe, especially beyond East-Central Europe.

The findings of the studies so far conducted, nevertheless, provide a strong justification for more extensive research on this wage practice. In Ukraine, for example, one-third (31%) of all employees interviewed were paid envelope wages and the total received amounted to between 20% and 80% of their gross wage (Williams, 2007). Comparing labour force and employer surveys in Latvia, meanwhile, the OECD (2003) find that 20% of private sector employees earn envelope wages whilst in Moscow some 65% of the labour force asserted that they receive envelope wages (Williams and Round, 2007).

The reason it is perhaps so popular with employers is because it allows them to avoid social insurance and tax liabilities. By paying the minimum wage to the employee as their official wage and then supplementing this with envelope wages, it also allows employers to differentiate between employees so as to encourage those no longer wanted to voluntarily leave in order to avoid redundancy pay (Hazans, 2005; Round *et al.*, 2008). It might be assumed that employees would also welcome such envelope wages since they receive higher wages than would otherwise be the case if employers had to pay their full social insurance and tax liabilities. In practice, however, this does not occur (Round *et al.*, 2008; Williams, 2007; Williams and Round, 2007). Employers fail to pass on the savings to employees and impose envelope wages onto employees. The outcome is that employees find themselves unable to gain full access to the mortgages and credit to which they would otherwise be entitled, and have lower pension and social security entitlements in systems where the pension and social security levels are tied to one's previous official wage. Governments, similarly, dislike envelope wage payments because they reduce tax revenue that could be used to fund broader societal projects (Williams, 2007).

Unknown so far, however, is whether this wage arrangement is ubiquitous across Europe, or whether it is confined to particular pockets of the European labour market. Below, in consequence, the first extensive cross-national survey of the extent and character of envelope wages in 27 EU member states is reported.

3. EXAMINING ENVELOPE WAGES IN THE EUROPEAN UNION

In late 2005 the European Commission funded a team (which included this paper's author) to design a direct survey to evaluate the extent and nature of both undeclared work in general and envelope wages more particularly in the European Union (TNS Infratest *et al.*, 2006). The fieldwork for the eventual survey, namely Special Eurobarometer No. 284 ('Undeclared work in the European Union'), conducted as part of wave 67.3 of Eurobarometer, was undertaken during May and June 2007.

In this paper, the findings with regard to envelope wage payments are reported, the subject matter of one section of the questionnaire. Mirroring the sampling method of other Eurobarometer surveys, 26,659 face-to-face interviews were conducted in the 27 EU member states, ranging from some 500 interviews in smaller member states to 1,500+ interviews in larger EU countries. In each nation, a multi-stage random (probability) sampling method was employed. A number of sampling points were drawn with probability proportional to population size (for total coverage of the country) and to population density according to the Eurostats NUTS II (or equivalent) and the distribution of the resident population in terms of metropolitan, urban and rural areas. In each of these selected sampling units, a starting address was then randomly drawn. Further addresses (every *n*th address) were then selected using standard 'random route' procedures from the initial address. In each household, meanwhile, the respondent was chosen at random (following the 'closest birthday rule').

All interviews were undertaken face-to-face in people's homes and in the appropriate national language with adults aged 15 years and over. The data collected was collated using CAPI (computer assisted personal interview) in countries where this was available. For all countries, a national weighting procedure was used for analytical purposes employing marginal and intercellular weighting by comparing the sample with the universe description taken from Eurostat population data and national statistical offices. In each nation, this weighting procedure ensured that the gender, age, region and size of locality of the sample were proportionate to the universe.

The survey results, nevertheless, remain estimates and should be treated with caution. Their accuracy, everything being equal, rests upon the sample size and upon the observed percentage. With samples of about 1,000 interviews, the real percentages will differ within the confidence limits detailed in table 1. This needs to be considered when reading the results below. Direct surveys, moreover, have tended to produce lower levels of participation in informal employment than more indirect survey methods using proxy indicators (Bajada and Schneider, 2005) and as such, the estimates of this survey should perhaps be treated as lower-bound estimates of the extent of envelope wage payments in the EU.

Table 1. Confidence limits of the observed percentages in the survey

Observed percentages (%)	Confidence limits (points)
10 or 90	+ or - 1.9
20 or 80	+ or - 2.5
30 or 70	+ or - 2.7
40 or 60	+ or - 3.0
50	+ or - 3.1

The face-to-face interview schedule covered a wide array of questions on the extent and nature of undeclared work starting with attitudinal questions, then questions on whether they had received undeclared goods and services followed by questions on whether they had received envelope wages and finally, whether they had supplied undeclared work. Given the focus in this paper on envelope wages, discussion here is confined to the questions asked in relation to this issue. Firstly, that is, respondents were asked, 'Sometimes employers prefer to pay all or part of the regular salary or the remuneration for extra work or overtime hours cash-in-hand and without declaring it to tax or social security authorities. Did your employer pay you all or part of your income in the last 12 months in this way?'. Secondly, and to understand whether envelope wages were paid for regular work, overtime or both, interviewees were asked 'Was this income part of the remuneration for your regular work, was it payments for overtime, or both?' and thirdly, they were asked what percentage of their gross yearly income from their main job is received as an envelope wage. Below, the results are reported.

4. EXTENT AND NATURE OF ENVELOPE WAGES IN THE EU

Of the 26,659 face-to-face interviews conducted, some 11,885 were with formal employees in employment. Some 1 in 20 (5%) of these employees (616 employees in total) had received all or part of their salary as undeclared wages within

the past 12 months. If extrapolated to the EU as a whole, this suggests that in absolute terms, some 11 million of the 210 million employees in the EU receive envelope wages. On average, those in receipt of envelope wages received two-fifths of their total wage in this manner. Is this wage practice evenly spread across the EU or concentrated in particular countries and regions? Does the character of envelope wage payments differ across the EU both in terms of whether it is paid for regular or extra work, who receives such wages and the businesses paying such wages?

4.1. Envelope Wages: A Geographical Analysis

Across the EU as a whole, 616 respondents reported that they received envelope wages, 29% for their regular work, 27% for extra work or overtime and 36% for both their regular and overtime work. In order to further investigate the geographies of envelope wages, and given the small numbers of respondents involved, the results from the 27 EU member states are here grouped in the first instance into four broad geographical regions:

- Continental Europe, UK and Ireland (Belgium, Germany, France, Ireland, Luxembourg, Netherlands, Austria and the UK);
- East-Central Europe (Bulgaria, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia and Slovakia);
- Southern Europe (Cyprus, Greece, Spain, Italy, Malta and Portugal), and
- Nordic countries (Denmark, Finland, Sweden).

Table 2. Prevalence and types of envelope wages: by EU geographical region

Country	No. waged employees surveyed	% who receive envelope wage	Envelope wage paid as remuneration for:			
			regular work	overtime/extra work	both regular and overtime work	refusal + do not know
Continental Europe	4,404	2	18	65	14	3
East-Central Europe	4,511	11	39	21	37	3
Southern Europe	1,933	4	18	43	26	13
Nordic countries	1,534	3	7	70	9	14
All EU, weighted average	11,885	5	29	27	36	8

Source: Eurobarometer survey No. 278, 2007.

When analysed through the lens of these four regions, table 2 reveals some clear patterns so far as the geographies of envelope wages are concerned. Envelope wages are more common in East-Central Europe with 11% of employees in this EU region receiving envelope wages compared with just 2% in Continental European nations, 4% in southern Europe and 3% in Nordic countries. There are also marked variations in the character of envelope wages in these four regions. Some two-thirds of envelope wages in both Continental Europe and Nordic countries (65% and 70% respectively) are received for overtime payments or extra work conducted. In East-Central Europe and southern Europe, however, envelope wages are paid more usually for regular work or for both regular work and overtime.

The outcome, as table 3 displays, is that although only just over a third (36%) of the employees surveyed are in East-Central Europe, well over two-thirds (68%) of those reporting that they received envelope wages worked in these countries and 84% of all employees receiving an envelope wage for their regular employment. As such, envelope wages are heavily concentrated in East-Central Europe.

Table 3. Distribution of envelope waged work across EU regions: by type of envelope waged work

Country	% of waged employees surveyed	% of all receiving an envelope wage	% of all receiving an envelope wage for:		
			regular work	overtime/extra work	both regular and overtime work
Continental Europe	36	14	8	27	6
East-Central Europe	36	68	84	43	81
Southern Europe	16	12	7	16	11
Nordic countries	12	6	1	14	2
All EU-27	100	100	100	100	100

Source: Eurobarometer survey, 2007.

However, and as table 4 reveals, when individual nations are analysed, there are marked cross-national variations in both the extent to which envelope wages are used and their nature. In Continental Europe, for example, the prevalence of envelope wages ranges from 6% of employees in Belgium to 1% in the United Kingdom, Luxembourg, France and Germany. Similarly, in southern Europe, its

prevalence ranges from 7% of employees in Italy to 1% in Malta. It is in East-Central Europe, however, that the variations are perhaps most polarised.

Table 4. % of employees paid envelope wages in the past 12 months, by EU member state

Country	No. of waged employees surveyed	% all employees receiving envelope wages	% of gross income received as envelope wages	Envelope wages paid for:			
				regular work	overtime/extra work	both regular and overtime work	refusal + do not know
EU27	11,885	5	43	29	27	36	8
East-Central Europe	4,511	12	50	40	16	41	3
Romania	453	23	70	48	9	41	2
Latvia	511	17	46	47	18	34	1
Bulgaria	446	14	44	46	15	37	2
Lithuania	446	11	48	44	10	46	0
Poland	337	11	53	35	15	50	0
Estonia	457	8	31	37	20	32	11
Hungary	392	8	24	19	50	27	4
Slovakia	537	7	25	39	43	18	0
Slovenia	431	5	23	13	40	28	19
Czech Republic	501	3	14	13	46	41	0
Southern Europe	1,933	6	37	15	25	38	22
Italy	401	7	63	12	17	44	27
Spain	423	5	19	18	36	32	14
Portugal	421	4	42	19	15	33	33
Cyprus	210	4	11	9	54	37	0
Greece	292	3	31	29	54	17	0
Malta	186	1	20	100	0	0	0
Continental Europe	3,907	2	24	20	61	16	3
Belgium	428	6	14	18	66	10	6
Austria	519	4	19	14	48	30	8
Ireland	458	2	26	11	66	0	23
Netherlands	515	2	18	0	75	15	10
Germany	657	1	23	35	65	0	0
France	507	1	54	11	61	28	0
Luxembourg	223	1	11	0	100	0	0
United Kingdom	600	1	1	27	53	20	0
Nordic nations	1,534	3	7	7	69	13	11
Finland	491	3	8	6	80	9	5
Sweden	546	3	7	6	80	9	5

Denmark	497	2	6	8	44	16	32
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Source: Eurobarometer survey No. 284, 2007.

There is a clear segmentation of the East-Central European nations with regard to envelope wages. On the one hand are those countries in which envelope wages are extensively used, paid to employees more for their regular hours and amount to on average around half of formal employees' wages (i.e., Romania, Latvia, Bulgaria, Lithuania and Poland). On the other hand, however, are those countries in which envelope wages are less common, paid more for overtime or extra work and amount on average to around a quarter of employees' wage packets (i.e., Czech Republic, Estonia, Hungary, Slovenia and Slovakia).

The outcome is that 54% of all employees receiving envelope wages are concentrated in just five East-Central European countries – Romania, Latvia, Bulgaria, Lithuania, Poland – that contain less than 16% of the EU adult population. Indeed, three-quarters of employees receiving envelope wages for regular work are in these five countries.

Which businesses, therefore, pay envelope wages? Which population groups receive envelope wages? And does this vary geographically across the EU?

4.2. Which Businesses Pay Envelope Wages?

Table 5 begins to unpack the type of business that pays envelope wages. This reveals that although this wage arrangement is ubiquitous across all business types, envelope wages are used more by smaller- than larger-sized businesses. In East-Central Europe, for instance, 19% of employees in businesses with 1–20 employees received envelope wages and this steadily declines as firm size increases, with just 3% of employees in businesses with over 500 employees receiving envelope wages. This is replicated across all other EU regions.

Table 5. Prevalence of envelope in EU regions: by business type and population group

% of all employees receiving envelope wages	Nordic nations	Continental Europe	East-Central Europe	Southern Europe
1	2	3	4	5
No. of employees in business				
1–20	9	4	19	8
21–50	5	2	13	3
51–100	0	1	11	9
101–500	3	1	12	3
501+	0	1	3	4
Sector				
Construction	9	4	22	8
Industry	1	1	10	12

Household services	0	1	3	11
Transport	3	1	18	4
Personal services	2	1	17	3

Table 5 (cont.)

1	2	3	4	5
Retail	6	4	13	3
Repair services	0	2	18	0
Hotel, restaurant, cafes	17	7	11	2
Agriculture	0	0	19	0
General Occupation				
Managers	2	1	12	4
Other white collar workers	2	2	8	6
Manual workers	4	2	15	6
Gender				
Man	4	2	15	7
Woman	2	1	9	4
Age				
15–24	9	4	16	9
25–39	3	2	13	6
40–54	2	1	11	5
55+	1	1	9	3
Gross formal job income/month (€)				
<500	0	3	14	1
500–1000	5	3	10	5
1001–2000	4	3	21	8
2001–3000	3	1	0	0
3001+	2	1	0	6

Source: Eurobarometer survey No. 284, 2007.

Examining the incidence of envelope wages across different sectors, meanwhile, the finding is that there are variations across the EU in the sectors in which envelope wages are most common. In East-Central Europe, the sectors in which envelope wages have penetrated most deeply are construction, agriculture, transport and repair services, in southern Europe it is manufacturing industry and household services, but in both Continental European and Nordic nations it is the hotel, restaurant and café sector along with construction and retail sectors in which envelope wages are most prevalent.

4.3. Who Receives Envelope Wage Payments?

It is not just that some types of business more commonly pay envelope wages. As table 5 reveals, some population groups are also more likely than others to receive envelope wages. On the whole, the patterns are remarkably similar across all regions of the EU. In all regions, this wage arrangement is more prevalent amongst manual workers than among white collar workers. Men are also more likely than women to be paid envelope wages and across the EU as a whole, 6% of men in employment but just 4% of women employees receive envelope wages. The outcome is that some two-thirds (67%) of those receiving envelope wages are men. Envelope wages are also more common amongst younger employees across all EU regions. In Nordic nations, for instance, some 9% of those aged under 25 receive envelope wages, while this steadily declines with age and is only 1% among those aged 55 or more.

There is also a relationship between formal gross wages and envelope wages. However, this varies across the EU. Envelope wages are more common amongst those with lower formal incomes in East-Central Europe, where such wages are paid more for regular work, but more prevalent amongst those with higher wages elsewhere in the EU where envelope wages are used more to reimburse overtime work. In sum, although envelope wages are concentrated in some population groups more than others, this wage practice is ubiquitous. Few, if any, social groups are exempt from this practice.

5. POLICY IMPLICATIONS

It might be assumed that doing nothing is the most appropriate approach towards envelope wages. After all, if envelope wage practices are clamped down on, where at least the employees are officially registered and a portion of their earnings declared, employers might turn to wholly off-the-books employment contracts. The problem with this laissez-faire approach, however, is that allows a continuation of the situation where employees cannot gain full access to not only social security and pension payments since their official wages are lower than their actual wage but also mortgages and credit due to their low official wage. Allowing envelope wages to continue also perpetuates a climate of unfair competition for legitimate businesses (both on an intra- and inter-national level) and encourages a race to the bottom in terms of employment conditions and standards. The outcome for governments is that the attainment of broader societal goals such as social inclusion is hindered by depriving the state of the revenue required to finance social protection. For these rationales, a laissez-faire approach is here rejected and intervention advocated. Intervention in this realm, however, can take diverse forms.

One policy intervention is to simply increase the level of fines for those caught paying envelope wages and to increase the probability of detection. The problem is that evaluations of increasing penalties and detection methods are not conclusive (for a review, see Kirchler, 2007; Williams, 2006). Another option, therefore, is to provide incentives to prevent employers turning towards envelope wages in the first place. These include: simplifying regulatory compliance such as the procedures to both register and pay declared employees; shifting from direct to indirect taxation systems, and raising the level of the minimum wage. The latter in particular needs serious consideration. In East-Central Europe where envelope wages are concentrated, minimum wage levels have been set cautiously at around half the average wage level (European Commission, 2007). The rationale was to prevent a shift from formal to informal employment. The problem, however, is that low minimum wages might have deterred a shift into informal employment, but has provided scope for paying a large portion of employees' earnings as an envelope wage. Raising the minimum wage closer to the average wage would therefore reduce the portion of the total wage that could be paid as an envelope wage. The issue of course is that employers might then decide to employ workers on a wholly undeclared basis. This policy measure of increasing the minimum wage level will therefore need to be piloted and critically evaluated, especially with regard to determining whether there is a tipping point at which employers shift from formalising to informalising work.

Another option, especially to tackle employers already paying envelope wages, is to offer an amnesty to those wishing to fully declare the wages they pay. Another is to shift from the use of direct to indirect taxes, a proposal currently advocated by the European Commission for tackling undeclared work more widely (European Commission, 2007), in order to reduce employer contributions and therefore the need for employers to seek savings by using envelope wage arrangements. Finally, there is also the option of providing tax education and to raise awareness about the benefits of formal employment so as to win 'hearts and minds'. An example here is the campaign pursued in Latvia about the benefits of declared work and disadvantages of envelope wages entitled 'work contracts work'. Although this has not been so far evaluated, evidence from UK advertising campaigns that extol the benefits of declared work display a return-cost ratio of 19:1 in terms of revenue returns for tax authorities (i.e., £19 return for every £1 spent) while punitive measures have a return-cost ratio of just 5:1 (National Audit Office, 2008). In consequence, such indirect controls could be an effective policy approach for tackling envelope wages.

None of these policy initiatives, it should be noted, are mutually exclusive. Governments could increase the minimum wage and at the same time offer amnesties to employers deciding to bring envelope wage payments into the declared realm and then, for those failing to do so, implement higher fines for those subsequently caught using improved detection methods whilst at the same time introducing tax education campaigns.

6. CONCLUSIONS

To evaluate the prevalence and distribution of envelope wages in the EU, this paper has reported the results of a 2007 Eurobarometer survey conducted in 27 EU member states and involving 26,659 face-to-face interviews. The finding is that 1 in 20 employees in the EU had received such envelope wage payments in the previous year from their formal employer and that these undeclared payments on average amounted to some two-fifths of their gross wage. Such a wage practice, moreover, is ubiquitous in all countries, sectors, firm sizes and socio-economic groups throughout the EU, even if it is relatively more common in some rather than others.

Analysing the countries in which envelope wages are more prevalent, it has revealed that envelope wages are much more common in East-Central Europe, where such payments are more likely to be for regular employment hours, whilst in Continental Europe and Nordic countries envelope wages are less common and received more for overtime or extra work conducted. Indeed, some 54% of all envelope wages, and three-quarters of envelope wages paid for regular work hours, are concentrated in just five countries, namely Bulgaria, Latvia, Lithuania, Poland and Romania. Despite this spatial concentration, it should not be ignored that this is nonetheless a ubiquitous practice, albeit one more concentrated in some countries, business types and populations than others.

Indeed, these findings have important implications. On the one hand, they reveal that this wage practice needs to be brought out of the margins and positioned more centre-stage in research on work practices in Europe and beyond and also that further investigations are now required, such as on the nature of its impacts on workers receiving such wages, legitimate businesses who must compete with those paying illegitimate envelope wage and governments suffering loss of tax revenue. On the other hand, however, these findings also reveal the need for more in-depth discussion of how this wage practice might be tackled. Hopefully, therefore, this paper will encourage others to not

only further interrogate this so far largely neglected illegal wage practice in Europe but also to further explore how to tackle this arrangement. If it does so, then it will have achieved its intention.

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