

## The Shadows of Europe

### Strengthening Regional Security through Labor Reform

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The European response to the 2015 migration crisis has overlooked a crucial threat to regional stability—the European shadow labor market. Previous reforms intended to increase employment flexibility in Italy, Greece, and Spain unintentionally reduced the job security of young European workers, forcing them into the shadow economy. Barriers to employment for immigrants have exacerbated this trend.

The inability of governments to rein in their shadow economies, which includes all undeclared or untaxed income from otherwise legal economic activity, will delegitimize domestic institutions and magnify political tensions within the European Union. Brussels should therefore encourage Southern Europe to balance flexibility and equality in their labor markets to maintain European unity and security cooperation.

#### *Recent Trends Towards Greater Job Insecurity*

Since the 1980s, Southern European governments have gradually rolled back employment protection legislation through the deregulation of non-standard work, including temporary and part-time contracts. Although the reforms decreased firing costs for employers, the growth in non-standard contracts had a differential impact on young and old employees. Young workers—aged 18 to 25—disproportionately sign non-standard contracts, which attribute to high job insecurity.

In addition, the millions of immigrants who have entered Europe since the 2015 migration crisis confront legal and *de facto* barriers to employment. Illegal immigrants cannot legally work in the formal economy. Asylum applicants must wait to find employment until their application and work permit are processed, which can take up to two years. Non-legal restrictions, such as language barriers and discrimination, also block asylum seekers from formal employment.

Youth with employment instability and migrants without formal work are the future of Southern Europe's labor force. If unmitigated, job insecurity will push young and migrant workers into the shadow economy.

## *The Shadow Economy and its Dangers for the State*

The shadow economies as a percentage of gross domestic product (GDP) in Spain, Italy, and Greece remain the highest among all Organization for Economic Cooperation and Development (OECD) countries. Relatively weak tax enforcement and economic growth have undermined Southern European efforts to curb shadow activity since 2008. As young and migrant workers increasingly turn to informal employment, Southern Europe's management of shadow activity will continue to flag.

- *Spain.* The size of Spain's shadow economy was 17.2 percent of GDP in 2017. Difficult policy coordination between the Spanish autonomous regions handicaps national efforts to improve tax collection and job insecurity.
- *Italy.* Italy's shadow economy was 19.8 percent of GDP in 2017. Italian immigration authorities were extremely unprepared for the migration crisis, and recent labor reform has not improved the employment stability of young workers.
- *Greece.* In 2017, the Greek shadow economy was the largest in Western Europe at 21.5 percent of GDP. Greece's political system has been fragile since the 2010 sovereign debt crisis, and systemic deficiencies in Greek labor policy and asylum processing will reverse efforts to stabilize the official economy.

Employees and employers in the informal sector evade taxation, which erodes government capacity and distorts key policy indicators. In addition, the high poverty associated with shadow activity interrupt efforts to narrow the income inequality gap. Finally, shadow employment heightens economic anxiety and political discontent due to the heavier tax burden on the formal economy. The shadow economies in Spain, Italy, and Greece will impair basic government functions and foster greater public dissatisfaction.

## *Regional Divisions and Consequences for Collective Security*

Public discontent in Southern Europe following the 2008 global financial crisis significantly heightened tensions between EU member states. As shadow economies lead Southern European citizens to feel further left behind their northern neighbors, the north-south divide will deepen. Protest parties created after the 2008 recession will consequently appeal to more voters disillusioned with the EU status quo.

As protest parties gain support in Southern Europe, their anti-North Atlantic Treaty Organization (NATO) and pro-Russian platforms will impede collective security cooperation. In Spain, Podemos demands greater Spanish autonomy within NATO and advocates for Russian participation in regional defense coordination. The Five Star Movement in Italy has openly supported Russian President Vladimir Putin. In Greece, Syriza has been sympathetic to Russia's

position on issues like sanctions and aspires to reorganize European security to exclude Cold War alliances, like NATO.

### *Balancing Flexibility with Equality in Southern European Labor Markets*

Balancing a flexible labor market with more equal access to stable employment will help address rising job insecurity in Southern Europe. This recommendation identifies a few policy options aimed at increasing job security under non-standard employment contracts. Labor reform focused on both flexibility and equality will slow employment trends in Southern Europe, block incentives to work in the shadow economy, and prevent the expanding division of the EU.

- *Flexibility for Employers.* Firms that can easily hire and fire new workers will be more likely to register their employees with tax and social security authorities. Strong employment protection legislation typically incentivizes firms to employ workers in the shadow economy because the cost of replacing employees is so high. In addition to minimizing shadow activity, labor flexibility can promote firm competitiveness and increase overall employment participation.
- *Equality for Employees.* Equal treatment and benefits for standard and non-standard employment will prevent workers from supplementing their income in the shadow economy. A new type of labor contract that offsets flexibility for employers with employee protections would improve job security while maintaining the benefits of non-standard contracts. Policymakers can also narrow the legislative definition of temporary or part-time contracts to provide greater agency to employees. Finally, improved access to training can ease the transition from non-standard to standard employment. Each policy should be adjusted to fit the specific characteristics of the Spanish, Italian, and Greek economies.

The large shadow labor markets in Spain, Italy, and Greece are the next substantial threats to regional unity and security. The European response to the migration crisis has overlooked the vulnerability caused by job insecurity and informal employment in Southern Europe. Brussels must, therefore, encourage greater employment equality in these countries as a necessary step toward a stronger and more secure European Union.