The Shadows of Europe
Strengthening Regional Security through Labor Reform

Rebecca Lamb

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Introduction

In 2013 alone, 2.1 trillion euros went undeclared to tax authorities in Europe. This tax evasion makes up the European shadow economy, which includes all otherwise legal economic activity that goes undeclared to or untaxed by government agencies. Since the 2015 migration crisis, the 2.46 million asylum seekers who have arrived in the European Union (EU) face significant pressure to enter this shadow sector.

Labor market vulnerabilities in Southern Europe, including job insecurity among young workers and employment barriers for new migrants, will likely encourage greater tax evasion. Recent reforms to improve employment flexibility in Spain, Italy, and Greece increased the number of non-standard contracts relative to permanent employment—especially among workers aged 18 to 25 years. At the same time, incoming migrants face massive legal and unofficial barriers to legitimate employment. As European youth and migrants confront rising obstacles to stable work, current attempts to regulate shadow activity in Southern Europe will likely founder.

Large shadow economies reduce government tax revenue, heighten current economic anxieties, and threaten European political and security coordination. Spain, Italy, and Greece have the largest informal sectors relative to gross domestic product (GDP) in Western Europe. If left unaddressed, the shadow labor markets of Southern Europe will deepen divides among EU member states and empower existing protest parties.

Balancing sufficient employment flexibility with more equal labor protections will improve the job security of both native and migrant workers. Labor contract reform for non-standard work can help reinforce domestic stability in Southern Europe, encourage European unity, and strengthen regional security cooperation.
Labor Market Vulnerabilities, Immigration, and the Shadow Economy

_In the space of a generation, the average European worker has gone from having a job for life to having more than ten in a career._

- European Commission, 2017

Rising job insecurity among Southern European youth and obstacles to legitimate employment for migrants will interrupt current efforts to curb tax evasion. The migration crisis exposed and exacerbated the labor market instability already confronted by young European workers. As a result, European youth and migrants will be pushed into the informal economy. A large and unregulated shadow economy in Southern Europe, particularly in Spain, Italy, and Greece, will reduce government capacity, reinforce current income inequalities, and heighten public dissatisfaction with the domestic economy.

Recent Trends Toward 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 years—disproportionately sign non-standard contracts, while many older workers hold open-ended, permanent contracts. Furthermore, non-standard employment as a share of total employment has risen significantly since these reforms began.

Young employees under fixed-term contracts face high job insecurity, and reduced employment protections in Southern Europe prevent easy transition from non-standard to permanent employment. The International Labor Organization defines employment security as protections for workers against sudden job loss and has attributed heightened concerns over job security to the dominance of non-standard work. Young workers under these contracts also often lack access to job training, which is crucial for career advancement. Thus, the youth of Southern Europe are trapped in a vicious cycle of increasing job insecurity.

This rise in non-standard employment in Southern Europe endangers labor market stability. Under current migration policy, this volatility will only grow. Like many young Europeans, asylum seekers face severe obstacles to finding long-term, secure employment.

Barriers to Employment Following the 2015 Migration Crisis

Millions of illegal immigrants and asylum seekers have traveled to Europe since the start of the migration crisis. After arriving in Southern Europe, migrants must overcome more severe hurdles to employment than their young European counterparts.

While refugees have been successfully integrated in some countries, the EU has focused primarily on border security and asylum processing since 2015. Reforms of the Common
European Asylum System in 2011 focused on these two issues, but coordinating internal and external border policy has proven difficult. These challenges will only mount as arriving migrants are left without formal employment.

The millions of asylum seekers and immigrants already in the EU confront legal and de facto barriers to employment. Illegal immigrants cannot legally work in the formal economy. Asylum applicants must wait for legitimate employment until their application is processed, which can last up to 18 months, and some countries do not administer work permits for six to nine months beyond that. Even with a work permit, non-legal restrictions, such as language barriers, discrimination, and the failed recognition of previous education or job qualifications, prevent asylum seekers from finding formal employment. Finally, immigrants who do obtain legal work are more likely to sign a temporary contract, similar to labor trends faced by European youth.

Youth without employment stability 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 economy, which includes all undeclared or untaxed income, reduces government revenue and, therefore, undermines government capacity. The main drivers of informal employment include a high tax burden on employers or employees, low respect for tax administration, and rigid labor restrictions. The most common forms of shadow labor are a second, informal job after regular working hours or work by individuals who are legally barred from formal employment. In Southern Europe, young workers facing high job insecurity fall into the first category, with asylum seekers and illegal immigrants in the second.

In 2017, the shadow economies as a percentage of GDP in Spain, Italy, and Greece remain the highest among all Organization for Economic Cooperation and Development (OECD) countries. Although improvements in tax collection have consistently reduced the informal economies of Northern Europe, progress in Southern Europe came to a halt between 2008 and 2013 due to weak tax enforcement and relatively slow economic growth. This relapse exposed the labor market vulnerability of Southern Europe that predated the migration crisis. Between 2013 and 2017, the shadow economies of Spain, Italy, and Greece remained almost double the size of Northern European informal sectors. As job insecurity forces young and migrant workers into informal employment, Southern Europe’s management of shadow activity will continue to weaken.

Employees and employers in the informal sector attempt to evade taxation and social security contributions, which erodes government capacity. In addition, shadow economies reinforce economic inequalities and heighten public dissatisfaction with the political process.

- Reduced government capacity. A sizable shadow economy distorts statistics on important policy indicators, including unemployment, GDP, and inflation.
statistics are a significant obstacle to informed policy decision-making. In addition, the formal economy faces a higher tax burden when a large portion of taxable income goes unreported, and government revenues stay artificially low. An unchecked shadow economy, therefore, interrupts government management of its formal economy.

- **Entrenched economic inequalities.** Labor market segmentation—in particular between old and young workers—expanded the income inequality gap in Spain, Italy, and Greece following the 2008 financial crisis. Informal-sector workers lack the labor protections available in the official economy, which can lead to persistent low wages and rising poverty. Although shadow employment may help supplement the salaries of non-standard employees, inequality will be more entrenched in the formal economy. Reduced government capacity and high poverty associated with shadow activity interrupt efforts to narrow the income inequality gap.

- **Heightened public dissatisfaction.** A heavier tax burden on the formal economy and larger income inequalities will likely heighten current economic anxiety among the public. In November 2017, the top concern for domestic policy in Spain, Italy, and Greece was unemployment. Seventeen percent of Greeks and 16 percent of Italians cite taxation as a top concern facing their countries—the highest in all EU member states. About 36 percent of all Europeans consider “social inequalities” to be the main challenge for the EU moving forward. Furthermore, in a futures analysis of global shadow economies, the Association of Chartered Certified Accountants (ACCA) predicts that political volatility will increase in any country facing informal-sector pressures like those in Southern Europe. Rising political volatility in Spain, Italy, and Greece will impair basic government functions and foster greater public dissatisfaction.

The shadow economy will weaken government capacity in Southern Europe. If left unaddressed, an unstable Southern Europe will magnify tensions among EU member states and strengthen the anti-establishment messages of existing protest parties.

**Regional Divisions and Consequences for Collective Security**

Heightened public dissatisfaction with Southern Europe’s domestic political systems will threaten European unity and security coordination. Weakened regulation of shadow activity in Spain, Italy, and Greece will exacerbate tensions with northern EU member states. As this north-south divide grows, protest parties will take advantage of European disunity to expand their electoral support. The platforms of the major protest parties in Southern Europe outwardly support a pro-Russian security strategy, which destabilizes the role of the North Atlantic Treaty Organization (NATO) in regional defense.
The North-South Divide

Public discontent in Southern Europe following the 2008 global financial crisis significantly heightened tensions among EU member states. The perceived northern-imposed fiscal restraints were not well received in Southern Europe. Since the recession, voter turnout declined in Spain, Italy, and Greece, while participation in Northern European countries like Germany and Sweden increased. In addition, protest parties like Podemos in Spain, the Movimento Cinque Stelle in Italy, and Syriza in Greece transformed traditionally bipolar party systems into multi-polar systems.

As the economic gap among member states expands in response to shadow employment, the north-south divide will deepen. In 2017, a majority of Italian, Greek, and Spanish citizens did not believe their voice counted in the EU. Greater labor market vulnerabilities and larger shadow economies will lead Southern European citizens to feel further left behind by their northern neighbors. At the same time, citizens in countries like Germany will resent Southern Europe’s dependence on Northern European financial support. Political frictions between Northern and Southern Europe following the global financial crisis were only the beginning of a broader bifurcation of the EU—rooted in unmanaged shadow economies.

As the north-south divide grows, protest parties created after the 2008 recession will appeal to more voters disillusioned with the EU status quo. Shadow employment and worsening north-south relations will breed a generation of anti-establishment young voters in Southern Europe.

Protest Parties as a Threat to European Security

As worsening north-south relations empower anti-establishment political parties, regional security coordination will become more difficult. According to the European Commission, joint decision-making, financial stability, and political unity are essential for regional security. Furthermore, if nationalist parties fragment European defense capabilities, EU coordination with NATO will falter. A strong EU-NATO strategic partnership is crucial to counter the shifting threats facing Europe.

Podemos in Spain, the Movimento Cinque Stelle in Italy, and Syriza in Greece promote party platforms that are outwardly pro-Russian and anti-NATO. Their rising power due to labor market vulnerabilities and regional divisions, therefore, poses a concrete threat to regional security.

- **Podemos.** The party platform of Podemos demands greater Spanish autonomy within NATO. The online platform also advocates for a “European security architecture in which Russia participates,” which would directly undermine NATO authority. Although the party recently backed away from its commitment to leave NATO, it still supports Russian involvement in EU defense cooperation. In addition, Spanish nationalism, which had been discouraged since the dictatorship of Francisco Franco, surged following the economic crisis and attempted secession of Catalonia. Anti-NATO and pro-nationalist security platforms in Spain will undercut efforts to coordinate European defense capabilities.
• **Movimento Cinque Stelle.** The Movimento Cinque Stelle, or Five Star Movement, won one third of the votes cast in the Italian election on March 4, 2018—the largest share it has ever received. The election produced a hung parliament, but the results guarantee the Five Star Movement a position in the future coalition government. Dissatisfaction with the migration crisis and economic situation in Italy played a major role in the Five Star Movement’s recent popularity, especially among young voters. The party has pushed for exit from the Eurozone and openly supported Russian President Vladimir Putin. Additionally, a poll conducted by the Demos & Pi research institute in February 2018 found that 19 percent of Italian voters across all political parties had a “positive or very positive” opinion of former fascist leader Benito Mussolini. Rising fascist sentiment, combined with the recent election results, will create a “prolonged period of political instability” in Italy, according to a report by Reuters.

• **Syriza.** Syriza, or the Coalition of the Radical Left, won 36 percent of votes in the January 2015 national election, making party leader Alexis Tsipras the Greek prime minister. Syriza’s foreign policy platform endorses “no [Greek] involvement in wars or military plans,” indicating a resistance to centralized EU defense. Furthermore, the party aspires to reorganize European security coordination to exclude Cold War alliances, like NATO. When the party came to power in 2015, the Russian diplomat to Greece was the first foreign diplomat welcomed by Tsipras. Syriza has been more sympathetic to Russia’s position on issues like the invasion of Ukraine and European sanctions, and its representatives in the European Parliament have consistently voted against motions critical of Russia. While focus since the recession has been on anti-austerity policy, Syriza’s pro-Russian platform threatens EU-NATO relations.

As protest parties gain support in Southern Europe, their anti-NATO and pro-Russian platforms will impede collective security cooperation. Although these parties emerged following economic crises, the ultimate threat they pose is to European security. Analysis of Southern European domestic policy is necessary to assess the country-specific vulnerabilities fueling anti-establishment discontent.

**Spain, Italy, and Greece: Assessment of Current Policies**

An assessment of labor policy, immigration policy, and informal activity in Spain, Italy, and Greece reveals the threat each country poses to European unity. Despite some labor market improvements and slower migration inflows, Spain’s autonomous regions impede national policy implementation. Italian labor and immigration policies are insufficient and unprepared to address growing job insecurity among youth and migrants. Finally, the labor reforms, asylum processing, and shadow economy in Greece present the most extreme case of economic and political fragmentation.
Spain

The Spanish government recently instituted labor reforms to redefine temporary work, but immigration policy and uncoordinated taxation among autonomous regions leave its shadow economy as the third largest among OECD countries.

- **Labor policy: reversing previous reforms.** In 2017, Spain had one of the highest shares of temporary contracts out of total employment contracts in the EU. The 1984 Worker’s Charter allowed the use of temporary contracts even in jobs with permanent needs, and since then, the share of temporary employment has grown substantially. The Spanish government has implemented policies to reduce job insecurity faced by young workers under non-standard contracts. Reforms in March 2012 gave more control to employers over working conditions and established a “training right” for workers. Despite slight improvements, labor contract segmentation is deeply ingrained in Spanish employment and, therefore, requires greater policy attention.

- **Immigration policy: slower migration route.** The number of illegal border crossings into Spain grew from 6,800 in 2013 to 23,143 in 2017, fewer than in Italy and Greece. Although the state oversees national asylum processing, the autonomous regions of Spain are responsible for the social integration of immigrants, including employment. While the asylum process officially lasts three to six months, it takes about one and a half years in practice. After their application is accepted, asylum seekers must wait an additional six months until they can legally request a work permit. Although legal and unofficial barriers prevent immigrant employment, Spain faces a smaller scale of migration compared to the rest of Southern Europe.

- **The shadow economy.** The size of Spain’s informal economy was 17.2 percent of GDP in 2017. Excluding the revenue lost to shadow activity, Spain raises less tax revenue as a share of GDP than any other EU member state, largely as a result of weak coordination among its autonomous regions. As employment insecurity and the incentive to work in the informal sector rise, the limitations of decentralized Spanish policy will expand shadow activity and exacerbate public economic anxiety.

Limited labor market improvements and a smaller scale of immigration make Spain less of a threat to European unity compared to Italy and Greece. However, unchecked informal activity will still handicap the central government as it faces difficulties coordinating among the autonomous regions.

Italy

Despite recent restructuring of non-standard labor, Italian policymakers have been unable to control the growing employment protections gap between young and old workers. The huge influx of immigrants further exposed young workers’ limited access to stable employment.
• **Labor policy: misdirected changes.** Over the past 20 years, the Italian labor market implemented significant reforms that led to a rise in temporary contracts and labor segmentation between young and old workers. The share of temporary workers under 28 years old rose by 20 percent between 2006 and 2011, while the share of workers over 37 years old rose by less than 5 percent. Furthermore, the rate of transition from temporary to permanent employment has fallen. In the 2015 Jobs Act, the Italian government created an open-ended contract that no longer requires legal justification for new employee layoffs. Instead of stimulating permanent employment as intended, the Jobs Act made firing employees easier for firms. These attempts to reduce the prevalence of temporary contracts have not improved the employment stability of Italian youth.

• **Immigration policy: extremely unprepared.** Italy was unprepared for the surge in immigration since 2015. The number of illegal border entries jumped from 40,000 in 2013 to 181,126 in 2016. The European Commission established new “hotspots” to improve asylum processing and the prosecution of illegal immigrants in Italy. The asylum application process is designed to take a maximum of 18 months. As of December 2016, however, the backlog of pending asylum cases was 99,920—significantly delaying application processing. Asylum seekers officially have access to the labor market two months after their application is filed, but residence permit delays often lengthen this period. Efforts to improve the asylum process have been made, but Italian immigration authorities were ill-equipped for the migration crisis.

• **The shadow economy.** Italy’s shadow economy was 19.8 percent of GDP in 2017. In 2014 and 2015, the Italian government instituted reforms to reduce the tax burden on labor and simplify the tax system. Although simplified tax reporting typically encourages workers to enter the formal economy, Italy has not improved the segmentation of its labor market. The ease of firing new workers under Italian labor law reinforces the job insecurity of young workers and pushes them into informal employment. If unaddressed, labor insecurity will undermine tax enforcement efforts.

As the third largest economy in the EU, Italy is an essential state for regional unity. Therefore, it is in the interests of European policymakers to prevent the weakening of Italian governance due to unchecked shadow market activity.

**Greece**

Greece has both the highest number of illegal border crossings and the largest shadow economy in Western Europe. While temporary employment is the main driver of job insecurity in Italy and Spain, part-time employment is the major vulnerability in the Greek labor market.

• **Labor policy: moving in the wrong direction.** Since the 2010 sovereign debt crisis, Greek labor reforms are following a similar path as Spain and Italy. Prior to 2008, temporary and part-time employment were below the EU average. Reforms to increase labor flexibility have had little effect on temporary employment but a significant impact on
part-time employment. Between 2010 and 2013, the share of part-time contracts grew from 26 percent of employment to 37 percent, and the conversion of full-time contracts to part-time contracts tripled over this period. Similar to temporary contracts, part-time employment reduces job security. Moreover, this conversion to part-time labor has increasingly occurred without employee consent. The rise of involuntary part-time work expands the job insecurity of young workers in Greece, where the youth unemployment rate is already double the EU average.

- **Immigration policy: systemic deficiencies.** In 2011, the European Court of Human Rights and the EU Court of Justice found “systemic deficiencies” in the Greek asylum system. 81 885,386 migrants arrived in Greece in 2015 alone. 82 The number of illegal border crossings fell following the EU-Turkey Joint Statement, but the Greek asylum procedure has yet to improve. 83 The asylum application process typically takes six months, but can be extended another nine months. 84 Greek legislation allows asylum seekers to access the formal labor market as soon as their application is approved, but applicants must complete an additional employment registration process. 85 While over 27,000 asylum applicants were in the pre-registration phase of this process in July 2016, fewer than half had completed the full labor application as of December 2016. 86 While asylum seekers are permitted to work, the deficiencies of Greek immigration policy impede asylum seekers’ access to formal employment.

- **The shadow economy.** In 2017, the Greek shadow economy was the largest in Western Europe at 21.5 percent of GDP in 2017. 87 The Ministry of Labor has prioritized informal economic activity for domestic revenue collection, but a program for labor integration of vulnerable populations will not be implemented until 2020. 88 Growing inequality in the Greek labor market, particularly following the migration crisis, will prevent further economic recovery.

The Greek political system has been fragile since the sovereign debt crisis, and current policy will further weaken government capacity. If unmitigated, Greek shadow labor activity will reverse efforts to stabilize the domestic economy and deepen public distrust of the EU.

Current labor and migration policy will leave Spain, Italy, and Greece behind their northern neighbors, threaten European unity, and empower pro-Russian protest parties. Labor market reform in Southern Europe is, therefore, essential to prevent unchecked shadow activity and strengthen regional security cooperation.

**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. European policymakers must encourage Spain, Italy, and Greece to maintain hiring and firing flexibility for employers while improving protections for employees in non-standard work. Because these vulnerabilities originate in existing European job insecurity, the problem must be addressed with labor reform, not short-term asylum
improvements. The migration crisis is just one source of the labor inefficiencies in Spain, Italy, and Greece. If the labor market for young workers in Southern Europe improves, employment opportunities for migrants will expand over time.

Labor reform focused on both flexibility and equality will slow trends toward rising non-standard employment in Southern Europe, block incentives to work in the shadow economy, and help prevent the expanding division of the EU. Long-term European unity depends on the restructuring of Spanish, Italian, and Greek employment.

Flexibility for Employers

Firms that can easily fire and hire new workers will be more likely to register its 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. High costs to fire workers make the labor market inflexible. In addition to minimizing shadow activity, flexibility can promote firm competitiveness and increase overall employment participation.

The goal of deregulating non-standard employment in Southern Europe was to increase firm productivity and labor market participation. However, the Italian, Spanish, and Greek governments did not foresee the potential negative consequences for employment equality. Labor flexibility is crucial to limiting shadow activity, but successful reform must also consider equality among employees under different work contracts.

Equality for Employees

Equal treatment and benefits for standard and non-standard employment will prevent workers from supplementing their income in the shadow economy. Reduced protections for workers do not necessarily lower unemployment or improve labor market participation, which were key goals of past contract deregulation in Southern Europe. Since these deregulations, workers under non-standard contracts have suffered larger reductions in employment protection than have permanent workers. While some recent Spanish policies focused on balancing flexibility with equality, unequal job insecurity between non-standard and standard employment is still a major challenge to economic productivity and shadow economy regulation in Southern Europe.

Whether implemented simultaneously or individually, the following three policy options provide workers with a clearer path to employment stability. Each should be adjusted to fit the specific characteristics of the labor markets in Spain, Italy, and Greece.

- Labor contract reform. A new type of labor contract that offsets flexibility for employers with employee protections would improve job security while maintaining the benefits of non-standards contracts. For example, in single labor contracts, the level of protection increases with the worker’s employment tenure. Employment protections are very minimal during the entry phase of the contract, which gives firms the freedom to easily
hire and fire new workers. However, the single labor contract is open-ended and includes a second, stability phase during which the employee receives stronger employment protections. France was the first European country to propose a single labor contract in 2005.

In 2003, Austria proposed another labor contract reform to encourage the transition from non-standard to standard work. Under this contract, all employee salaries finance an untaxed fund for severance payments. The severance payments are then distributed to workers under both temporary and permanent labor contracts, whereas previously temporary employees received no severance. These measures decreased the gap in employment protections between temporary and permanent employment and reduced the incentive to hire using temporary contracts. If implemented, a new labor contract modeled after these examples will improve job security for employees without severely reducing labor market flexibility.

- **Narrower definition of non-standard work.** In addition to or instead of a new category of labor contract, policymakers can narrow the legislative definition of temporary or part-time work. For example, the 2012 Spanish labor reforms restricted the use of fixed-term contracts solely for job training periods or to hire disabled workers. Current legislation in Greece requires a reason for the renewal of non-standard contracts, although not at their initial signing. Legislation requiring justification for the signing of non-standard contracts helps prevent unequal labor protections among employees. Southern European governments could also limit the number of times a firm can renew a temporary contract, which encourages longer-term employment agreements. While restrictions on non-standard work may discourage hiring, liberalization of temporary contracts can actually reduce employee motivation and overall labor productivity. To improve employment security and labor productivity, definitional changes to non-standard work should provide greater agency to employees.

- **Improved access to training.** Finally, Southern Europe can implement more systematic job training programs for young workers, migrants, and any other non-standard employees. Job training is essential for career security and advancement, but the cost of training employees under temporary contracts often outweighs the benefit for the firm. Training reduces skill barriers for new workers and eases the transition to more permanent employment. Private job training programs significantly increase both employee job security and firm productivity. James Heckman, a Nobel Prize-winning economist, found that about half of the employment skills learned are accumulated through on-the-job training, not in school. If job training under non-standard contracts is required or more actively encouraged by government authorities, firms and employees would benefit from increased productivity and greater protections, respectively.

Balancing flexibility with equality in employment protection legislation is essential to discourage entry into the shadow economy. This recommendation covers only a few policies aimed at increasing job security under non-standard employment contracts. Structural labor reform requires coordination among employers, workers, and government authorities. It is in the interests of each EU member state to encourage such coordination in Southern Europe. European
political unity and collective security necessitate labor reform that focuses on maintaining flexibility for employers and ensuring equal protections among employees.

**Conclusion**

Despite the 2015 crisis, incoming migrants themselves do not pose the most serious danger to the EU. The European response to the migration crisis has overlooked the vulnerability caused by rising job insecurity and informal employment in Southern Europe. The shadow economies in Spain, Italy, and Greece will weaken domestic government capacity, hasten a North-South division in Europe, and impede EU-NATO security coordination.

These large shadow labor markets are, therefore, a disregarded yet substantial threat to regional unity. Brussels must encourage greater employment equality in these countries as the next step toward a stronger and more secure European Union.
Appendix A: Shadow Economy Size as a Share of GDP\textsuperscript{106}  
(Ordered largest to smallest size in 2017)

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*Values based on current forecasts
Appendix B: Map of Shadow Economies as Share of GDP in 2016\textsuperscript{107}  
(Made in Tableau)

2 The exact definition of the shadow economy varies among scholars. The International Labor Organization (ILO) defines the informal or shadow economy as “all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements.” However, the shadow economy does not include any illicit or illegal activities such as the trafficking of drugs. See “Transition from the Informal to the Formal Economy Recommendation, 2015 (No. 204),” International Labour Organization, 2015, http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:R204 (accessed March 10, 2018). According to Freidrich Schneider, the shadow economy includes all undeclared work, which accounts for about two-thirds of its size, and underreporting of work, which accounts for the final third. See Schneider, “The Shadow Economy in Europe, 2013.” This paper follows the ILO and Schneider’s definitions of the shadow economy, which will also be referred to as the informal, unofficial, or underground economy.


4 This paper does not cover the case of Portugal. The three countries of focus have larger shadow economies and higher migration inflows than Portugal. See Roberto Dell’Anno, Miguel Gómez-Antonio, and Angel Alafán-Pardo, “The Shadow Economy in Three Mediterranean Countries: France, Spain and Greece. A MIMIC Approach,” Empirical Economics 33, no. 1 (July 1, 2007), https://doi.org/10.1007/s00181-007-0138-1 (accessed March 8, 2018). For the estimated size of the shadow economies in Europe, see Appendix A.


6 Reforms in the 1980s in Spain and Italy liberalized temporary contracts in an attempt to promote job growth, but this liberalization has instead worsened domestic labor segmentation between the young and old. The ILO defines labor segmentation as the division of the labor market into separate submarkets or segments. Segmentation is particularly an issue in Southern European economies, which have the highest rates of youth unemployment and the greatest difference in employment protection between temporary and permanent workers. See Pietro Garibaldi and Filippo Taddei, “Italy: A Dual Labour Market in Transition: Country Case Study on Labour Market Segmentation” (International Labour Organization, August 8, 2013), http://www.ilo.org/employment/Whatwedo/Publications/working-papers/WCMS_218971/lang--en/index.htm (accessed February 28, 2018). Such reforms in Greece have primarily occurred since the 2008 global recession, but have had similar segmenting effects. See International Labour Office Research Dept., “Studies on Growth with Equity: Productive Jobs for Greece” (International Labour Organization, 2014), http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_319755.pdf.

7 A more flexible or liberalized labor market usually decreases the incentive for informal work, but Garibaldi and Taddei attribute the increase in youth unemployment in Italy since 2009 and the widespread use of fixed term contracts to these 1980s reforms. They show that the percentage of temporary and fixed employment contracts has increased from 5 percent of total employment in 1990 to 14 percent in 2008. See Ibid.

8 Carlos-García Serrano and Miguel Malo find that the reduction of restrictions on temporary contracts in Spain in 1984 resulted in the wide use of these contracts, which segmented the types of jobs held under temporary versus permanent contracts. Temporary contracts are used for low-paid, high-rotation jobs, while permanent or open-ended contracts are used for high-paid, low-rotation jobs. They also find that young Spanish workers have higher temporary employment rates than older workers. See Carlos García-Serrano and Miguel A. Malo, “Beyond the Contract Type Segmentation in Spain: Country Case Study on Labour Market Segmentation” (International Labour Organization, August 8, 2013), http://www.ilo.org/employment/Whatwedo/Publications/working-papers/WCMS_218970/lang--en/index.htm (accessed March 1, 2018). The OECD also finds that workers aged 15 to 24 years are three times as likely as older workers to hold a temporary job. See “Taking the Measure of Temporary Employment,” OECD Employment Outlook 2002 (OECD, 2002), http://www.oecd.org/els/emp/oecdemploymentoutlook2002.htm (accessed March 9, 2018).


12 The OECD estimates that holding temporary employment reduces job training by 6 percent, which is approximately the same impact as “the difference between not having finished secondary schooling and having obtained a tertiary qualification.” See “Taking the Measure of Temporary Employment.”

13 The Organization for Economic Cooperation and Development (OECD) estimated that OECD countries recorded the greatest number of asylum applications in 2015—about 1.66 million—since the Second World War, with another 1.64 million applications in 2016. Almost three-quarters of these applications were submitted in EU member states. See International Migration Outlook 2017 (OECD Publishing, 2017), http://dx.doi.org/10.1787/migr_outlook-2017-en (accessed March 10, 2018).


15 Ibid.

16 The twenty-eight member states of the EU filed 2.46 million first-time asylum applications between 2015 and 2016. See Mercator Dialogue on Asylum and Migration (MEDAM). In 2015, 2.2 million people were found to be “illegally present” in the EU, meaning the person failed to register properly or left the member state responsible for processing their asylum claim. This number dropped to 984,000 in 2016. See “EU Migrant Crisis: Facts and Figures,” European Parliament, June 2017, http://www.europarl.europa.eu/news/en/headlines/society/20170629STO78630/eu-migrant-crisis-facts-and-figures (accessed March 9, 2018).

17 Directive 2013/22/EU of the European Parliament and of the Council of 26 June 2013 outlines the reception conditions of asylum applicants in the EU. Article 15 explains that access to the labor market should be granted no later than nine months after the application for international protection was lodged. However, member states are allowed to impose conditions for granting access to the labor market, including prioritizing EU citizens for employment. In addition, language barriers, administrative formalities, and the recognition of degrees are obstacles to employment access for asylum seekers entering various EU member states. See “Reception Conditions,” Asylum Information Database (AIDA), http://www.asylumineurope.org/comparator/reception (accessed March 10, 2018).


21 Ibid.
Following 2009, Western Europe’s tradition of reducing its shadow economy took effect, which kept the shadow economy relatively small. The higher GDP growth in Eastern Europe has reduced the previous strength of the shadow economy. However, Southern Europe has faced very minimal reductions in its shadow economy relative to GDP. See Schneider, “The Shadow Economy in Europe, 2013.” Schneider used the multiple indicator multiple cause (MIMIC) approach to calculate informal economy size. The MIMIC method provides relative estimates of the size or development of the shadow economy. Combined with the currency demand method, which calibrates the relative estimate into an absolute estimate, this is the most commonly used method of measurement for the shadow economy. See Schneider and Williams for an in-depth explanation of the econometrics calculation process.


Schneider calculated that in 2011, the average loss in taxes relative to total taxation in the EU was 9.1 percent. However, the tax loss as a share of total taxation was 14.7 percent in Greece, 12.8 percent in Italy, and 11.6 percent in Spain. See Friedrich Schneider, “Tax Losses Due to Shadow Economy Activities in OECD Countries from 2011 to 2013: A Preliminary Calculation,” *Turkish Economic Review* 3, no. 1 (March 2016), http://www.kspjournals.org/index.php/TER/article/view/686/720 (accessed March 8, 2018).

The European Commission found that labor market shrinkage in Greece from 2008 to 2014 intensified income inequality. See European Semester, Greece, April 2016. Labor market segmentation is also a leading cause of Spain’s high level of inequality, one of the largest in the EU. See European Semester, Spain, 2017. Finally, although Italy is a relatively rich country, its wealth is concentrated in the top 10 percent of wealthiest households and primarily held by older populations. See Garibaldi and Taddei.


The second most important issue for Greece and Spain was the “economic situation,” and in Italy, the “economic situation” fell third behind immigration. See “Standard Eurobarometer 88: Public Opinion in the European Union, First Results” (European Commission, Autumn 2017), http://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Survey/getSurveyDetail/instruments/STANDARD/surveKy2143 (accessed February 28, 2018).

The Spanish results showed that 5 percent of those polled thought that taxation was a major concern in Spain. The EU average concern for taxation was 7 percent. See *Ibid*.


Political volatility can include the fragmentation of party systems, as is already occurring in Southern Europe with the emergence of anti-institutional parties. It could also manifest without any new political parties, but instead current centrist parties adjust their policy to the left or right to fulfill public demands and maintain power. Regarding the futures analysis, the ACCA report also identifies GDP growth, unemployment, and bureaucratic quality as the top three current factors determining the size of the Italian shadow economy. Italy is the only country from Southern Europe included in their shadow economy estimations. They calculated that the 2016 informal sector was 26.32 percent of GDP, and this estimation is predicted to rise to 26.56 in 2020 and settle at 26.37 in 2025. See Chua.

In Spain, voter participation was 73.8 percent in 2008 and fell to 69.8 percent in 2016. In Italy, participation fell from 83.6 percent in 2006 before the financial crisis to 80.5 percent in 2008 and 75.2 percent in 2013. Finally, Greek voter participation began at 74.1 percent in 2007 and fell to 70.9 percent in 2009 and 62.5 percent in 2012. Morlino and Raniolo explain that in countries less hit by the financial crisis, like Sweden and Germany, voter participation slightly increased, “a traditional symptom of higher competition among parties because of a perceived malaise and

34 Morlino and Raniolo identify the cleavage between winners and losers from globalization as a key causal factor of anti-establishment party growth. They show that these protest parties mobilize the dissatisfaction of voters toward not only the incumbent political elites but also toward specific policy issues like fiscal austerity and immigration. While their analysis excludes demographic factors like population aging and the migration crisis, the inability to respond to the shadow economy will worsen these political phenomena. Morlino and Raniolo conclude that from 1992 to 2014, it is very clear that “the Mediterranean societies of the twenty-first century are shaken by waves of protest and are characterized by the emergence of social movements linked to globalization and to the transformation of capitalism itself.” New protest parties fundamentally changed how the traditionally two-party systems of Southern Europe were organized. See *Ibid.*

35 Eurobarometer asked its respondents “Please tell me to what extent you agree or disagree with each of the following statements: My voice counts in the EU.” The EU average is that 44% of respondents “agree” with the statement, 50% “disagree,” and 6% “don’t know.” In Greece, 77% of respondents “disagree” that their voice is heard in the European Union, while only 20% “agree.” In Italy, 64% “disagree” with the statement, while 29% “agree.” Finally, 55% of Spanish respondents “disagree,” and 39% “agree.” Countries like Germany, Denmark, and Belgium all have average “agree” ratings greater than the EU average. See “Standard Eurobarometer 88: Public Opinion in the European Union, First Results.”


43 While currently undecided, the Five Star Movement may form the coalition government with either the far-right League party or the post-fascist Brothers of Italy party. *Ibid.*


54 The allowance of temporary contracts for any type of job broke the “causality principle” in Spanish employment law, which states that firms can only hire workers with open-ended contracts for permanent tasks and workers with temporary or fixed contracts for temporary employment tasks. See Garcia-Serrano and Malo.
In 2007, temporary employment accounted for 10.9 percent of the total labor force in Greece, while the EU average was over 16 percent. 27 percent of workers under 25 worked under temporary contracts this same year, and the highest proportions of citizens judging public services as "bad" or "very bad," showing the falling legitimacy of the central government. See "European Semester: Country Report Italy 2017."

59 Asylum reception is divided into three phases, each lasting approximately six months. During the first phase, asylum applicants are provided government accommodation and a monthly financial allowance of €15.60 per person, plus €19.06 per minor. Other necessities provided to the applicant include public transport, health-related expenses, and expenses related to administration proceedings. However, during the second phase, asylum seekers must live in private apartments or housing, the rent of which is covered by the asylum system, but no additional financial support is given. See Queipo de Llano and Zuppiroli.

60 Ibid., 46.

61 Schneider and Boockmann.

62 The Spanish regional governments were responsible for a bout one third of the average total government deficit each year from 2013 to 2016. See “European Semester: Country Report Spain 2017.”

63 Garibaldi and Taddei.

64 In addition to this young-old dualism in the labor market, the percentage of temporary employees out of total employment grew from 5 percent in 1990 to 14 percent in 2008. See Ibid.

65 Ibid.


67 Ibid.


70 The full eighteen months are usually used only if the Territorial Commission for International Protection (CTRPI) requires certain extensions. The CTRPI may extend the time limit of asylum procedures for the following reasons: complex issues with the law or facts, a large backlog of asylum applications, or the failure of the applicant to comply with his or her obligations to cooperate. See Ibid.

71 Ibid.

72 The previous Reception Decree required asylum seekers to wait six months before searching for work. See Ibid.

73 Schneider and Boockmann.

74 The Jobs Act, implemented at the end of 2014, was a wide-ranging reform of the Italian labor market. In addition to reducing the tax burden on labor, the Italian government has worked to reduce the labor tax wedge on low-wage and average-wage single workers, which were some of the highest in the EU. See “European Semester: Country Report Italy 2017.” The tax wedge is defined as “the difference between labor costs to the employer and the corresponding net take-home pay of the employee.” A wide tax wedge means the employee takes home a relatively smaller pay. See Directorate-General for Taxation and Customs Union, “Taxation Trends in the European Union: Data for the EU member states, Iceland and Norway” (Luxembourg: European Commission, 2017), https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_trends_report_2017.pdf. Some reforms include required electronic invoicing in certain industries and the introduction of pre-filled tax declarations. See “European Semester: Country Report Italy 2017.”

75 Italy accounts for 16 percent of the euro area’s GDP. The European Commission’s 2016 Eurobarometer survey found that Italy has one of the highest proportions of citizens judging public services as “bad” or “very bad,” showing the falling legitimacy of the central government. See “European Semester: Country Report Italy 2017.”

76 In 2007, temporary employment accounted for 10.9 percent of the total labor force in Greece, while the EU average was over 16 percent. 27 percent of workers under 25 worked under temporary contracts this same year, and
the EU-level was 41.3%. See International Labour Office Research Dept., “Productive Jobs for Greece.”

87 Ibid.
88 Ibid.
89 Ibid.

80 The Greek youth unemployment rate in 2014 was 52 percent, and the EU-28 average was 21 percent. See Ibid.

81 These deficiencies included a lack of reception centers, poor detention conditions, and other issues preventing the efficient processing of asylum requests. The European Commission’s 2016 Schengen Evaluation Report acknowledged reforms made by the Greek government to improve its asylum system but also stated, “the overall functioning of the Schengen area is at serious risk.” The suspension of Dublin Regulation transfers to Greece resulted from two cases revealing the deficiencies of the Greek asylum process: MSS v. Belgium and Greece and N.S. v. Secretary of State for the Home Department. In both cases, an asylum applicant that was rejected in another country and returned to his or her country of entry was detained in inhumane conditions in Greece. See Theresa Papademetriou, “Refugee Law and Policy: Greece,” United States of America Library of Congress, March 2016, https://www.loc.gov/law/help/refugee-law/greece.php (accessed March 9, 2018).


83 For illegal border crossing estimates, see Ibid. A new law was adopted in Greece in April 2016 to expedite the implementation of the EU-Turkey Statement. This law introduced provisions to tackle backlog asylum cases including the creation of two-year residence permits on humanitarian grounds and to improve external border control. See, International Migration Outlook 2017. The EU-Turkey statement also inadvertently divided the asylum process, as asylum seekers arriving after March 2016 have access to a fast-track border procedure and are excluded from relocation. See Alexandros Konstantinou, Athanasia Georgopoulou, and Aikaterini Drakopoulou, “Country Report: Greece” (Asylum Information Database (AIDA), 2016), http://www.asylumineurope.org/reports/country/greece (accessed March 9, 2018).

84 Konstantinou, Georgopoulou, and Drakopoulou.
85 Ibid.
86 Ibid.
87 Schneider and Boockmann.

88 The number of tax audits did increase in 2015, but the recent retirement of full-time labor inspectors may prevent the continuation of this trend. Labor inspectors have targeted sectors that exhibit the highest rates of undeclared work, such as food services, cleaning services, and construction sites. See “The National Reform Programme: Greece.”


91 Cirillo, Fana, and Guarascio.

92 A report by the ILO found that poorly designed reforms that weaken employment protection legislation will likely be “counterproductive for employment and labor market participation, in both the short and the long run.” See International Labour Office Research Dept., “World Employment and Social Outlook: The Changing Nature of Jobs,” 15.

93 Garibaldi and Taddei.
94 Ibid.
95 Ibid.
96 Ibid.

98 International Labour Office Research Dept., “Productive Jobs for Greece.”


100 Lepage-Saucier, Schleich, and Wasmer.

101 Ibid.

102 Cirillo, Fana, and Guarascio.

103 Lepage-Saucier, Schleich, and Wasmer.


105 Ibid.

106 Data from Schneider and Boockmann.

107 Data from *Ibid.*