

# The informal economy and welfare reform

Community Links budget briefing, June 2010



## Summary

A reformed welfare system, that encourages and supports people to formalise their cash-in-hand work, could save large amounts in reduced benefit payments to those currently working informally.

A significant number – in some areas perhaps as high as 50% - of people on benefits are working informally, most out of need not greed, yet it rarely features in benefit reform proposals, certainly not with the profile its scale warrants.

A reformed system would also remove the barriers that force people into informal work in the first place.

**The budget should announce the start of a process for integrating a thorough analysis of the informal economy into proposals for reform of the welfare system. This could be through the creation of an Informal Economy Advisory Group led by DWP, with select representation from charities, academics and unions, and input from other departments particularly HMRC.**

Doing so will not only save money by harnessing the work ethic of people employed cash-in-hand, but more importantly will help lift thousands out of poverty.

*“People don’t work informally because they like it, it’s because they don’t have a choice. So the solution is providing opportunities, choice and alternatives to the informal economy.”*  
James, 25

## Introduction

Community Links, a grassroots community charity working with 30,000 people each year in east London, has recognised and researched the informal work of people on low incomes for over a decade. In research involving over 5000 people around London and further afield we found that up to 20 per cent had worked informally in the previous year, including six per cent working while claiming benefits. This suggests the possibility that up to half of benefit claimants are working informally in some areas.

Income from this informal work is much less than the average formal earnings for the area, and most of the work is in low-paid, temporary, and insecure jobs: catering and hospitality, cleaning, construction, sales, childcare, or care work.

The need for a bit of extra money is the most common reason given for working informally, followed by the lack of jobs in the formal sector. Over half of those working informally say they would like to formalise their work even under the current tax and benefits system – our experience suggests this would rise dramatically if the right incentives and support were available.

Nationally, it is thought informal work could account for 12% of GDP, and be worth as much as £120bn (Chen 2003; Schneider 2002).

We have long argued for wholesale reform of the welfare system so that it better reflects the types of jobs available today, and responds to the way people live their lives. We fed in to the Centre for Social Justice’s (CSJ) *Dynamic Benefits* report, which powerfully illustrated the disincentives to taking up work presented by the current system, and we agree with many of its proposals.

The report acknowledges that a “*more generous disregard will mean that many of those working in the informal economy can be recognised, and have their income regularised.*” However, we believe it did not grasp the full implications of the informal economy for its proposals, nor factor them into its budgeting. Since this report, written under Iain Duncan Smith’s guidance as head of CSJ, is the

*“This work is not reliable, you may be busy for a few weeks and then work dries up, you can’t go off benefits just because you’ve got a bit of work like this, it’s very hard to get back benefits once you lose them.”*  
Amos, 22

*“I got my plumbing qualifications this year, and want to set up my own plumbing business. At the moment I only get a few hours work a week. I can’t tell the Jobcentre because I would lose all the money, and I need it to buy equipment. I hate defrauding the system. Hopefully by the New Year I will have enough clients to be able to come off benefits and set up full time, but until then I don’t have a choice.”*  
George, 37

best guide we have as to the intentions of the new government, we are concerned that this important issue may, once again, be overlooked.

### **The potential for savings**

If those working informally while claiming benefits were given the right incentives and support to declare their work, it could result in significant reductions in the benefit budget.

A more generous earnings disregard and fixed taper – like that proposed by Community Links in the past, and in *Dynamic Benefits* – would be a significant incentive for claimants to formalise their work, since they would be able to keep more of the money earned. Government would be paying these claimants less than the full out-of-work benefits currently received, while ensuring the incentive to work and declare it remains strong. It would also increase the incentive for people to enter the formal rather than informal economy in the first place.

It is likely that most of those currently working informally would be earning below the income tax threshold, but once that first and biggest hurdle of formalising work has been overcome, people would progress on to higher earnings, becoming net contributors over the longer term.

*“It haunts me to realise that I am committing benefit fraud, but I suppose I had no choice, because being in debt is not the better option...otherwise bailiffs could have been knocking at my door.”*  
Kaylie, 37, lone parent

Without a more detailed analysis of the informal job market and the proposals for benefit system reform, it is impossible for us to quantify possible savings. We believe government is best placed to provide this analysis, while our role is to draw the issue to their attention and advise, from our perspective working with people in this situation every day, how reforms might play out in local communities like east London.

### **Financial incentives to work are not enough on their own**

Removing from the welfare system the gross financial disincentives to work is a necessary but insufficient step on its own. Just as those out of work often need support and training to get a job, those in informal work also need the right support to formalise.

We believe a formalisation service, either run separately or integrated into the Work Programme, is an essential tool in harnessing the enterprise of those currently working cash-in-hand. It would support individuals to make the transition into the formal economy, and crucially would not look back at their past work histories. Any threat of sanction for previous informal work would render the service useless.

Community Links is currently undertaking research, supported by the Joseph Rowntree Foundation, to identify exactly how a service like this might work. Initial discussions with HMRC indicate a keenness for our findings to be shared with government, and we would be happy to build on this.

### **Recommendations for the budget:**

- A commitment from government to include a thorough analysis of the informal economy in the next Welfare Reform Bill.
- This could be through the creation of an Informal Economy Advisory Group led by DWP, with select representation from charities, academics and unions, and engagement from other departments particularly HMRC. It could be modelled on the Hidden Economy Advisory Group convened by HMRC in the lead-up to the last budget.
- A wider process for working closely with groups like Community Links when proposing changes to the welfare system, which should look not only at work incentives in the benefit system, but also the administration of benefits, and level at which they are set.

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