



Research report

Understanding the Hidden Economy

Qualitative research with Ghosts and
Moonlighters

Business Customer & Strategy

July 2011

Understanding the Hidden Economy

About Business Customer and Strategy (BC&S)

Business Customer and Strategy is part of Business Tax.

The goal of BC&S is to maximise Business Customer compliance for HMRC at best cost for both HMRC and the customer. This is done by developing business tax strategies through customer understanding, working with teams in HMRC and across government departments.

Contents

Research requirement (background to the project)	3
Who did the work (research agency)	3
When the research took place	3
Method, Data and Tools used, Sample	3
Main Findings	4

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Understanding the Hidden Economy

Research requirement (background to the project)

The objective for this research was to understand why do some businesses enter and operate in the Hidden Economy?:

- What are their motivations?
- What are the wider social and societal drivers?
- How do they hide? What strategies and business processes do they adopt to remain hidden?
- What makes these small businesses continue operating within the hidden economy? What are the barriers to them exiting it and what could be the potential levers?
- What, if any, are the common characteristics of small businesses operating in the hidden economy?

Who did the work (research agency)

The research was conducted by The Futures Company.

When the research took place

The research was conducted between January 2010 and September 2010.

Method, Data and Tools used, Sample

Phase 1: Mining existing knowledge

- Desk research and expert interviews

Phase 2: Understanding the context

- 3 x informer groups with small businesses across the spectrum of attitudes to compliance and from a range of industries and 1 x group with agents. Groups were 2 hours in duration and comprised 8 people.
- Webnography; analysis of online forums
- This phase analysed the wider social and societal drivers of compliance and non-compliance and the range of attitudes that exist to provide context before our in depth exploration with the target audience.

Phase 3: Understanding evasion

- 15 x confessional scrapbook tasks
- 15 x depth interviews (90 minutes long)
- Sample split between totally hidden primary or secondary income, semi hidden and employing staff off the books across a wide range of industries and 4 UK locations.

Understanding the Hidden Economy

Phase 4: Focus on ghosts and moonlighters

- 18 x confessional scrapbook tasks
- 18 x face-to-face depth interviews (90 minutes long)
- An equal split of ghosts and moonlighters operating in a wide range of industries across 5 locations in the UK. All were earning a significant income from their undeclared business (more than £10,000 per annum) and all businesses had been running for more than one year.
- Please note that this report is focussed on the ghost and moonlighter audience, although the drivers of hidden activity also apply to evaders.

Main Findings

Entering the Hidden Economy

A combination of individual, social and structural factors are driving this behaviour. These factors do not apply equally in every case; different individuals are driven by different combinations of drivers.

At an individual level the most common drivers are:

- **Perceived need:**

The perception of need is relative and cuts across lifestyles and incomes. At one end of the scale there are people who are barely coping and living a basic, hand to mouth lifestyle. At the other end of the scale are people who appear to be leading a comfortable lifestyle, but still feel strongly that they need their undeclared money to provide for their family or to maintain a consistent standard of living. What may look like greed from the outside can be viewed as real need by the individual, for example if they feel they are doing this to provide what is needed by their children for a good quality of life. The perception of need can cause anxiety and can lead people to adopt what they may previously have considered to be extreme or unacceptable behaviours.

- **Lack of confidence in own ability to comply:**

A lack of confidence can sometimes be a problem, even for those who would consider themselves to be quite 'savvy' about business. Many people underestimate the support available to them. Others may simply be afraid of not understanding or not being understood by the 'establishment' or 'authority'.

- **Self regulation:**

This audience have a tendency to 'self-regulate', with tax often viewed as something to be paid 'up to a point'. Many of those operating in the hidden economy are conducting their own mental self assessment of what they should be paying and what they should

Understanding the Hidden Economy

allow to go undeclared. There is a strong sense that a 'reasonable' amount of evasion is acceptable, if not explicitly permitted.

- **Entrepreneurial drive:**

Some people see their evasion as part and parcel of an entrepreneurial drive and are very proud of their success. For them, squeezing as much net profit as they can, is part of this – they may see evasion as just one of the many risks that are taken as 'part of the game'.

- **Anger at the perceived mis-use of public money:**

Anger at how public money is used, is not just a post-rationalisation – it can really be a driver of this behaviour as well. It is important not to underestimate the strength of the anger and distrust this cohort feels, for example at the use of 'their taxes to pay for the war in Iraq' or at the high number of benefits claimants in their town. This anger is unlikely to be the sole driver, but it can be a powerful catalyst and provides an important justification for continuing the behaviour. In some cases, not declaring income can even be seen as 'staying true to my morals.'

At a social level the most common drivers are:

- **Family and cultural values:**

If a person's parent or grandparent is a ghost or moonlighter there seems to be a strong chance that the behaviour will be passed on (but if parents are compliant it does not necessarily follow that their children will be!). Family members can be powerful role models who are looked up to unquestioningly – it may be hard to go against certain family values or against the way a family business is set up.

- **Industry norms:**

It can also be hard to go against perceived ingrained industry norms. In some industry contexts there is a sense that it would be uncompetitive or even foolish to fully declare tax, or almost that you would be breaking rank if you challenged the *status quo*.

- **Societal acceptance:**

This audience often see their behaviour as socially acceptable. They feel that society does not condemn the behaviour and that there is little or no moral weight against it. Indeed, in some cases, hidden activity is seen to be making a positive contribution by providing services that might otherwise be unaffordable; or by preventing people from needing to claim benefits. This group feels that social acceptability is on the rise.

At a structural level the most common drivers are:

- **Perceived cost of complying (not just tax):**

Understanding the Hidden Economy

The real 'costs' of complying are seen to be more than just the payment of tax itself. The system is seen to be complex and difficult and people feel that there would be additional time costs to their business of learning new skills and administration. Most felt that they would need to pay an agent to overcome system complexity, so would be paying tax and a fee. There is also a perceived burden of justifying legitimate actions that may be considered suspicious by HMRC.

- **System geared against small / irregular amounts:**

It is thought to be too difficult to declare small or unreliable amounts of income. There is a perception that the system is designed purely for big businesses and doesn't fully cater for the individual. People often worry about the complexity of declaring small amounts or even simply inputting amounts from multiple sources. It is often thought that the 'hassle' of declaring such information, is deemed to be disproportionate to the income.

- **Low level of scrutiny from government / authority:**

Touch points with authority suggest a low level of government interest or scrutiny, which impacts on perceived levels of risk. It is possible to have business vehicles, premises or a business bank account (although usage of business bank accounts for undeclared income streams is rare) without anyone asking questions. This gives people the sense that the government turns a blind eye to individuals or are simply not interested in smaller businesses. The low level of scrutiny can lead to a perception that the government is not capable of catching very small businesses.

Entering the hidden economy

All the ghosts and moonlighters were conscious of a point when they decided to set up on their own and not declare their income.

The tipping point is often as simple as opportunity presenting itself. With enough individual, social and structural drivers in place, a single opportunity can be enough to push people to think 'why not?' After that, hidden economy activity can rapidly 'snowball'.

A change in life circumstances is likely to be the catalyst that provides the need, opportunity or both. Debt, divorce, redundancy, bankruptcy, having children or retirement can lead to a change in behaviour, particularly where people feel they have a 'clean slate' and can 'start again' without HMRC questioning why they don't have an income.

Several people cited a bad experience of public service / government as the point at which their attitude changed. On the whole, people do not distinguish between different parts of government, but rather see 'government' as a whole. If they feel wronged or unsupported by, for example, Job Centre Plus, The Child Support Agency or Citizens Advice Bureau at their time of need, some people have a strong sense of quid pro quo: 'they didn't help me so I

Understanding the Hidden Economy

won't contribute'. These encounters can push people from minor evasion to not declaring a whole income stream, or may even cause a u-turn from a totally compliant attitude. This is therefore a cross-cutting issue: missing opportunities to intervene with joined up government support can be costly in the long run.

Operating in the Hidden Economy

This cohort do not self-identify their behaviour as extreme or even significant, despite the relatively high level of their undeclared income. Ghosts and moonlighters with this level of undeclared income are as likely as evaders to think their behaviour less bad than others or that they are at the small end of the scale. The perception of seriousness is relative and ghosts and moonlighters point to people who are 'worse' than them, including benefits cheats, big business avoidance, MP's false expense claims, and criminals.

This is partly because people operating in this way don't keep accounts. There are often multiple smaller income streams that are not mentally aggregated, and they use cash because they are trying to avoid activity appearing on their bank statement. They are unlikely to know their monthly / annual income, or even to feel they are making a profit, despite accepting their relatively high levels of undeclared income when pushed to work it out.

Many feel a strong sense of justification for what they do. People can maintain peace of mind and a sense of general 'decent' character if they feel they (or their household) have made a net contribution – to the government, or to wider society. Most don't think they are doing something morally wrong, although they know they should declare the money. They do not usually talk about their behaviour with others, and may keep it from even close family members – but for most this is to avoid getting caught rather than out of shame. They do not see themselves as 'villains'; this is considered to be mainstream behaviour.

Potential interventions

A variety of types in intervention were explored with the audience to understand what would have most potential to change their behaviour and to either get them to re-enter the formal economy or to have prevented them entering the hidden economy in the first place.

- 'Social' or community based interventions have minimal leverage with this target since they mostly do not feel that what they do is wrong.
- Enablers have powerful appeal, and simplifying the system for people with very small and less formal businesses would really help upstream when people are starting out, but are likely to have limited traction to get people to exit the hidden economy on their own.
- Threats of catching more people also miss the mark with many who feel that HMRC does not have the resources to 'find the small people'.

Understanding the Hidden Economy

- Voluntary disclosure alone would not motivate people to come forward – they may be interested but are likely to put off coming forward until ‘next time’. There is more potential when voluntary disclosure is combined with financial incentives.

Blockers of not being registered are the most powerful type of intervention across the broad range of circumstances and attitudes within this target audience. Shutting down opportunity is key, and it's more frightening to this target than threats of catching more people. Increasing interrogation across the multiple ‘official’ touchpoints people come into contact with could help universally reduce people’s perception that they can operate without a trace.

Facilitating re-entry is an important part of this equation. Many of these businesses are potentially viable in the formal economy and could make valuable contributions to the exchequer. However if shutting down opportunity is not combined with facilitating re-entry there is a danger they will just shut up shop. For those who are more knowledgeable and entrepreneurial, the benefits do not currently seem to outweigh the costs. Could tools / case studies help demonstrate that it is possible to earn the same amount of money after registering because of the opportunities that open up? Once people have been pushed to declare, dispelling tax myths and helping build business confidence about earning potential as a registered business could be effective with the more business-minded.

Different approaches will be more powerful with different types of people’ Understanding the different attitudinal typologies within this cohort will allow a more targeted approach to intervention.

Attitudinal Typologies

Attitudes and attitudinal differences cut across both ghost and moonlighters. Ghosts can be attitudinally similar to moonlighters because of the way they view their tax status:

- As a household unit: if their partner is paying tax they can still feel they have good cover and are net contributors;
- As a lifetime contribution: in particular retired people can feel that they are under the radar and feel justified that they have paid tax ‘all their working lives’.

As a result, the distinction between ghosts and moonlighters is likely to be less useful in understanding behaviours and targeting potential interventions than identifying attitudinal typologies within this diverse audience.

This research has helped us to identify six emerging typologies, profiled below.

“Trying to keep up”:

- Their motivation is sustaining an established lifestyle / quality of life.
- They may see their hidden activity as temporary, e.g. clearing debt, until children leave home, until a divorce settlement comes through.

Understanding the Hidden Economy

- They often believe they are doing it for the benefit of others e.g. partner, children: ‘they shouldn’t have to go without; should have chances I didn’t have’
- They would rather not be doing it, but feel strong sense of justification.

“Well-paid hobby”:

- They really enjoy what they do and take pleasure in the different aspects of their work e.g. meeting people, the craft.
- They know they should declare the money and yet do not think of the work they do as a ‘business’.
- If the work stopped being fun they would stop.
- They consider registering and tax administration to be too formal / too much hassle for what they do.

“No other way”:

- These are people who are likely to have chaotic lives and be barely coping. They live hand to mouth and have a very basic lifestyle. They may be suffering from other related problems such as anxiety or depression.
- They are the most likely to be worried about getting caught and / or to feel ashamed of what they do but this does not stop them because they believe there is no other way to survive.
- They may have ‘fallen through the net’ and missed more conventional ways out of their difficulty, e.g. debt consolidation, bankruptcy, but do not realise this.
- Fear of getting caught means that they are too afraid to ask anyone for help with their problems.

“Following the crowd”:

- Their behaviour is largely driven by the context they find themselves in. Family, an employer, colleagues or friends have strongly influenced their decision not to declare their income.
- They don’t have deep personal convictions with regards attitudes to paying tax – they could easily be swayed either way.

“Entrepreneur at heart”:

- They have a strong entrepreneurial spirit – and could be a valuable addition to formal economy as a result.
- Pride and self sufficiency drive much of their behaviour and attitudinally, they are most likely to be high risk takers.
- They are motivated by financial success and want to make as much money as possible – not paying tax is one of their strategies for success.
- Despite being business savvy, they are not confident in their ability to do tax administration or to grow the business to a point where they could achieve equivalent earnings after tax.

“Catch me if you can”:

Understanding the Hidden Economy

- This group think they are invincible – they do not feel at risk at all and see no downsides to the way they operate.
- They are often self-confident and their behaviour is entrenched – they foresee no possibility of behaviour change in the future.
- They have a very strong personal justification for what they do – they are the most likely to cite anger at the spending of public money as a driver. They are very cynical about government.
- They are very tactical about covering their tracks and have a good understanding of HMRC's limitations.