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The territorial governance of the shadow economy

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Abstract. The findings of studies of local economies can be applied to those concerned with 'shadow' and illegal activities. These activities need to be seen not as situations with an absence of governance and markets, but as constituting particular kinds of governance—this often being concerned with ensuring the functioning of markets. A scheme for modelling this type of governance is proposed, and is then used to formulate a critique of most of the prevailing policy approaches to trying to counter the shadow economy and to encourage the 'emersion' of firms from it. Some instances of policies that are better grounded in an appreciation of the reality of the shadow economy as a social order are also cited.

The past few years have seen a remarkable increase in interest in the analysis of regional and local models of capitalism. For the most part these studies have concerned strong and successful local economies, and the institutional structures that seem to support them. There has been less interest in local structures that are just as strong, but which are associated with forms of competitiveness rooted in 'shadow' activities and the evasion of fiscal and other regulation. In this paper we propose an approach for extending the study of local economies to include these apparently 'deviant' forms.

The origins of the general interest in local economies can be found in two main factors. First is the paradoxical way in which globalization and its related organizational changes have increased the importance of local institutional settings determined by firms having chosen their locations from a variety of possibilities and local policy makers having set out to attract the firms. Second, in many countries there have been moves to increase the margins of manoeuvre of decentralized levels of regulation, promoting the growth of so-called 'territorial regime competition'.(1)

These trends have stimulated a line of research that has investigated the relationship among society, economy, and politics at local level that has been producing interesting results since the late 1970s. These studies have increasingly focused on analysis of the governance of local economies. Drawing on the tradition of economic sociology, they analyze the regulative mechanisms of local societies and economies and investigate the mechanisms of production of local collective competition goods and the intentional creation of competitive advantages for firms in a defined area. This is of particular interest for understanding the characteristics and development of competition between regions and local systems (Crouch et al, 2001; 2004; Pichierri, 2002; Trigilia, 2005). 'Competition goods' denote those goods (services, products) that a

(1) For comparative studies see: Crouch et al (2001; 2004), DiGaetano and Strom (2003), Kantor and Savitch (2002), Le Galès (2002). See Kristensen and Zeitlin (2005) for the relationship between global players and local contexts, and Streeck (1997) for the concept of regime competition.

firm uses to improve its competitiveness. When such goods are collective they are provided for the firm by virtue of its membership of a certain collectivity and not through the general market: they might be provided by a public authority to all relevant firms within its jurisdiction; or they might be provided as 'club' goods by a membership association or, less formally, by virtue of membership of a particular community. If the collectivity is a local one (local government, a local association, etc), the goods become local collective competition goods, or LCCGs (Crouch et al, 2001).

Most of these studies focused on successful cases characterized by regulative contexts in which local governments, associations, and networks of firms play an important role. These institutions and organizations have been able to produce and allocate the local collective competition goods that are the basis of the dynamism of these areas. Particularly prominent in the research have been industrial districts in the Third Italy, Baden-Württemberg in Germany, Rhône-Alpes in France, and Catalonia in Spain, all regions characterized by strong institutions devoted to promoting economic competiveness. Less attention has been devoted to local development processes in regions and local systems with weak institutions. This needs to change following, on the one hand, the reunification of Germany and the admission to the European Union of Central and Eastern European countries and, on the other, the emerging processes of local development in economically underdeveloped areas such as southern Italy or some regions in Spain. What is particularly interesting is that the institutional architecture that characterizes these areas is completely different from that in strong regions. Trade unions and employers' associations are fragmented and have a low level of membership; local governments have a low level of legitimacy, or are not actively involved in the production of local competition goods; networks of firms are often informal, with irregular labour conditions.

Comparative analysis has underlined three different independent variables to explain the recent rise of competitiveness in parts of these areas. The first variable concerns historical traditions which have contributed to establishing competencies, technical skills, and know-how in a particular area, converting skills and competencies connected with an earlier form of production into new organizational forms. The second is the presence of medium-scale and, in some cases, also large-scale firms facilitating economic growth in some specific areas. But the third has been the shadow economy. It is this last that distinguishes growth in these areas from that in strong regions. In a certain sense it replaces the institutional architecture that has been the basis of provision of local collective competition goods in strong regions, acting as a sort of functional equivalent, producing such goods related to labour flexibility in terms both of organization and of costs. But it has not been able to produce more sophisticated tangible and intangible local competition goods such as multiservice centres, formal professional training processes, or information about international markets. As a result, the shadow economy is at the same time both an opportunity and a constraint: it promoted economic growth in some areas during the 1980s and in the first half of the 1990s; but it hindered processes of local development based on 'modern' LCCGs.

This paper focuses on this twofold relationship between shadow economy and local development. We underline how and why the shadow economy has been an element of growth, but not of local development, fostering competitiveness of firms, but also turning out to be a major constraint, delaying any shift towards the 'high road' or economic development based on high added value rather than on cost alone. At the same time, we show how this twofold role is related to the main features of the governance model that characterizes the shadow economy. These are features that also influence the effectiveness of public policies addressed to promoting what is known in Italy as *emersione*, the process whereby firms 'emerge' from irregularity into regularity.[2] Thus, combining methodological tools developed by the literature on governance with an analysis of the main features of the shadow economy, it will be possible to show the institutional foundations of economic development in backward local systems and better explain why and how the shadow economy plays a very important role in these regions.

We first focus on the literature on the governance of local economies, whose scope is wide and which presents many elements of differentiation (Burroni et al, 2005). This approach enables us to distinguish between various modes of governance and to identify a series of features and attributes typical of each, this being particularly helpful in defining advantages and critical elements of the shadow economy. In the second part we analyze the concept of shadow economy and its main features. In the third part we concentrate on the modes of governance that have a strong presence in the shadow economy; in the final part we critically analyse policies aimed at favouring the 'emersion' of firms and workers from the shadow to the regular economy.

Characteristics of the shadow economy

In this paper we use the term 'governance' in the sense that has been developed by a number of neoinstitutionalist authors to indicate the various means by which the behaviour of actors within institutions is regulated (Campbell et al, 1991; Crouch, 2005; Hollingsworth and Boyer, 1997; Hollingsworth et al, 2002). We make use of the following governance forms, as defined by Crouch (2005): substantive state, or government; procedural state, or law; market; corporate hierarchy (that is, the firm as organization, rather than as nexus of markets); association; community; and network.

The general institutional governance approach was at an early stage adapted to the study of economic sectors by Hollingsworth et al (1994), and then to various types of local economic system, specializing in the production both of traditional goods (for example, textiles and leather manufacturing), and of more advanced ones (for example, biotechnology) and services (such as television programmes) (Crouch et al, 2001; 2004). But this kind of analysis can also help us to focus on the links between the local institutional environment and the shadow economy.

As we show, the shadow economy is an informal but effective regulatory mechanism which has a clear impact on economic development, and it is strongly embedded in the continuous interaction that takes place between local community and society (Rodríguez-Pose and Storper, 2006). For this reason, studying this phenomenon by means of governance analysis helps to identify what can be defined as the 'institutional architecture of the shadow economy', highlighting the main features, advantages, and weaknesses of regulative systems typical of economically and institutionally backward areas.

Thus, the analysis of governance modes enables us to (i) define the reasons why the shadow economy constitutes a competitive advantage in some areas; (ii) underline why it hinders development in the medium to long term; and (iii) stress the critical aspects

[2] The Italian language uses consistent aquatic analogies for describing what in English is generally called the 'black' or 'shadow' economy. This economy itself, or firms and labour in it, are described as 'submerged' (*sommerso*). The process of coming out of the shadow economy is therefore *emersione*. In English the word 'emersion' is commonly used only in astronomy, but it can be considered as a simple opposite to 'immersion', which always refers to the process of entering into water or another liquid, or to analogies to that. We therefore use 'emersion' here as a translation of *emersione*, in this sense of coming out of a previously submerged or concealed state; though we use the more familiar English term 'shadow economy' rather than 'submerged economy'.

of policies aimed at reducing the significance of the shadow economy. First, it is necessary to define better the concept of shadow economy adopted here.

The shadow economy is usually presented in the wider context of the informal economy (Mingione, 1991). Interpreting it in terms of the analysis of governance, this refers to all activities that are carried out without recourse to government, law, or the market, including those which could have made use of these formal modes of governance but which, in practice, do not do so. For example, people may help elderly neighbours with tasks that they would otherwise have to buy as personal services (shopping, garden maintenance, etc). Parents of small children may help each other with babysitting, or grandparents may look after their children's children. If these activities are carried out as unpredictable acts of generosity and gifts, they are not strictly speaking subject to governance: the giver or provider of the service is under no obligation to maintain the practice. If the practice becomes regular and subject to a sense of obligation, it can be considered as an example of pure community or network governance.

Sometimes the exchanges around these services become more strictly reciprocal: for example, the phenomenon of babysitting circles, where parents receive tokens when they care for another parent's children, and use the tokens to pay another parent for babysitting help. This is a combination of community and market governance. Lacking the assistance of law, these arrangements are vulnerable to the forging of tokens; punishment of the offenders depends on the power of community. In modern societies most activities of this kind are restricted to actions between individuals or families. However, there might occasionally be acts of informal 'helping out' among firms, even firms in competition with each other, if local community pressures are strong enough to enable them to trust that defection from the norm of reciprocity will be punished.

These elements of the informal economy are legal although, as Mingione (1991) describes them, not provided for by law; other elements of the informal economy are actually illegal. Mingione's full scheme is presented in table 1. The shadow economy is concentrated in those activities that are illegal, monetary, and private: his sectors II, III, and IV. He gives as examples of sector II those formal activities that contain informal elements, such as partial 'black' payment. This might occur when a worker or contractor receives part of his or her payment through normal channels, and part illegally. This kind of mix may be particularly favourable to emersion, as the enterprise concerned has an open, legal existence. Sector III includes such standard shadow-economy activities as illegally holding second jobs, employment without

Table 1. Mingione's spectrum of informal activities (source: Mingione, 1991, page 80).

Formal	Informal						
Legal		Illegal		Not provided for by law			
Monetary					Nonmonetary		
Public			Private				
I Pure formal activities	II Mixed formal/informal activities	III Activities that elude fiscal, social security, or labour legislation	IV Criminal activities	V Paid activities or transactions not provided for by law	VI Reciprocal or voluntary unpaid activities	VII Self-provisioning (within the household)	VIII 'Normal' domestic work

Table 2. The informal economy (considerably adapted from Lippert and Walker, 1997, page 5).

Behaviour within activity	Form of activity	
	Legal	Illegal
Legal	(i) Voluntary help	(ii) None
Illegal	(ii) The grey economy (Mingione's sector III). Dealing in normal goods and services, but in a manner contrary to legal rules.	(iv) The criminal sector (Mingione's sector IV). Dealing in goods and services that are illegal in themselves.

contract, or informal self-employment. In sector IV are such things as theft, drug trafficking, and fraud.

An important distinction between Mingione's categories III and IV is that the activities in sector III could be legal if they were carried out in accordance with prevailing regulations; whereas those in category IV are illegal, criminal, in themselves. Informal activities therefore face the issue of legality at two different points: whether the activity itself is a legal one; and whether the way in which it is being conducted (the behaviour) is legal. We can illustrate this as shown in table 2.

Box (ii) in this table is empty: it is not possible to behave legally within an illegal activity. Box (i) (legal informal behaviour within a legal activity) is outside our interest. The shadow economy comprises the remaining two categories. In (iii), the grey economy, the activity itself is legal (as in the production of normally traded goods and services), but is being carried on without paying tax and/or abiding by other rules governing the production process. There is no way in which the activities in (iv) can be carried out legally. The activities in (iii) and (iv) are all marketed, but in markets that are not simply not using, but which are positively rejecting, law. Since the market normally depends on law to support its contracts, operators here therefore face a serious problem of enforcement of their market transactions. They might be able to depend on strong community norms alone for this, especially in communities where the state is widely rejected. In the case of (iii) this may suffice, as all that is needed is concealment of the illegal components of the activity. Criminal activities (iv) probably require something more severe, as the forces of government and law will often be opposing their activities with their own coercive power.

Mingione's scheme can be further adapted to take account of different phases in the production and distribution process at which illegality may occur. This is necessary in order to deal with the diversity presented by the shadow economy as it appears in a wide series of activities, ranging from traditional sectors (agriculture, building industry, retail trade, housework, and services to the person) to more advanced ones such as manufacturing and services to firms. It remains widespread in all advanced economies (Schneider and Enste, 2000) and its territorial background is very varied, including urban and metropolitan areas with shadow economies linked to service industries, as well as local regions specializing in goods production; often there is an important link between shadow economy and immigration (Portes, 1994). However, it is particularly important in certain European local production systems, where its prominence can be explained by three main factors (Trigilia, 1998).

First, in recent years, objective conditions on the labour market have loosened, but labour regulation in some European countries remains rigid, giving employers an incentive to evade regulation. Thus the presence of a complex and strong regulative system with many intricate rules can favour the development of shadow activities.

Second, restructuring in large firms along with the emergence of networks of small-scale firms and the fragmentation and variability of markets has enlarged the room for manoeuvre of the informal economy. Third, the possibility of using new production technologies at low costs has reduced the importance of economies of scale in some sectors, favouring the emerging of forms of shadow economy based on very small firms which are difficult to track.

Lucifora (2003) has emphasized the link between the development of shadow activities and: the absence of economic infrastructure; economic backwardness; a low per-capita income; high rates of unemployment; and a general prevalence of weak legality within the local or wider society. Shadow activities are less widespread in modern and advanced regions. There is often a strong connection between the number of small firms and the extent of the shadow economy, while in these regions collective organizations are often weak: trade unions and employers' associations have low levels of membership and legitimacy, and they look at the rise of irregular work as a necessary compromise that helps maintain the competitiveness of local firms. When these characteristics are found alongside local entrepreneurial resources and long-standing traditions connected to an earlier presence of a large specialized firm, or of historical traditions of artisans, the shadow economy has often constituted the key that has helped local firms to exploit niches left open by economic globalization (Standing, 1999; Trigilia, 1998). In this way it becomes an element of competitiveness.

There are many links between formal firms and the shadow economy (Chen, 2004), and it is possible to identify many possible mixes of regularities and irregularities in the production and distribution of goods (table 3).

Table 3. Production and distribution of goods in the shadow economy (adapted from Trigilia, 1998).

Case	Productive process	Distribution and commercialization	Goods
1	legal	legal	legal
2	irregular [a]	legal	legal
3	legal	legal	irregular
4	irregular	irregular	legal
5	irregular	irregular	irregular

[a] Irregular—contrary to legal rules.

Case 1 does not concern us here: the firm produces and distributes a regular good in accordance with rules and practices established by the law. In case 2, there are irregularities during the productive process although the resulting good is regular and distributed through legal channels. Irregularities taking place in the production phase can be of different types. In some instances, firms are illegal and can only employ workers illegally; in others, there are both regular and irregular workers; in others again, all workers have a regular contract, but they are required to work overtime or receive a salary lower than the amount agreed. In addition to these forms of evasion of labour regulation, there is tax evasion—also at either the production or the distribution phase, or both. In some cases the final firm is legal, but its suppliers and subsuppliers have adopted forms of hidden economy; for this reason it is particularly useful to study the shadow economy as an entire network rather than as single firms. In case 3, goods are produced and distributed regularly but have some irregularity in their basic features. Case 4 presents irregularities both in production and in the distribution process. In addition, in this case, irregularities can be of different types: sale of goods through illegal channels (for example, markets or peddlers without permits who do not declare their incomes); legal vendors who underreport their taxable earnings. In case 5 there are irregularities in all three phases.

The result is thus a continuum, delimited at one end by a regular economy that legally produces and distributes regular goods, and at the other by a completely hidden economy with irregularities in production, distribution, and even in the resulting good. In order to understand these aspects better it is necessary to relate them to the model of analysis of governance we have developed.

Shadow economy and modes of governance

We now turn to analysing the specific institutional architectures required by the territorial governance of a shadow economy. We do this in terms of the scheme set out by Crouch (2005, chapter 5), which identifies dichotomous choices along several dimensions which underlie the exercise of governance: the various governance modes are distinguished by their positions on these dichotomies. We can hypothesize that governance in areas with a high level of informal economy follows the pattern shown in table 4.

Table 4. Attributes of governance of the shadow economy.

Dimension of governance	Dichotomous choices [a]
(1) Relationship to institution/territory:	*endogenous*/exogenous
(2) Character of governance rules:	*informal*/formal
(3) Character of implementation of governance:	*substantive*/procedural
(4) Form of communication prescribed:	*dialogue*/signalling
(5) Structure of communication prescribed:	*vertical*/horizontal
(6) Strength of enforcement of rules:	*high*/low
(7) Reach of enforcement:	*limited*/extensive
(8) Ease of exit from relationships:	*difficult*/easy
(9) Character of collectivity served:	*private*/public

[a] Italics indicate positions of shadow economy governance.

With the exception of the vertical structure of communications, this scheme shares many elements with community governance, and shadow economies are usually embedded in and dependent on strong local communities. Individuals have informal, long-term relationships and governance is endogenous to the territory. In these local contexts traditional institutions, such as family, play an important role and information is shared by means of reserved, even secretive, channels. In the absence of clear and formal rules, communication is horizontal and dialogue-based (actors often negotiate transactions and forms of work individually). Despite the high level of informality, the enforcement level of this model of governance is high. Those who do not comply with the local informal rules (or who break codes of *omertà* by divulging practices to official authorities) are excluded from the community by mechanisms of informal control; workers who do not respect these rules do not find a job, and entrepreneurs who breach local norms do not find reliable workers or subsuppliers. However, except in the case of major criminal networks of a Mafia type, the enforcement reach of this governance is usually spatially restricted: control devices are rooted in the territory, and the high degree of endogeneity of this governance mode makes it relatively ineffective when exported to other local systems. Also, it cannot act publicly and openly. Workers—and firms—who want to exit from this system often have to relocate: emigration is the only exit from this model.

Work organization within firms differs from the interfirm and firm–community relationship in some respects, being characterized by a high level of informal hierarchy with decision-making processes based on vertical communication; workers have few rights in these systems. A high level of informal hierarchy also characterizes relationships between final firms and subcontractors. This model is able to produce and allocate local competition goods, but most of these have a 'club', or private character: these goods are produced by close networks and can be used only inside these networks, even though in some instances they can affect the entire local system. Local networks of firms are effective in transferring information concerning employment, skills, etc.

Clearly, the shadow economy prevails in those areas where governance by the state (government and law) and by formal economic associations are weak, but where market regulation plays an important role. Governance within the firm and inside the networks of final firms and subsuppliers is like corporate hierarchy, but is less formal.

As we have already mentioned, this mode of governance has competitive strengths. The high level of informality favours a model of labour organization characterized by high internal flexibility (between workers) and also between final firms and subsuppliers. It ensures lower labour costs, whilst community regulation conveys those features of enforcement that are necessary to the functioning of any economic system without recourse to government and law. However, this is a short-term competitiveness which occurs with medium-quality and low-quality products, medium variability of production flows, and very low costs. In particular, its competitive capacity is undermined by risks, which can be grouped in two categories: one exogenous and one endogenous to the local system (table 5).

Table 5. Factors hindering competitiveness in shadow economy local systems.

Exogenous variables
Opening of international markets and arrival of new competitors.
Need to increase state taxation and consequent end of 'silent compromise'.
Emergence of new territorial policies that set up incentives directed toward regular firms.
Rise of policies to reduce shadow economy.
Endogenous variables
Inability to produce local collective competition goods.
High level of localism.
Low capacity of entrepreneurial and institutional innovation.

The exogenous risk factors are listed below.

(1) Most importantly, the opening of international markets and increased competition from countries with very low labour costs and high labour flexibility, undermining the competitiveness of European local systems based on the so-called 'low road'.

(2) The need to increase taxation to finance welfare programmes and economic policies raises the determination of governments to assert control. The silent compromise between hidden firms and local and regional institutions, which favoured the irregularities, disappears and firms have fewer possibilities to employ shadow labour. At the same time, tax and labour-market reforms in many European countries have fostered labour flexibility and the reduction of labour costs—reducing the competitiveness gap between areas with regular and those with shadow economies.

(3) There are new territorial economic policies, both at national and at European levels, aimed at promoting local development by means of incentives to firms and networks of firms that do not employ shadow labour.

The endogeneous risk factors are as follows.

(1) The fact that territorial regime competition is increasingly based on the availability of advanced local tangible and intangible competition goods. Such goods can only be produced in small measure by those regulative mechanisms on which the shadow economy is based. They need the active participation of local governments, entrepreneurial associations, and stable and permanent institutions which are able to produce them with a medium-term and long-run perspective.

(2) The highly endogenous and informal governance mechanisms of the shadow economy hinder the opening of the local system to the outside: this is an element of weakness when firms become ambitious and aim at building their competitiveness on wide networks and relationships crossing the borders of local systems.

(3) Areas with informal economies are increasingly suffering the 'competiveness gap' which derives from their incapacity to introduce innovations, which follows from their narrow networks and limited possibilities of exit.

To some extent it was the very success of local economies based on the down-market competitiveness of the informal economy that attracted attention to these areas and eventually produced the policies for *emersione* which have threatened this form of growth. However, as shown below, these policies—most of which were set up to incentivize firms and to strengthen market mechanisms—have not always been successful.

Lights and shadows of policies of emersion

As we have already indicated, shadow labour is used in advanced economies as well as in backward areas—albeit at different levels of intensity. Statistics show that in Western European, irregular labour and firms are concentrated in certain sectors (for example, building) and geographical areas (southern Italy and some parts of Spain). The same is true in Central and Eastern Europe (CEE). However, in these last cases, there has been less attention from policy makers, there being only a few cases of policies to reduce irregular labour. In the great majority of cases in CEE it is seen as the lesser evil compared with the problems of lagging economic growth. In fact, there is a widely diffused idea that to interfere too much with the hidden economy could make matters worse and create a vicious circle which would set back economic progress.

However, in general, in the past few years there has been a growth of policies in Europe targeted at the shadow economy for three reasons. Above all is the idea that the low road of the shadow economies is not the best one to pursue, and that a gradual regularization of the firms and workers involved could encourage investment and the generation of collective competition goods leading to more efficient competitive strategies. Second, as already noted, the state wants to increase tax revenues. Third, many scholars and policy makers consider that, quite apart from economic issues, the shadow economy hinders the development of social cohesion. This has been an important factor influencing EU policy, explaining why many EU initiatives aim either at sensitizing nation-states to, or at directly promoting, policies to confront the shadow labour market in particular. It therefore becomes interesting for our present purposes to try to determine the impact of these forces on the systems of governance characteristic of the shadow economy, and also to see how these governance systems influence the outcomes of the policies and instruments being turned against them.

As we shall see, many policy areas affect the shadow economy—especially macroeconomic, labour, urban, and social protection policies (Chen, 2004). These can trigger local institutional change, modifying the interaction between community and social regulatory mechanisms but, as we shall see, the governance systems that characterize the shadow economy have until now considerably restricted their effectiveness (Rodríguez-Pose and Storper, 2006).

The first point to note is the great diversity of policy instruments being used in different countries (Lucifora, 2003; Megale and Tartaglione, 2006). This can be seen initially from how different regimes allocate responsibility. In Germany and France, firms are punished for using shadow labour, whereas in Poland it is the workers themselves who are criminalized. In Denmark and Italy recent measures seek to punish customers who buy products made in the shadow economy. There is a similar diversity in measures directed to reduce the scale of the shadow economy. In general there are three families of policies:

(a) those aimed at preventing the development of the shadow economy (through general interventions directed at the institutional conditions that are seen to have favoured the emergence of such an economy in the first place);
(b) those that aim at reducing the incentives to have recourse to shadow forms of, primarily, labour, through inspections and sanctions;
(c) proactive policies that encourage firms to emerge from the shadows.

Examples of type (a) policies can be found in Sweden, where reforms of the welfare system during the 1990s reinforced the links between individual contributions to the social security system and benefits received, with the aim of indirectly favouring formal participation in the labour market (Pierson, 2001; Scharpf and Schmidt, 2000). Under this system, the relationship between contributions and benefits was reinforced to ensure that working legally guarantees participation in the distribution of benefits from the welfare state. This was stated openly as a goal by policy makers, alongside that of reducing the costs of benefits. Similar policies of a general character were also introduced in Germany (Streeck and Trampusch, 2005). In 2002 the Hartz Committee presented a report that related the development of the informal economy to excessive regulation of the labour market, and proposed measures that were gradually followed, such as the encouragement of temporary jobs—limited to certain types of workers and firms—and support for a training programme aimed at promoting formal participation in the labour market. The Italian government introduced the possibility of legal work for pensioners—traditionally one of the main groups in the irregular labour market. The Spanish government sought to reduce the size of the informal economy indirectly, by reducing taxation on low incomes and introducing new forms of flexible labour contracts. These schemes all operate indirectly on the shadow economy through intervention targeted on what we have defined as the institutional conditions that favour the growth of irregularity. It is also necessary to note that important indirect measures are embedded in immigration policies: in many cases first-generation, and even second-generation, immigrants constitute an important reservoir of supply of illegal labour, and for this reason many immigration policies include important provisions for encouraging legal employment.

Type (b) policies can be found in all European countries (Lucifora, 2003). In the past few years a control strategy based on three principal aspects has been diffused. In particular there has been (1) an intensification of checks carried out on work premises where casual labour is employed. Alongside this is (2) an increasingly tight cooperation among various administrations and public institutions with the aim of better identifying incorrect business conduct. Finally, there is (3) the promotion of campaigns to sensitize people to the risks of being in the informal labour market. This is the path which has been followed since the mid-1990s in Sweden, for example, where there have been intensified checks on establishments and publicity campaigns directed particularly at the young. The French case is interesting from this point of view, with recent cooperation and coordination among the institutions concerned with the control of irregular labour, for example, the Commission Nationale de Lutte contre le Travail Illégal (National Commission for the Campaign against Illegal Work), which includes the labour inspectorate, police, taxation bodies, social security institutions, and social partners (Mateman and Renoy, 2001). Sensitization measures usually involve participation by interest organizations both of employees and of employers; there are examples in Belgium, Norway, Sweden, Italy, and Spain. At the same time, there are laws concerned explicitly with the shadow economy, such as the German Gesetz zur Bekämpfung der Schwarzarbeit (Black Labour Law), dating back to 1957, but with important amendments since the end of the 1990s. This provides for sanctions both against those offering and against those employing black labour, such as exclusion from bidding for public contracts by firms known to have used illegal labour; it also promotes cooperation among various institutions engaged in the campaign against the problem.

The third strategy (c), aimed at encouraging firms to leave the shadow sector, is of particular interest to us here, and seems to be mainly characterized by innovative instruments directed at modifying the forms of governance on which the sector is based. An example is that of the 'vouchers' introduced in France and Belgium, to simplify payment for domestic services. With these vouchers it is possible for anyone to employ directly and temporarily a domestic worker: either the worker receives the vouchers directly, called *Chèques emploi service* (service employment cheques) in France, or one pays the firm that employs the worker. Another interesting case is that of Germany, where there has been an attempt to reduce shadow labour by making the labour market more flexible with the introduction of specific forms of contract, such as the so-called 'minijobs'. These provide labour contracts at a maximum of 15 hours a week, aimed at and explicitly reserved for pensioners, students, and married women. Employers' social insurance contributions are reduced, and those of the employees waived completely. After this, the government introduced the 'midijob', with a higher wage and longer hours of employment, designed to constitute a form of transition from this atypical situation to normal standard employment (Kemmerling and Bruttel, 2005).

In general, there has been a rise in measures targeted on wage flexibility and external flexibility, often introduced through collective bargaining. There are examples of collective agreements designed to achieve these goals from Belgium, Finland, Italy, Germany, and the Netherlands; and also more general pacts—in these countries again, but also in Hungary, Norway, and Poland (EIRO, 2004). There have been further interesting developments in Italy where, since the mid-1990s, there had been a growth of 'realignment contracts', aimed mainly at the Mezzogiorno and the textile, clothing, and shoe-making sectors. It is here that we encounter policies for emersion in its full sense (Baculo, 2004; Megale and Tartaglione, 2006; Meldolesi, 2000; 2003).

In Italy, employers are permitted to pay lower wages than provided for in national collective agreements, on the condition that they will gradually raise the levels to the national averages. This arrangement was replaced at the end of the 1990s with an initiative launched by the Comitato nazionale per l'emersione del lavoro non regolare (National Committee for the Emersion of Irregular Labour). This encouraged negotiation among social partners at the local level, following the logic of the realignment contracts but monitored and coordinated by the National Committee, and with regional and local task forces, closer to the ground, who promoted and sustained reaching of the agreements. In addition, there were temporary 'tutors', employed by the National Committee, to provide advice services to firms who wanted to pursue a path to legalization. In 2001 a campaign was launched for the regularization of shadow labour, in which employers were able to wipe the slate clean of their past illegality by paying reduced taxes and social contributions for three years, so that they could gradually confront the increased labour costs that they would face as legal employers.

They were also able to agree a plan for their emersion with a specific commitment to a time period within which they would achieve full convergence with the formal economy. If the time period proposed was not complied with, the firm would become liable for paying the past taxes in full and not at the reduced rate.

The success of this measure is still in doubt: the results of a number of recent evaluation studies suggest that the impact of these policies is very limited (EIRO, 2004; Mateman and Renoy, 2001; Meldolesi, 2003; Renoy et al, 2004). It is therefore interesting to use the methodological approach that we have developed here to try to understand why there has been this limited efficacy, formulating hypotheses which could then be tested in empirical research. Three points in particular suggest themselves. First, the policies described above are predominantly aimed at individual firms, or even individual workers, and not at the system of governance in which these are inserted. It is therefore difficult for these policies to create the conditions in which the strategies of individual actors might be modified. Second, in the great majority of cases, the policies adopted produce a regulatory context that is unstable and temporary. They are based on measures and on a system of sanctions and incentives that tend to change continually over time. Such instability, as we shall see, cannot succeed in forcing the actors to renounce any recourse to the shadow economy. The third element of weakness results from the poor level of coordination among the different measures at local and national level: the high degree of fragmentation of the various interventions does not help to create synergies, and does not mobilize the resources necessary to modify the institutional context that supports the shadow economy. We need to examine these critical elements in more detail.

Excessive concentration of measures on individuals

First, we address the fact that in most cases measures have been concentrated on individual firms, workers, and even consumers. The problem, however, as we have seen, is strongly rooted in an institutional and regulative tissue bound to a particular territory and with a model of governance, informal but powerful, that constitutes the principal base of its reproduction and diffusion. Measures directed at individuals, and which seek to encourage emersion by means of recourse to the market, will not easily exercise any significant impact in areas where the shadow economy is concentrated. As we have noted, the governance of the informal economy already supports the market. Without measures to modify the regulatory ensemble in which actors are rooted, it will not be possible to put into play a set of incentives strong enough to persuade individuals—whether firms, workers, or customers—to decide to adopt behaviour that is, in their context, deviant and innovative, and to shift from informality to the regular economy.

Therefore, these individualized measures are not succeeding in modifying the institutional architecture in which the informal economy is based, namely: networks of localized enterprises in which the irregular economy is concealed; and a robust system of governance that is endogenous and informal, but which has a strong enforcement capacity— albeit spatially limited. Policies such as vouchers, based on an ethical sensitivity on the part of actors, or interventions based on fiscal penalties and contributions, do not change the habits of economic actors which are rooted in the contexts of the shadow economy to the extent these actors will exit from their local system of governance.

The experimental and temporary nature of policies

The second weakness of many approaches to the shadow economy is the fact that measures and policies often have an experimental and temporary character: they are established for limited periods of time, and when the next, replacement programme arrives there are radical changes in organization and regulation. Such instability does not help to consolidate a stable institutional framework on which firms deciding to embark on emersion can count in the long term. Somewhat paradoxically, the stable governance and certain and clearly identifiable incentives and sanctions of the informal economy are contrasted with a model of governance which, though formal and legal, has conditions and advantages that are limited in time and uncertain. This explains why in many cases there is a 'limited emersion', that is, behaviour tied in an instrumental way to certain financial incentives and liable to slip back into illegality as soon as these incentives change or disappear. As recent studies show, institutional stability is important for sound development policy—favouring trust relations among private and public actors, affirming processes of cumulative learning, and favouring the realization of collective goods and the pursuit of long-term and medium-term objectives.

Low level of coordination among interventions

The third problem is the low level of horizontal coordination among various interventions—not only between those for enforcement and those for giving incentives for emersion, but also between policies for development and those for the labour market. There is also often poor coordination among actors: individuals such as single enterprises, collective ones like interest-representation organizations, and also between private and public actors. Fragmentation seems to lead to a dispersion of interventions across a territory, with an incapacity to mobilize adequate volumes of resources to attain the declared goals. It also hinders the achievement of goals because, as has been seen, the shadow economy is difficult to confront through individual measures used in isolation. This is not just a matter of coordinating enforcement measures and sanctions with more proactive policies aimed at giving incentives for emersion from shadow labour. It is also a question of coordinating policies for emersion with other, more general, policies such as those for security and the reduction of criminality, or with immigration policy. At the same time, it is difficult to disengage policies for the shadow economy from those for development which concern LCCGs which assist local firms and lead them to 'high road' competitiveness. If the mode of territorial regime competition does not change radically, it is difficult to consolidate a clear emersion from the shadows.

Conclusions

It is important before giving the conclusions of our primarily critical argument to make reference to some examples where policy makers have shown a better awareness of the requirements of policy in this area. Several of these can be found in southern Italy—a region where problems of shadow economy and their embeddedness in wider issues of criminality are deeply embedded. In some instances, local governments, often initially individual mayors, have taken advantage of national policy instruments to take a new approach to the difficulties of their localities. There has been a mobilization of participation and a clear commitment on the part of local governments and institutions, representative interest organizations, and a few larger firms, in the preparation of plans and projects for emersion for small enterprises (Valzania, 2006). There have then been campaigns to sensitise firms to the possible returns to be gained from moving into legality, and the provision of various advantageous mechanisms for firms and workers who decide to embark on a course of emersion. The attack on the shadow economy here has been linked to new policies favouring development, for example, through the provision of improved infrastructure. Firms embracing emersion have been able to participate in planning these policies, with local authorities being willing to reach neovoluntaristic agreements with them, aimed at responding to the precise competitiveness requirements of the local system of production. Recent OECD Territorial Reviews of Spain and the Czech Republic, as well as of Italy, report examples of policies aimed at: promoting trust relations among firms themselves, and between them and local administrations; assisting synergies between public and private investments; and providing new LCCGs for firms through development plans achieved through collaboration with local actors.

Those involved in these initiatives seem aware of a reality that is, in general, escaping the proponents of strategies against the shadow economy: that the kinds of relations among economic actors which constitute this economy are *not* characterized by a simple absence of regulation. As a result of this misperception, it is generally believed that it would be sufficient on the one hand to introduce a system of sanctions, and on the other to promote instruments that favour a regulation of the market, as in the voucher plan, and that this can automatically modify the set of conventions among individual actors, workers, and firms, and lead to the gradual regularization of economic relations. As we have seen, however, a shadow economy often possesses a mode of governance with a high level of enforcement and extremely limited opportunities for exit, together with a system of inspection and sanctions that can be pervasive and efficient. We have also seen that this regulatory system constitutes an institutional infrastructure on which market relations among enterprises can be based. It is, in fact, this system of governance that brings regularity, predictability, and the presence of constraints, and which renders credible actors' obligations, issues basic to economic transactions.

The three types of instruments that we have considered—that is, interventions designed to prevent the development of a shadow economy, policies aimed at removing incentives for having recourse to such forms of work through inspection and sanctions, and policies which promote emersion from shadow labour and which have a more proactive character—ignore for the most part the fact that the shadow economy acts in a particular environment and that it is regulated by a well-defined mode of governance which distributes resources, mediates conflicts, and orients and addresses the action of economic actors—even allocating certain kinds of local collective competition goods (albeit of a private character) which actually favour a low-road competitiveness of local firms. Obscuring the institutional foundations of the shadow economy in this way, these approaches risk having an extremely limited effect on the phenomenon.

For this reason it is of particular value to deepen knowledge of the shadow economy through case studies that enable us to study regulative characteristics. We need to analyze the relation between policies for emersion and the various levels of enforcement, its territorial extent, the role of informal rules, the effective possibility of exit available to different actors, and the level of endogeneity of the relations between firms and workers. In this way we can, on the one hand, throw light on the specific connection between economy and local society that characterizes the shadow economy and, on the other hand, demonstrate the critical components of policies for emersion. From this perspective it is also possible to make use of a comparative perspective. From the identification of similarities and differences between cases from different countries, we can identify elements that are very useful for refining methodological instruments capable of best bringing together the relationship between the regulative dimension, the organizational ensemble, and the role of individual actors, and to identify the reasons both for virtuous circles and for perverse effects.

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