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Extending Social Security to the Informal Economy

Evidence from Bosnia and Herzegovina
and the Republic of Moldova

Kenichi Hirose
Miloslav Hetteš



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= 20.90 Moldovan lei (MDL)

Foreword

As affirmed by fundamental international documents such as the Universal Declaration of Human Rights (1948), the International Covenant on Economic Social and Cultural Rights (1966), as well as regional instruments such as the European Social Charter (1961, revised 1996), every member of society has the right to social security, and is entitled to its realization through national efforts and international cooperation.

“Ensuring adequate social security for all” is one of the key goals of the ILO’s Decent Work agenda. In this regard, the ILO Social Protection Floors Recommendation No. 202 (2012) calls for ILO Member States to build comprehensive social security systems and extend social security coverage by establishing and maintaining national social protection floors to ensure that all members of society enjoy at least a basic level of social security throughout their lives. The Transition from the Informal to the Formal Economy Recommendation No. 204 (2015) also calls for Member States to progressively extend social security, maternity protection, decent working conditions and minimum wages to all workers in the informal economy.

Most European countries have already established comprehensive social security systems. The existing systems typically operate in the forms of contributory social insurance systems and non-contributory, tax-financed social assistance systems, both of which constitute the main pillars of the European social model. Although the existing social security systems in European countries have achieved reasonably high population coverage, gaps still exist, notably among workers in the informal economy, migrant workers and farmers in rural areas.

The purpose of this report is to analyse the effects of the informal economy on social security, and to discuss possible policy measures to extend the social security coverage for workers in the informal economy. Some parts of this report appeared in other ILO reports (ILO, 2016a, 2016b, 2016c). This report incorporates the comments received after the publication of these previous reports, and contains updated statistical data.

This report is organized as follows: Section 1 reviews the scope and definition of the informal economy and undeclared work, and analyses the effects of informality on the right to and financing of social security. Sections 2 and 3 present the case studies of Bosnia and Herzegovina and the Republic of Moldova, based on the findings of the ILO missions in 2014 and the ILO survey of Moldovan farmers in 2015. Section 4 summarizes the key observations from the two case studies, and discusses the effective policies for extending social security coverage to workers in the informal economy in the context of Central and Eastern Europe.

Budapest, October 2016

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1. Problem analysis

1.1 Informal economy and undeclared work – scope and definition

The informal economy is a complex phenomenon caused by a wide range of economic, social, institutional and cultural factors that vary from one country to another. In the ILO Recommendation No. 204, the term “informal economy” (also known as the “grey” or “shadow” economy) refers to *all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements*.

The majority of workers and economic units in the informal economy produce legal goods and services, albeit sometimes not in conformity with legal requirements. A global study¹ indicates that around two-thirds of the income earned in the informal economy is spent in the formal economy. Therefore, the activities of the informal economy should be distinguished from illicit activities, in particular the provision of services or the production, sale, possession or use of goods forbidden by law, as they are the subject of criminal law and are outside the scope of regulation or protection under labour legislation.

The informal economy includes workers and economic units operating outside the formal reach of labour legislation. Typical examples include enterprises operating without a proper business registration, employees holding informal jobs, workers in unrecognized or unregulated employment relationships, and economic units operating on their own or with contributing family workers. Work conducted in the informal economy is frequently accompanied by low pay and precarious working conditions. By definition, these workers lack workers representation, the right to association and social protection.

The agricultural sector has one of the highest occurrences of informal employment in South Eastern Europe, including in Bosnia and Herzegovina and the Republic of Moldova. These workers and supporting family members work on their own land or are hired by bigger landowners. Their income depends on unpredictable environmental, climatic and natural conditions. Moreover, agricultural work is often more hazardous than other types of work. These vulnerabilities make it all the more important to provide adequate social protection for this group.

In South Eastern Europe, informal work is traditionally performed by diverse groups of domestic workers, many of whom are women. Generally domestic workers work under informal contracts (oral contracts based on custom) to provide household services or support family work, mostly in agriculture. Although they are sheltered from absolute poverty since food and accommodation are provided, they often do not receive regular remuneration or social security coverage. The closed and limited working environment in a rural setting makes it difficult for responsible authorities to carry out proper inspection and control.

In addition to informal employment, another major component of the informal economy in European countries involves workers and economic units that operate within the formal reach of the law, but the law is not effectively enforced or simply not applied in practice. A typical case involves undeclared work, where *economic units wilfully avoid taxation, social and labour laws and regulation*.² The informal payment of wages in cash is commonly known as “envelope wages.” In this regard, the European Commission defines undeclared work as “any paid activities that are lawful as regards their

1. Schneider *et al.* (2010).

2. ILO (2014).

nature but not declared to public authorities, taking into account differences in the regulatory system of the EU Member States.”³

1.2 Effects of informality on social security

There are a number of advantages in extending social security to informally employed workers. Clearly, the extension of social security coverage will improve the well-being of informally employed workers and their families by protecting them against various social risks. It also helps improve the productivity and employability of informally employed workers, which in turn facilitates their transition into the formal economy. By covering all groups in a society, it enhances social inclusion and cohesion.

Typical forms of non-coverage and non-compliance include:

- an employer (particularly in a small- or micro-enterprise) or an own-account worker (such as a farmer) failing to register as a contributor;
- an employer underreporting the number of their employees (such as part-time or casual workers);
- an employer or a worker under-declaring their wages; and
- the non-payment (arrears) of contributions or wages.

Clearly, if a worker in the informal economy fails to comply with social security law (let alone other fundamental labour legislation), then the worker and their family members are unprotected against substantial social risks. It should be noted that most countries in Central and Eastern Europe provide health insurance coverage for the unemployed, retired and disabled, as well as the dependent family members from the State budget. Therefore, a certain number of workers in the informal economy (such as family workers) are at least covered by health insurance. However, this is not the case with contributory cash benefits for income security.

Undeclared work refers to formal employment situation in which workers and employers declare a lower than actual income in order to maximize their current disposable income or profit. For a social security system, undeclared work implies fraud and evasion of tax and social security contributions. In a typical case of wage under-declaration, a worker and their employer report only the minimum contribution level stipulated by the law, while the remaining portion of their wage is paid directly and informally from the employer to the worker. This secures at least a certain benefit level if the worker completes their required contribution period. The problems related to the under-declaration of income are sometimes more complex and difficult to tackle compared with those of non-coverage.

To illustrate this, the following Figure presents the wage distribution of the contributors (excluding the self-employed) to the Pension and Disability Insurance Fund of Serbia from 2005 to 2009. The vertical line indicates the minimum contributory base.⁴ It should be observed that there is a significant concentration of contributory wages in the range between 40 and 60 percent of the average wage. More than 60 percent of workers contribute below the average wage, and 14 percent of workers contribute based on wages below the legally prescribed minimum. Although the distribution of actual wages is not available, these observations strongly suggest the prevalence of wage under-declaration.

The under-declaration of income threatens the sustainability of social security systems and the adequacy

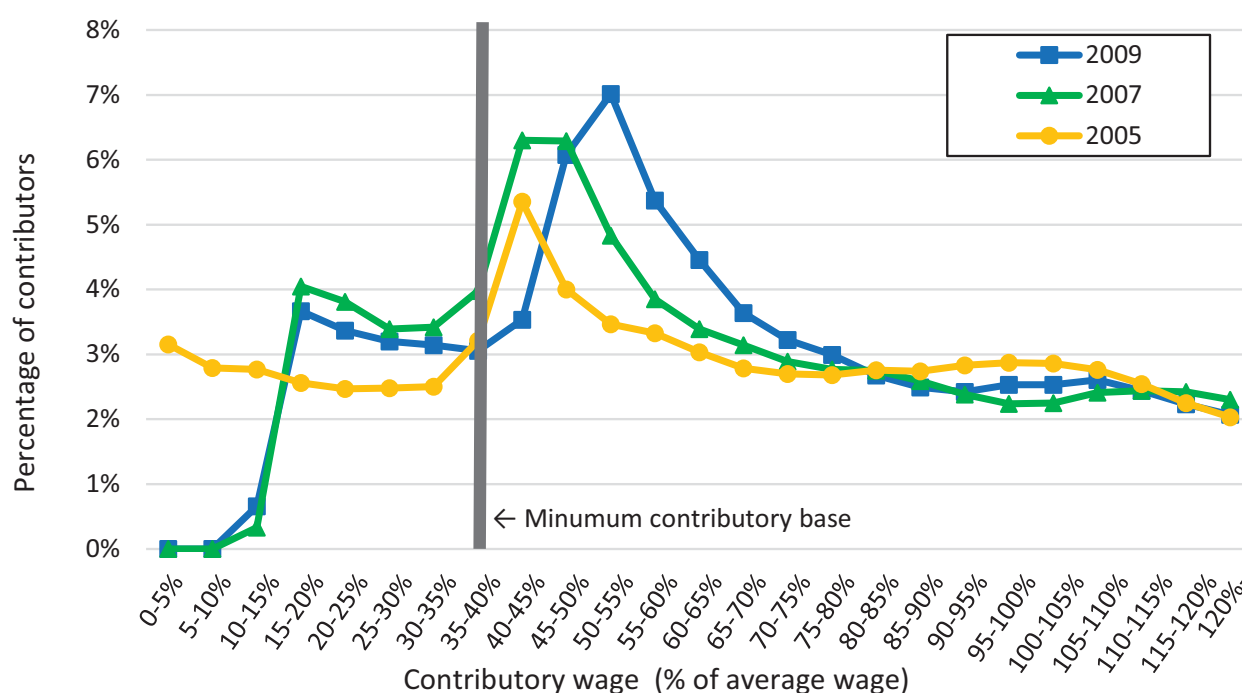
3. European Commission (2007).

4. The minimum contributory base has been set at 35 percent of the average wage since 2007. Previously it had been set at 40 percent of the average wage.

1. PROBLEM ANALYSIS

of social security benefits. It can lead to a significant leakage of funds of social security systems, causing an imbalance between their revenue and expenditure. As a result of the recent reforms in Central and Eastern Europe, benefits are more closely linked with contributions. Therefore, lower contributions will result in lower benefit levels, particularly cash benefits such as pensions, thereby rendering the workers and their families exposed to a higher poverty risk. This could eventually require States to subsidize the shortfall of the social security systems and to spend more resources on social assistance and other social protection programmes for low income households. Moreover, the under-declaration of income seriously undermines the credibility of social security systems. It can lead to the erosion of the public willingness to pay contributions, and result in a further aggravation of the contribution collection performance.⁵

Figure. Distribution of the contributory wage, Serbia, 2005–2009



Source: Pension and Disability Insurance Fund of Serbia.

* * *

The following two sections present an analysis of social security coverage, compliance, and contribution collection in Bosnia and Herzegovina and the Republic of Moldova. Our analysis will focus on the health insurance and pension systems. It should be noted that both Bosnia and Herzegovina and the Republic of Moldova have recently implemented unified systems for the collection of contributions and taxes by transferring the contribution collection functions to their tax authority.⁶ To implement this policy, these countries have made significant investments in their information and communication technology infrastructure and human resources. Our analysis will also assess the effectiveness of the unified collection system, and the use of the information and communication technology.

5. The results of a survey conducted in the Republic of Moldova in 2014 reveal that although 50.9 percent of the respondents believe it is worth it to pay social security contributions, 30.9 percent do not, and 18.2 percent did not answer. See ILO (2016).

6. A notable exception is Poland, where the Social Insurance Institute (ZUS) collects and registers social security contributions.

2. The case of Bosnia and Herzegovina

2.1 Overview of the informal economy

The informal economy and weak tax collection remain a challenge in Bosnia and Herzegovina. Despite the economic growth in recent years, the labour market suffers constantly from high unemployment (more than 13 percent), with a high proportion of long-term unemployed persons and unemployed youth. In these circumstances, the informal economy works as a social buffer for workers, many of whom do not have any option but to accept informal employment.

The current Labour Code of the Federation of Bosnia and Herzegovina allows both written and oral employment contracts. The latter is prone to be misused for informal employment, and an amendment has been proposed that would eliminate oral employment contracts. In the Republika Srpska, only written employment contracts are allowed. It is a priority of the Ministry of Labour and Veterans Welfare of the Republika Srpska to adopt a new Labour Code, which envisages, among other things, measures to reduce the informal economy and changes in the minimum wage setting.

Although many experts believe that the informal economy in Bosnia and Herzegovina is considerable, quantitative evidence is scarce. Several researches have attempted to estimate the size of the informal activities in Bosnia and Herzegovina, but the estimates vary widely, typically between 30 percent and 50 percent of GDP. Table 1 presents the estimates of the number of workers in the informal economy and the amount of unreported wages in 2008. Table 2 presents the number of contributors to the pension and disability insurance funds of both entities by contribution status from 2011 to 2013.

Table 1. Key indicators on the informal economy, Bosnia and Herzegovina, 2008

Indicator		Federation of BiH	Republika Srpska	Brčko District	Total BiH
Employed population	(persons)	528,000	350,000	16,242	894,242
Informal employment	(persons)	196,000	90,000	7,000	293,000
	(% of employed population)	37.1%	25.7%	43.1%	32.8%
Unreported wages	(million BAM)	1,765	813	64	2,643
	(% of GDP)	11.3%	9.6%	11.0%	10.7%
Unpaid social security contributions	(million BAM)	773	352	54	1,158
	(% of GDP)	4.9%	4.2%	9.4%	4.7%
Unpaid income tax	(million BAM)	58	54	3	115
	(% of GDP)	0.4%	0.6%	0.5%	0.5%

Source: Tomas (2010).

Table 2. Number of contributors to the pension and disability insurance funds, Bosnia and Herzegovina, 2011–2013

Year	Contributors	Contributions		
		paid at more than the minimum wage	paid at the minimum wage	not paid
FBiH				
2011	520,188	69.8%	18.0%	12.2%
2012	517,395	68.9%	18.9%	12.1%
2013	524,463	67.2%	20.2%	12.6%
RS				
2011	275,316	57.0%	36.1%	6.8%
2012	276,195	57.5%	36.4%	6.2%
2013	276,267	56.4%	36.9%	6.7%
BiH				
2011	795,504	65.4%	24.2%	10.4%
2012	793,590	64.9%	25.0%	10.1%
2013	800,730	63.5%	25.9%	10.6%

Source: Domljan *et al.* (2015).

Concerning the informal employment in Bosnia and Herzegovina, the following observations can be made.

- As Table 1 shows, the number of workers employed in the informal economy in 2008 was estimated at 293,000 persons, or 32.8 percent⁷ of the employed population in Bosnia and Herzegovina that year.
- By occupation, informality is particularly high in agriculture (around 30 percent) and in unskilled jobs (more than 20 percent). By age, informal employment is high among workers aged 15-44 years, due probably to the high unemployment in this age group.
- As Table 1 indicates, it is estimated that 2.6 billion BAM, or 10.7 percent of GDP, was unreported in 2008. As a result, the estimated amount of unpaid social security contributions is 1.2 billion BAM, or 4.7 percent of GDP, and the estimated amount of unpaid income tax is 115 million BAM, or 0.5 percent of GDP.
- Table 2 shows that, of all contributors to the pension and disability insurance funds in 2013, 25.9 percent were paying contributions at the minimum wage and 10.6 percent paid no contributions. This suggests that the minimum wage was inappropriately used in some circumstances as the base for social security contributions.

Moreover, there is anecdotal evidence indicating a particularly resilient feature of the informal economy. In 2008, a joint action campaign against the informal economy was conducted in the Federation of Bosnia and Herzegovina by the tax administration, the federal ministries, the social security institutions and the labour inspectorate. This one-off action campaign resulted in transferring 60,000 workers from the informal to the formal economy. However, without sustained efforts, 40,000 returned to informal work after two months.

7. The original study reported this number to be 24.6% of the labour force.

2.2 Social security coverage for workers in the informal economy

Bosnia and Herzegovina has a comprehensive social protection system including social insurance, social assistance, family and children's benefits, and war veterans' benefits. The social insurance consists of pension and disability insurance, health insurance and unemployment insurance. The compulsory social insurance systems are primarily financed by employers' and employees' contributions, although the systems rely significantly on the public budget for subsidies and for covering deficits. In addition, social assistance and other benefits are financed by the public budget.

In the current constitutional framework of Bosnia and Herzegovina, the role of the State (the Ministry of Civil Affairs) in the area of social protection is limited to coordination and international cooperation. Social insurance is implemented under the jurisdiction of two entities – the Federation of Bosnia and Herzegovina and the Republika Srpska. Each entity has its own pension and disability insurance fund, health insurance fund, and employment services, which administer unemployment insurance benefits.⁸ These systems are regulated by separate entity-level laws. In the Federation of Bosnia and Herzegovina, the situation is more complex due to the shared responsibilities between the Federal government and the ten cantons. In addition, the Brčko District, which is an independent administrative unit of Bosnia and Herzegovina, operates its own health insurance fund, but the inhabitants must join either the pension and disability insurance system of the Federation of Bosnia and Herzegovina or the one of the Republika Srpska. The following sections analyse the social security systems in the two entities and the District. Clearly, such a divide in the system poses formidable challenges in implementing a coherent social security policy at the national level.

The Federation of Bosnia and Herzegovina

(1) Health insurance

The Ministry of Health of the Federation of Bosnia and Herzegovina is in charge of the health policy. In the Federation, health insurance is implemented by ten cantonal health insurance funds and the Federal Health Insurance Institute, which covers tertiary health care providers. Each cantonal fund operates independently. From the total contribution revenue, 89.8 percent is allocated to the cantonal funds, and 10.2 percent to the federal fund.

As Table 3 presents, more than 2 million persons (of whom 61.8 percent were directly insured and 38.2 percent were dependent family members) are covered by health insurance in the Federation of Bosnia and Herzegovina. The number represents 86.5 percent of the total population. Farmers are covered on a voluntary basis, but their actual membership is very low, at less than 8,000.

Notably, employees consist of only 23.6 percent of the insured population. The unemployed and pensioners represent a noticeable share – 12.7 percent and 19.6 percent of the insured population, respectively. The health insurance contribution rate for employees is 16.5 percent of their gross wage, shared by the employees (12.5 percent) and the employers (4.0 percent). There is also a proposal to lower the contribution rate. The contribution rates for other groups vary by canton, but are set at lower levels (for example, 1.2 percent for pensioners and 1.25 to 2.5 percent for the unemployed).

The public budget subsidizes select groups such as children, the disabled, and pregnant women. Non-insured groups include the unemployed not registered with the employment offices, rural populations,

8. The unemployment insurance benefit is 40 percent of the average wage. The duration of the benefit differs according to one's contribution period. The maximum unemployment benefit payment duration is 24 months with a 30-year contribution period.

and those covered by special funds (such as Roma). A non-insured person can still receive health care services in emergency cases.

Table 3. Population covered by health insurance by category, FBiH, 2012–2013

Year	2013		2012	
	Number	%	Number	%
Employees	476,853	23.6%	470,250	23.2%
Pensioners	397,047	19.6%	390,865	19.3%
Unemployed	255,942	12.7%	245,825	12.2%
Disabled	46,832	2.3%	47,895	2.4%
Foreigners	33,212	1.6%	33,824	1.7%
Farmers	7,847	0.4%	8,593	0.4%
Others	30,358	1.5%	28,100	1.4%
Subtotal	1,248,091	61.8%	1,225,352	60.6%
Dependents	772,945	38.2%	797,697	39.4%
Total	2,021,036	100.0%	2,023,049	100.0%
Total population (% of insured persons)	2,337,200 (86.5%)		2,338,277 (86.5%)	

Source: The Federal Health Insurance Institute of the FBiH.

(2) Pension and disability insurance

The Pension and Disability Institute of the Federation of Bosnia and Herzegovina implements pensions and employment injury benefits under the policy guidance of the Ministry of Work and Social Welfare.

Table 4 presents the number of employees and pensioners since 1990. Unlike health insurance, the pension system coverage is limited to contributing members only. As observed from Table 4, the number of employees decreased almost to one-third during the 1990s due to the economic transition and the conflict. Since then, the number of employees has not recovered to the pre-conflict levels. As of July 2014, the number of employees is less than 20 percent of the total population. The simultaneous decline in employees and increase in pensioners has deteriorated the pension system dependency ratio; in 2014, the number of contributors per pensioner was 1.14 which is one of the lowest levels in the region.

Table 4. Number of pensioners and employees, FBiH, 1990–2014

Year	Number of pensioners (A)	Number of employees (B)	Dependency ratio (B/A)
1990	380,000	1,208,400	3.18
1991	408,120	1,130,492	2.77
1992	415,902	1,081,345	2.60
2002	284,637	390,201	1.37
2010	368,794	424,598	1.15
2011	376,180	439,473	1.17
2012	381,704	435,356	1.14
2013	388,676	438,593	1.13
2014 (31.07)	390,284	444,506	1.14

Source: The Pension and Disability Institute of the FBiH.

The pension contribution rate for employees is 23 percent, shared between the employee (17 percent) and the employer (6 percent). According to the Pension and Disability Institute, many private enterprises pay social security contributions at the minimum wage. In the Federation, the minimum wage is 365 BAM (net wage), which has not been increased since 2011. The national average wage in October 2014 was 838 BAM (net wage), or 1,281 BAM (gross wage).

Farmers can join the pension system on a voluntary basis. Their contribution base is set below the minimum wage, to create an incentive for membership.

The minimum old age pension equals 60 percent of the gross minimum wage (326 BAM per month in 2014). About half of pensioners receive the minimum pension. The guaranteed pension for a full-career contributor is 80 percent of the gross minimum wage (434 BAM per month in 2014). The current law applies a strict indexation rule. Pensions are not indexed in line with an indicator (such as wages or prices), but adjusted according to the amount of contributions collected. Thus the current pension system faces a risk of inadequate benefit levels in the future.

(3) Contribution collection

Since the Law on Contributions came into force in 2011, the Tax Administration has been solely responsible for the collection of tax and social security contributions. The Tax Administration operates a unified information system which integrated 23 information systems previously used by different institutions.

The Tax Administration has 1,300 staff. In addition, at least two staff members in each of the 73 municipality offices are assigned to the registration of workers. Since 2013, the tax administration implements a plan of communication and a plan of control targeting high-risk categories.

The Health Insurance Institute (including the cantonal health insurance funds) and the Pension and Disability Institute exchange members' data with the Tax Administration on a daily basis. Based on the contribution record, the Health Insurance Institute updates the health insurance booklets of the insured every three months.

Although the unified collection system has made several achievements, there is still room for improvement. According to the Pension and Disability Institute, there is a lack of effective cooperation between the Tax Administration and the social security institutions to conduct joint control activities. Even though the Pension and Disability Institute provides the Tax Administration with information on delinquent employers, often no follow-up action is taken. In 2014, the joint coordination body of the social security institutions and the Tax Administration was terminated and replaced by *ad hoc* operational meetings convened at the request of the social security institutions. Furthermore, the penalty is only 500 BAM for one unregistered worker, and can be imposed only by Court order.

Republika Srpska

(1) Health insurance

The Health Insurance Fund of the Republika Srpska implements health insurance. As Table 5 indicates, the health insurance system covers 1.0 million persons, or 76 percent of the 1.33 million population in the Republika Srpska. Of the persons with health insurance, 65.2 percent are directly insured and 34.8 percent are dependent family members. The public budget subsidises certain groups, including children, the elderly aged 65 or more, mothers of children under one year of age, and the disabled.

2. THE CASE OF BOSNIA AND HERZEGOVINA

The number of employees represents only 22.8 percent of the insured population. However, as seen in Table 5, the contributions collected from employees account for 87.2 percent of the total contributions. The health insurance contribution rate for employees has been 12 percent of their gross wage since 2013, when it was reduced from the previous rate of 12.5 percent.

Table 5. Population covered by health insurance by category, Republika Srpska, 2013–2014

Year	2013		2014					
	Number as of 30 June	%	Number as of 30 June	%	Share of regular contributors	Average contributions (BAM/month)	Average expenditure (BAM/month)	Average cont./average exp.
Employees	238,450	23.7%	228,626	22.8%	95.9%	155.5	72.0	216.1%
Pensioners	209,269	20.8%	217,190	21.7%	99.6%	1.2	72.0	1.6%
Unemployed	159,284	15.8%	165,496	16.5%	98.3%	25.6	72.0	35.6%
Foreigners	24,374	2.4%	24,628	2.5%	99.1%	—	—	—
Unemployed receiving benefits	3,054	0.3%	2,338	0.2%	107.5%	89.8	72.0	124.8%
War veterans and families	4,765	0.5%	4,863	0.5%	99.3%	6.9	72.0	9.5%
Social assistance beneficiaries	3,216	0.3%	2,853	0.3%	78.3%	63.5	72.0	88.2%
Farmers	2,020	0.2%	6,980	0.7%	41.3%	41.8	72.0	58.1%
Displaced persons	469	0.05%	496	0.05%	99.2%	17.5	72.0	24.3%
Subtotal	644,901	64.1%	653,470	65.2%	92.9%	64.8	72.0	90.1%
Dependents	360,924	35.9%	348,763	34.8%	—	—	—	—
Total	1,005,825	100.0%	1,002,233	100.0%	—	—	—	—

Source: The Health Insurance Fund of the Republika Srpska.

It should be noted that the contribution rates for health insurance and the pension and disability insurance are stipulated in a separate Law on Contributions of the Republika Srpska. The Law states that the whole contributions should be deducted from the employees' payroll, and employers are obliged to transfer the contributions on behalf of their employees. The new Law on Contributions envisages a fixed contribution base by occupation, regardless of one's actual salary.

With a view to extending the coverage for farmers, the Republika Srpska introduced a programme linking contribution payments with various advantages for farmers, such as discounts on pesticides and fertilizers. As a result of this incentive, the number of registered farmers grew rapidly, from 2,020 in 2013 to 6,980 in mid-2014 (it is expected to reach 13,000 by the end of the year).

Currently, contributions cover 90 percent of the health insurance expenditure. However, its costs are expected to increase continuously due to the rapidly ageing population. Considering the difficulty in increasing the contribution rate, a proposal has been made to allocate supplementary revenue from the tobacco tax or the environmental tax to the health insurance fund.

(2) Pension and disability insurance

The Pension and Disability Insurance Fund of the Republika Srpska implements the pension system under the policy guidance of the Ministry of Labour and Veterans Welfare. In 2010, the Republika Srpska amended its Law on Pension and Disability Insurance.

The under-declaration of income is a common practice in the Republika Srpska. Some private companies report the same wage (slightly above the minimum wage, which has been 370 BAM net since 2011) for all employees, while the average wage as of November 2014 was 827 BAM (net wage) or 1,333 BAM (gross wage). One reason for the under-declaration of income is that higher contributions are not fully reflected in the pension amount, since the annual personal coefficient cannot be more than four. However, the new Law introduced a point system in the pension formula, which relates contributions to their resulting pension amount.

The pension contribution rate is set at 18.5 percent of one's gross wage. Contribution income covers 80 percent of the expenditure. The public budget covers the deficit of 30 to 35 million BAM every year.

Farmers in the Republika Srpska previously had the option to join the pension system voluntarily. However, only 42 percent of farmers joined the system (25,000 out of the 60,000 registered farmers, including part-time workers). The new Law on Pension and Disability Insurance makes it mandatory for all registered farmers to join the pension system. The Law sets a flat-rate contribution (74 BAM per month) and provides a lower minimum pension (170 BAM per month). Contrary to the expectation of the authorities, only 783 additional farmers have joined the pension system thus far. The Ministry of Agriculture is considering further incentive measures for farmers to join the system.

(3) Social assistance

The Ministry of Health and Social Welfare, jointly with local municipalities, implement the Law on Social Protection, adopted in 1993 and revised in 2012. The payment of social assistance is subject to a means-test that is conducted by social workers. The amount of social assistance benefit is 15 percent of the average wage. The expenditure on social assistance is financed equally by the entity and the municipalities. The payment of war-related benefits to war victims and war-veterans has been transferred from the municipalities to the public budget.

(4) Contribution collection

In the Republika Srpska, a unified system of collection by the Tax Administration has been in place since 2010. The Tax Administration currently has a staff of 880, placed in the 64 municipalities of the entity.

The information systems of the Tax Administration and the social security institutions are not connected. However, a protocol on inter-ministerial cooperation has been adopted, which defines the roles of each institution and the procedures for their coordination. To improve this coordination, an inter-ministerial working group has been established, consisting of the Tax Administration, the Pension and Disability Insurance Fund, the Health Insurance Fund, and the Ministry of Health and Social Welfare. The working group meets regularly, and its conclusions are binding for all parties.

In the Republika Srpska, the under-declaration of income is considered a more serious problem than unregistered workers (informal employment). Under the current system, employers cannot open an entrepreneurial bank account without declaring their tax numbers. The challenge, however, is to control the private personal accounts, which are often misused for the payment of salaries for informally employed workers.

The Brčko District

(1) Health insurance

The Health Insurance Fund of the Brčko District is administered by the Department of Health and Other Services. There are 93,028 total inhabitants (preliminary result of the 2013 Census) in the Brčko District. The population covered by health insurance is 75,000, or 80 percent of the total inhabitants, including 15,000 employees, 12,300 unemployed persons, 12,000 pensioners and 28,400 family members. The health insurance contribution rate is 12 percent for employees, 9 percent for the unemployed, 9 percent for the beneficiaries of social assistance, and 1 percent for the retired.

(2) Contribution collection and compliance

The District applies a 2,000 BAM penalty for tax fraud. However, there are only six to seven such cases per year, less than the penalty cases charged by the labour inspection. In some cases, employees do not cooperate out of fear of losing their jobs.

3. The case of the Republic of Moldova

3.1 Overview of the informal economy

The National Bureau of Statistics of the Republic of Moldova adopts the following definition for informal employment:

Informal employment includes:

- self-employed workers who work in informal sector enterprises;
- employers who work in informal sector enterprises;
- members of informal production cooperatives;
- family workers employed in formal sector enterprises or informal sector enterprises;
- employees employed by formal sector enterprises, informal sector enterprises or private households of citizens who satisfy at least one of the criteria below:
 - employer does not pay social contributions for them;
 - do not receive paid annual leave (or financial compensation for untaken leave);
 - do not benefit from paid sick leave; and
- persons engaged in the production of agricultural products in households, exclusively for own consumption, with the duration of the working week of 20 hours or more.

Table 6. Key indicators on the informal employment, Republic of Moldova, 2011–2015

Year	2011	2012	2013	2014	2015
Employed population	1,173,500	1,146,800	1,172,800	1,184,900	1,203,600
Formal employment	812,800	805,900	810,000	799,400	785,200
Informal employment	360,700	340,900	362,800	385,500	418,400
Employees	96,900	78,200	76,200	72,100	—
Other workers(*)	263,800	262,700	286,600	313,400	—
% of informal employment in the employed population	30.7%	29.7%	30.9%	32.5%	34.8%

Note (*): Other workers include own-account workers, contributing family members, employers, and members of producers' cooperatives.

Source: National Bureau of Statistics of the Republic of Moldova.

Concerning the informal employment in the Republic of Moldova, the following observations can be made.

- As Table 6 shows, the percentage of the informal employment has been increasing since 2012. In 2015, a total of 418,400 persons had an informal job as their main job, which represented 34.8 percent of the employed population in Moldova.
- Informal employment is a common practice, particularly in the private sector. In 2013, almost all (99.8 percent) of informal employment is found in the private sector, while 61.0 percent of formal employment is found in the private sector.
- By industry, informality is particularly high in agriculture (82.4 percent in 2015). Informal employment is also high among older persons who need to earn additional income due to the

generally low level of pensions. It is reported that some employers actually pay full-time workers the minimum wage stipulated for part-time workers.

The Labour Code of the Republic of Moldova (Article 7^{1 (2)}) defines undeclared work as “any work fulfilled by an individual for and under the authority of an employer without respecting the provisions of the current Code on signing of individual labour agreements.”

In 2011, the Moldovan government adopted the National Plan of Action to combat undeclared work. Subsequently, the Ministry of Labour, Social Protection and Family drafted a public policy proposal on the reduction of the informal economy.

Table 7. Estimates of undeclared income and unpaid social security contributions, Republic of Moldova, 2010

	Number of workers	Estimated annual undeclared income (in million MDL)	Estimated annual unpaid social security contributions (in million MDL)		
			Social insurance	Health insurance	Total
Informal employment	353,500	4,776	1,618	474	2,092
Employees	100,900	1,775	515	124	639
Other workers(*)	252,600	3,001	1,103	350	1,804
Under-declared employment	296,460	4,518	1,310	316	1,626
Units with 20 or more workers	166,260	2,369	687	166	853
Units with 1 to 19 workers	130,200	2,148	623	150	773
Total (in million MDL)	649,960	9,294	2,928	791	3,719
Total (as a % of GDP)	—	12.9%	4.1%	1.1%	5.2%

Note (*): Other workers include own-account workers, contributing family members, employers, and members of producers' cooperatives.

Source: Own calculations based on the Ministry of Labour, Social Protection and Family (2011), Public Policy Proposal: Reducing the phenomenon of informal employment.

Table 7 presents the undeclared income and unpaid social security contributions based on the crude estimates made by the Ministry of Labour, Social Protection and Family using 2010 data. The results are explained as follows.

- In addition to 353,200 informally employed workers (representing 30.9 percent of the employed population), the number of under-declared employment was estimated by taking into account the number of private sector workers, where the average wage in an industry is lower than the average public sector wage in the same industry.⁹ It is estimated that 296,460 workers in formal employment (representing 25.9 percent of the employed population) were under-declaring their wages.
- For the industries with potential under-declaration, the average public sector wage was 3,431 MDL,¹⁰ while the average private sector wage was 2,244 MDL. The difference between the declared salary in the public and the private sectors, which equals 1,187 MDL, was taken as the minimum value of the under-declared salary.

9. These industries include agriculture, hunting and forestry; manufacturing; construction; wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods; hotels and restaurants; transport and communication; financial intermediation; and real estate, renting and business activities.

10. Establishments with more than 20 workers.

- The amount of unpaid social security contributions was estimated by applying the respective contribution rates to the unpaid salaries for employees, and by taking into account the flat-rate contribution rates for other workers. The estimated amount of undeclared income (due to informal employment and under-declaration) is 9.3 billion MDL, equivalent to 45 percent of the total wage bill¹¹ or 12.9 percent of GDP in 2010. Unpaid social security contributions from undeclared income are estimated at 3.7 billion MDL, or 5.2 percent of GDP. This consists of 2.9 billion MDL (4.1 percent of GDP) for social insurance and 0.8 billion MDL (1.1 percent of GDP) for health insurance.

3.2 Social security coverage for workers in the informal economy

(1) Health insurance

The Moldovan health insurance system is administered by the National Social Health Agency (Compania Națională de Asigurări în Medicină, CNAM).

As Table 8 presents, the health insurance system covers 2.5 million persons, or 82 percent of the population of Moldova (excluding the groups covered by other systems such as the army).

All employees in Moldova are mandatorily covered by the health insurance system. There were about 850,000 employees contributing to the health insurance system. In 2015, the health insurance contribution rate for employees was 9 percent, shared equally by employers and employees.

The State covers various groups outside the labour force, including children, pensioners, persons with disabilities, unemployed persons, pregnant women, mothers with four or more children, and families receiving social assistance. In 2014, a total of 1,620,000 persons were covered by the health insurance system through State funding. Irrespective of their health insurance coverage, everyone is entitled to receive free emergency health care services.

The non-covered population typically consists of temporarily returning migrants and vulnerable groups, such as Roma. As the result of a recent amendment, returning migrants should pay contributions in respect of their length of stay in Moldova. However, everyone is entitled to free emergency health care and primary consultations.

11. This estimate is more or less consistent with the finding from the Household Budget Survey, which suggests that 30-40 percent of the total wage bill is undeclared either through informal employment or under-reporting. However, this estimate should be taken with caution, due to the large number of reporting errors in the Household Budget Survey.

Table 8. Population covered by health insurance by category, Republic of Moldova, 2014

Category	Number of insured persons
I. Employees	846,789
II. Individually insured persons	48,925
III. Persons insured by State	1,619,999
Preschool children	367,329
Children under 18 in education	613,943
Pensioners	441,495
Unemployed	12,171
Persons with disabilities	149,438
Persons taking care of a person with a severe disability who requires care or constant attendance	2,535
Pregnant women	11,945
Mothers with four or more children	8,263
Beneficiaries of social assistance	3,060
Moldovans living abroad and foreigners	9,810
Farmers insured by State	10
TOTAL (I+II+III)	2,515,713

Source: The National Social Health Agency of the Republic of Moldova.

(2) Social insurance

Under the policy guidance of the Ministry of Labour, Social Protection and Family, the National Office of Social Insurance (Casa Națională de Asigurări Sociale, CNAS) implements the national social insurance system, which covers old-age, disability and survivors' pensions, employment injury benefits, sickness benefits, maternity benefits and unemployment insurance benefits.

The employed population is mandatorily covered by social insurance in Moldova. The number of registered persons is around 800,000, which is approximately the same as the number of formally employed workers. Those who are not covered are self-employed workers, farmers, migrants, as well as those covered by special schemes (such as members of the military and church workers).

The social insurance contribution rate for employees is 29 percent, of which employers pay 23 percent and employees 6 percent. Employers engaged solely in agricultural activities pay a reduced contribution rate of 16 percent, while employees contribute 6 percent the State contributes 6 percent. Therefore, the social insurance contribution rate for agricultural sector employees is 28 percent, one percentage-point less than for employees in other sectors.

The contributions cover 90 percent of the expenditure, and the deficit of 800 million MDL is covered by the State budget. Some benefits (childbirth benefits, support for extra school curriculum activities, and war veterans' benefits) have been transferred to the State budget.

In the social security contribution payment records, there are cases where some private enterprises report that the minimum wage is paid to all of their employees, from senior managers to junior staff. For this reason, there is a proposal to define a different minimum contributory base according to workers' skills and qualifications.

Several cases of fraud have been reported where workers declare higher (or actual) wages close to retirement or before taking maternity leave to obtain higher benefits. Recently, however, the benefit provisions have been modified to prevent such fraudulent attempts. The pension formula now takes into account the average salary of one's whole career since 1999,¹² while previously it was the average of the highest five consecutive years. The base for maternity benefits is now one's average salary for the previous 12 months,¹³ while previously it was the average of the previous six months.

(3) Contribution collection

The State Tax Service is responsible for collecting tax and social security contributions, and for transferring the contributions to the accounts of the health insurance and social security systems. It is also responsible for conducting inspections and fraud controls. The State Tax Service has 1,800 inspectors, of whom 400 communicate directly with employers. They focus on high-risk groups with an emphasis on prevention rather than enforcement. As a result of the operations in 2013, the State revenue increased by 32 percent, while the economy recorded an 8.9 percent growth.

The contribution records are kept at the social security institutions and are reported to the State Tax Service on a monthly basis. The collaboration between the social security institution and the State Tax Service is generally good, but delays in reporting have been observed.

According to the State Tax Service, although the responsibility for collecting social security contributions is stipulated in Chapter V of the Fiscal Code, there is no explicit legal basis for the enforcement of social security contribution collection.¹⁴

(4) Labour inspection

The State Labour Inspectorate has one central office and ten territorial offices with 87 inspectors, including six inspectors performing managerial jobs. Every year labour inspectors conduct 6,300 visits of 5,200 enterprises employing 240,000 workers, covering 40 percent of all formally employed workers.¹⁵ The State Labour Inspectorate collaborates with the police, the tax authorities, and the social security institutions.¹⁶

As a result of inspections and controls, 1,500 workers in the informal economy were moved to the formal economy in 2012. However, the number of formalized workers decreased to 330 in 2013 and to 202 in the first half of 2014.

One of the current issues with labour inspection is the controversial Law on the State control of business activity (Law No. 131 of 8 June 2012), which came into effect in 2013. The Law stipulates that State inspections (including labour inspections) should be conducted with five days' notice, and that the

12. The current pension formula produces significantly low pension amount with respect to the contribution period after 1999, due largely to the lack of revaluation of the past contributory wages.

13. The original proposal was to extend the period to 24 months.

14. The State Tax Service previously drafted a new Chapter X of the Fiscal Code, but it was not approved by the Ministry of Labour, Social Protection and Family.

15. Despite the requirements of the EU Association Agreement, Moldova currently does not conduct labour inspections of the self-employed due to a lack of resources.

16. Due to an inconsistency with the software used in the e-Government system, the Labour Inspectorate currently cannot access the registry of businesses maintained and updated by the Chamber of Commerce. This also affects the planning of labour inspections.

State may only inspect an employer once a year at maximum. Unscheduled inspections can be made only following the receipt of complaint letters, work accidents, or the violation of occupational health and safety regulations. Such restrictions impede the strategic conduct of labour inspections. The State Labour Inspectorate is of the view that labour inspections should be urgently removed from the scope of the above-mentioned Law.

The penalty per illegally employed person is 10,000 MDL (550 euro), which is much lower than in other states. For instance, the same fine is 3,000 euro in Romania. The labour inspectors do not have the right to fine directly, but must file the violation with the Court for a final ruling.

(5) Views of the social partners

The National Trade Union Confederation of Moldova has been supporting the National Action Plan for combating undeclared work through an information campaign. In the view of the trade unions, undeclared work is due to the high rates of tax and social security contributions, and the weak bargaining power of workers due to the scarcity of employment. In addition, the current penalty is too low. At the same time, there should be more incentives for compliance. Trade unions find it difficult to organize the workers in the informal economy due to their general lack of willingness to organize, although some of the informally employed workers seek the assistance of trade unions when they face problems.

According to the National Confederation of Employers of Moldova, employers are not solely responsible for undeclared work. Some workers ask for informal payment to have more take-home pay. It is unfair if declaring one's true income would result in paying more taxes and contributions without any additional benefits.

3.3 Social security coverage for farmers

In the Republic of Moldova, agriculture is a major economic sector. It accounted for 14 percent of GDP and employed 31 percent of the workforce in 2014. However, farmers and agricultural workers are one of the most disadvantaged groups. The agricultural sector has one of the highest occurrences of informal employment. In Moldova, more than 80 percent of workers in the agricultural sector work informally. Agricultural workers, especially own-account farmers in rural areas, are not adequately covered by social security. For these reasons, the social security coverage for agricultural workers requires focused attention.

(1) Current status of health insurance and social insurance coverage

Farmers and the self-employed are mandatorily covered by health insurance. The health insurance contribution for these groups is a fixed amount, set at 4,056 MDL in 2015. In 2014, there were 49,000 contributors in this category. Self-employed workers and farmers are eligible for discounted contributions if they pay their annual contributions by the end of March of that year. The rate of discount is 50 percent for self-employed workers and 75 percent for farmers. The rate of discount was 50 percent for both groups when it was first introduced in 2008, but was raised to 75 percent for farmers in 2010. About three-quarters of farmers apply this discount option.

Self-employed workers, such as individual entrepreneurs or lawyers, are mandatorily covered by the social insurance system. Their social insurance contribution rate is a flat-rate amount. In 2015, this contribution equalled 6,372 MDL per person per year. Unlike employees, self-employed workers pay their total contribution amount themselves.

On the other hand, farmers (owners and lessees of agricultural lands) are voluntarily covered by the social insurance system. The social insurance contribution rate for farmers is set at 25 percent of the flat-rate contribution for the self-employed. The annual amount of contribution for farmers was 1,584 MDL in 2015.

When the coverage of farmers (excluding their family members) became from mandatory to voluntary in 2009, the number of farmers covered by the social insurance system decreased dramatically, from 197,778 persons in 2008 to only 3,033 persons in 2009. The number has been declining ever since, reaching 1,302 persons in 2015, which is 0.7 percent of the number of farmers covered in 2008. Farmers and the self-employed may retroactively pay social security contributions to establish their right to benefits, but it is reported that this option is rarely used. This evidence indicates that, when farmers' participation in social insurance is voluntary, the existing preferential arrangements for farmers in the current social insurance legislation have very limited effects.

Farmers and the self-employed are treated differently in the benefit provisions. Although employees in the agricultural sector are entitled to all benefits despite their lower contribution rate, farmers and the self-employed are entitled only to the minimum old-age pension and funeral grant based on the flat-rate contributions. Furthermore, the minimum old-age pension for farmers is set at a lower level. In 2015, the minimum pension was 861.80 MDL for employees and 767.22 MDL for farmers. The average pension was 1,115 MDL, which is below the subsistence minimum level of 1,344 MDL. The minimum wage was 1,000 MDL in the public sector and 1,650 MDL in the private sector.

Under current law, workers who have been insured as farmers for at least a half of their insurance period are entitled only to the farmers' minimum pension, regardless of their other insurance periods. This incentivizes some farmers to stop their agricultural activities before the retirement age in order to receive a higher pension.

(2) Findings of the social security assessment survey for farmers

In November 2015, the ILO carried out a social security assessment survey to collect primary data on the living conditions, household income structure, and status of the social security coverage of 869 farmers' households in Moldova. To supplement the survey, interviews were carried out with a group of farmers and employers in the agricultural sector. The following summarizes the key findings of the survey.

Farmers' households receive low income. According to the survey, 66.8 percent of respondents' households earn an income less than 25,000 MDL per year, and 67.0 percent of households received less than 20 percent of their income from agriculture in cash.

Since farming does not provide sufficient income, households have to rely on other income sources. Farming is the main source of income for only 19.1 percent of the households surveyed. Income from employment represents the main source of income for 29.7 percent of the households surveyed. Additionally, 42.5 percent of respondents depend mainly on pensions and social benefits for their household income, which is consistent with the fact that many agricultural landowners are elderly.

The survey also confirmed that agricultural households are affected by irregular and seasonal income patterns. Only 51.0 percent of the households surveyed receive regular income, and many farmers are pensioners. While 52.5 percent of households receive their highest income during the harvest, 63.0 percent earn their lowest income during the winter. Many households receive no income during December and February.

Of all survey respondents, 72.3 percent are covered by health insurance, though 12.5 percent have no family member covered by health insurance. Among the respondents covered by health insurance, 40.1 percent pay contributions and 59.9 percent are covered by the State. Of the contributors, 47.1 percent pay health insurance contributions regularly, while 49.8 percent of them contributed when they urgently needed medical assistance. From our survey, 57.4 percent of the respondents knew about this discount programme.

Although the health insurance system has attained relatively wide coverage, the survey shows that the system still suffers from significant out-of-pocket payments and inaccessibility to health care services for many people living in rural areas. In the survey, 61.8 percent of respondents' households spend more than 1,000 MDL per year on out-of-pocket payments for health care. Although 76.4 percent of respondents' households have access to a medical centre located within 1 km, 69.7 percent must travel more than 10 km to visit the nearest hospital. Some farmers consider health insurance to be helpful only for hospitalization.

In the survey, 25.9 percent of respondents' households have no one paying social insurance contributions. For these farmers, the social security contributions are not affordable. According to the survey, 55.0 percent of respondents not paying social insurance contributions and 68.7 percent not paying health insurance contributions stated that they cannot afford to pay the contributions.

According to the survey results, 64.1 percent of respondents would need a pension amount that is more than 2,500 MDL per month. A pension level below 1,500 MDL per month was considered suitable by only 7.2 percent of people with an annual household income of 25,000 MDL or less. There is a huge discrepancy between the desired pension amount and the actual pension, since the average old-age pension for agricultural workers in 2014 was 950 MDL per month. However, a substantial increase in the pension amount would require additional resources. The survey shows that 47.8 percent of respondents would contribute more to receive a higher pension in the future, while 51.9 percent would not.

The farmers interviewed in the survey exhibited very negative views towards the State social insurance system and health insurance system, and to State systems generally. Of those respondents who were delinquent in their contributions, 9.2 percent stated that they do not need any pension or intentionally choose not to pay contributions, and 10.4 percent responded that they do not need health insurance.

Only 0.5 percent of respondents' households benefited from some kind of State assistance or subsidy during the last three years. In the interview, many farmers commented that the State subsidies favour larger farms, and that the rules governing the provision of State assistance and subsidies are not transparent.

Taking out private insurance for one's land or for a particular harvest is not popular. Only 4.4 percent of all respondents' households had insurance, although 22.8 percent of households with income exceeding 100,000 MDL had insurance. The private insurance market in Moldova is also underdeveloped.

4. Conclusion

4.1 Summary of the case studies of Bosnia and Herzegovina and the Republic of Moldova

In Bosnia and Herzegovina and the Republic of Moldova, the informal economy and undeclared work are major problems affecting the labour market governance, and thus are major obstacles in creating comprehensive social security systems.

In Bosnia and Herzegovina, it is estimated that 32.8 percent of the employed population worked in the informal economy in 2008. Informality is particularly high in agriculture (around 30 percent) and in unskilled jobs (more than 20 percent), and among workers aged 15–44 years. It is estimated that 10.7 percent of GDP was unreported in 2008. The estimated unpaid social security contributions amounts to 4.7 percent of GDP, and the estimated unpaid income tax amounts to 0.5 percent of GDP.

In the Republic of Moldova, 34.8 percent of the employed population had an informal job as their main job in 2015. Informal employment is a commonly exercised practice in the private sector, as almost all (99.8 percent in 2013) informal employment occurs in the private sector. Informality is particularly high in agriculture (82.4 percent in 2015). The estimated amount of undeclared income due to informal employment and under-declaration equalled 12.9 percent of GDP in 2010. The estimated unpaid social security contributions from undeclared income equalled 5.2 percent of GDP, consisting of 4.1 percent of GDP for social insurance and 1.1 percent of GDP for health insurance.

This evidence suggests that informal employment, especially undeclared work, is widely used and accepted as a necessary vice in both countries. The failure of the past unsustainable interventions in the Federation of Bosnia and Herzegovina, and the recent slowdown in the transition from the informal to formal economy in the Republic of Moldova, indicate the resilience of the informal economy.

The population coverage of social security differs by type of benefit. Both countries have attained nearly universal health insurance coverage, protecting more than 80 percent of the total population. In both countries, the State plays a crucial role in subsidizing the population with a low contributory capacity.

In contrast, the coverage is lower for social security benefits aimed at income security (such as old-age, disability and survivors' pensions, sickness benefits, maternity benefits, and unemployment benefits). Unlike health insurance, the rights related to these benefits are acquired by paying contributions to the systems, and their levels depend on one's contributions. Consequently, their coverage is limited to the population with a contributory capacity, consisting essentially of employees in the formal economy.

In the Republic of Moldova, farmers and the self-employed are entitled only to the minimum old-age pension and funeral grant based on flat-rate contributions. Furthermore, the minimum old-age pension for farmers is set at a lower level. There is a huge discrepancy between the desired pension amount and the actual pension. When the social insurance coverage of farmers became no longer mandatory, their actual coverage decreased to a minimal level.

Although effective measures to improve social security coverage are limited, there exist some good practices that have achieved visible results in increasing the number of contributors. In the Republic of Moldova, patented workers must pay social insurance and health insurance contributions when they

4. CONCLUSION

renew their licenses. In the Republika Srpska, the payment of health insurance contributions is linked with other special benefits for farmers, such as discounted chemical materials.

Both countries have already implemented a unified collection system for social security contributions and taxes by the tax authority. Although more evidence is needed to evaluate the effectiveness of the unified collection systems, the effective collaboration between the tax authority and the social security institutions is crucial for the successful implementation of this policy. In particular, a closer collaboration is required for inspections and controls, and for exchanging individual members' records.

4.2 Barriers in extending social security to the informal economy

Historically, social security systems were first developed for wage and salary workers in the formal employment sector. Therefore, if the same approach is applied to workers in the informal economy without taking into account their characteristics, the extension of the coverage may face various challenges, particularly in registration, compliance, contribution collection, and record-keeping.

The weak contributory capacity of workers in the informal economy due to their low and irregular income is a major obstacle in ensuring revenue for the social security systems. Since most workers in the informal economy receive irregular income, it is difficult to establish a reliable monthly contribution base. Delays and irregularities are frequently found between the actual work being done and payment being received. The frequent changes in informal work activities also contribute to the variable nature of their income. In the absence of employers' participation or State subsidies, the total contributions are not affordable for most workers in the informal economy.

The benefit design is also not responsive to the priority needs and resource constraints of workers in the informal economy. For instance, it would be difficult for workers in the informal economy to meet the qualifying condition for pensions, which usually requires a contribution period of at least ten years. Furthermore, regardless of informality, the lack of access to social security offices and service providers (such as secondary and tertiary health care providers) in rural areas makes it difficult for workers to join the system.

On the other hand, the social security institutions as well as the tax authorities and labour inspectorates do not have the capacity to effectively enforce the law compliance and to efficiently collect contributions. The prevalence of the under-declaration of income far exceeds the capacity of the control authorities. This makes it difficult for the relevant authorities to consistently apply sanctions throughout the country. As a result, most violations involving penalties end up in lengthy Court processes. The penalty levels in these countries are also relatively low in comparison with neighbouring countries.

Unless employers voluntarily comply with the contribution payment on behalf of their employees (which is rare), the efficient collection of contributions is difficult within the existing administrative infrastructure. Complex administrative procedures also represent a major bottleneck for contribution payment, in particular for small and micro-enterprises. The extensive amount of documents required for registering employees and paying regular contributions are not easily available to employers

The under-declaration of income also negatively affects the financing of the social security systems. If the contribution base represents only a portion of the workers' actual income, then the nominal contribution rates turn out to be relatively high.¹⁷ Such high contribution rates act as a high barrier for the

17. The total social security contribution rate is 41.5 percent in the Federation of Bosnia and Herzegovina, 33 percent in the Republika Srpska, and 38 percent in the Republic of Moldova.

participation of informally employed workers, and unfair burden the public and private sector workers within the formally employed population. The high tax wedge may also undermine the competitiveness of the countries, and discourage foreign investment.

The decision for employers and employees to under-declare their income depends on the potential pay-off between the gains in avoiding social security contributions and the costs of doing so – loss of benefits, penalties, administrative costs. However, it is possible that those engaging in undeclared work are not acting rationally for various reasons.¹⁸ Influenced by myopia, they tend to underestimate the value of the benefits they lose in the future and prefer immediate gain. This may be due to a lack of awareness of the social security concept and insufficient information about their benefit entitlements, coupled with weak financial literacy. In some countries, employment opportunities are so scarce that workers have little bargaining power to resist undeclared work.

Pension systems in Central and Eastern Europe have been suffering from sizable financial deficits, caused mainly by the policy to grant pensions to massive numbers of redundant workers in the transition period of the 1990s. In order to restore the financial sustainability of the pension systems, these countries have enacted a series of reform measures. As a result, a greater emphasis is placed on the contributory principle, and the benefit levels are more directly linked with the actually paid contributions. These conditions give rise to serious concerns about the adequacy of income security. The declining benefit levels and coverage gaps in the contributory social insurance systems will result in an increasing number of persons without adequate income protection.

Although the health care expenditure is more or less met by the current resources, an overwhelming portion of the revenue (87.2 percent in the case of the Republika Srpska) consists of employees' contributions. Thus, despite the State's participation in the health care financing, the employees are cross-subsidizing the rest of the population. In view of the rising health care costs due to an ageing population, the current health care financing mechanisms could eventually reach an impasse in the future.

Moreover, workers in the informal economy generally do not trust social security systems or any State institutions. This lack of confidence may have serious negative impacts on the proper functioning of social security systems, and a detrimental influence on future membership. It can lead to fraudulent attempts, such as claiming benefits without making sufficient contributions, or the apathetic view that one's family, community, or State will provide eventual support in the event of difficulties.

4.3 Policies for extending social security to the informal economy

Tackling informal employment and undeclared work requires coordinated and concerted actions of all stakeholders involved, notably the labour inspectorate, the tax authority and the social partners. Policies to extend the social security coverage to the informal economy should take into account the following issues.

(1) Improving compliance and contribution collection for undeclared work

Generally, actions against undeclared work consist of a combination of measures promoting self-compliance, through removing disincentives and providing appropriate incentives, and measures strengthening enforcement, through inspections, controls and sanctions.

18. The results of a survey of EU countries also suggest that many of those engaged in undeclared work do not appear to be rational economic agents but rather motivated by other social goals, such as redistribution. See EC (2014a).

4. CONCLUSION

In order for workers and employers to declare their full income, they should be convinced that it is worth while to make additional contributions. This may be difficult for health insurance as the benefits are in-kind and not linked with contributions. For cash benefits, the incentive is already built into the benefit formula that increases with one's contributions. However, in the lower income countries in Central and Eastern Europe, where the differences between the minimum and maximum benefits are relatively narrow, the extra benefit from additional contributions is rather limited.

Thus, the incentive measures should be complemented by enforcement measures. As noted earlier, there is still room for improvement in this regard. Focus should be placed on strengthening enforcement capacities of the responsible authorities, including the labour inspectorates and the tax authorities. The effectiveness of this approach depends on the reach of the control authorities and the credibility of threat they pose with the fines. Under the unified collection system, tax collectors are required to have a broad range of knowledge on the social security legislation. To supplement the specific knowledge, the tax authority can involve the social security institutions and jointly conduct inspections or collect contributions. The control authorities should respond more decisively to violation cases, strategically employing the use of sanctions and prosecution. Such actions will contribute to creating a public recognition of the risks and penalties involved in attempting to defraud the social security systems.

Efforts should also be made to improve administrative efficiency. This can be achieved through greater use of the information and communication technology for compliance and collection. The technology enables one to detect incorrect contributions and payments at an early stage, facilitate the data exchange between institutions, and improve communication between the social security institutions and their members. At the same time, the administrative procedures should be made simpler and more transparent while meeting essential requirements.

In the absence of a regular fixed income, a proxy measure can be used for one's contribution base. The measure should represent a notional income, which can be linked to the minimum wage or the average wage. The payment method should allow for flexibility by taking into account the irregularities in workers' income patterns, and should account for cases of force majeure, such as natural disaster. Sometimes, the major obstacle for people joining social security systems is a lack of cash income. In this case, subsidies for low-income groups could also be considered.

(2) Extending the social security coverage for informally employed workers

The fact that most countries in Central and Eastern Europe have attained reasonably high health insurance coverage implies that health insurance is considered to be the national priority among the social security benefits. The full achievement of universal health insurance coverage is feasible. In pursuing this goal, the State should play a key role in subsidizing the currently uninsured population.

To improve the coverage of contributory social security benefits, the social security organizations and other relevant authorities should adopt a flexible and progressive approach that takes into account the specific conditions of workers in the informal economy.¹⁹ In view of the good practices of the patented workers in the Republic of Moldova and farmers in the Republika Srpska in Bosnia and Herzegovina, similar "piggybacking" measures could be further implemented to improve the law compliance and contribution collection.

19. In this regard, Article 19 of the ILO Transition from the Informal to the Formal Economy Recommendation No. 204 (2015) states that "through the transition to the formal economy, Members should progressively extend the coverage of social insurance to those in the informal economy and, if necessary, adapt administrative procedures, benefits and contributions, taking into account their contributory capacity."

Although the completion of a certain contribution period is necessary for qualifying for cash benefits, requiring an excessively long qualifying period will make it practically impossible for informally employed workers to obtain the benefit rights. The eligibility conditions should take this into consideration. The requirement of uninterrupted contribution period should at least be avoided, in view of the frequent changes in employment status that characterize informally employed workers.

Social security institutions should tailor their services to the conditions of the target groups. The staff should be trained with the appropriate knowledge and skills to respond to the informal economy. In a country where many workers live far from the social security offices (such as farmers in rural areas), greater efforts should be made to improve access to these services. One-stop shops that offer all services in one place are a recommendable option. Other local networks, such as postal services, local commercial banks, community centres, and cooperatives, should also be used to canvas for potential members. Longer opening hours and less bureaucracy will provide additional incentives to join the system. It is also effective to utilize communication tools such as telephone helplines, social media, or other web-based outlets.

A more involved option for providing minimum income security within the national social security systems is to introduce a non-contributory universal benefit scheme, with or without a means-test. One idea is to introduce a social pension that provides a flat-rate benefit for all elderly persons, for example, aged 65 years or above. Although this option could rapidly achieve universal coverage, creating and sustaining the fiscal space would be the foremost issue. In addition, the system would face the complex problem of how to deal with workers' past contribution periods.

(3) Building public confidence in social security

Many conventional measures to extend social security are based on a two-pronged approach of incentives and enforcement ("carrots and sticks"). More fundamentally, however, the importance of the commitment of all actors involved cannot be over-emphasized. Unless there is confidence in the social security system, it will be extremely difficult to build a climate of support for desirable changes.²⁰ Therefore, the aforementioned measures should be supported by the efforts to create a "social security culture" that fosters trust in the social security systems. Clearly, such a culture cannot be built overnight. The continuous efforts of all stakeholders involved are essential.

For this purpose, awareness raising and education play a key role in developing a better understanding of the value of social security benefits and fostering positive attitudes towards full participation in social security systems. To this end, the ILO conducted an awareness-raising campaign in 2016 in the Republic of Moldova on informal employment and undeclared work, which is summarized in the Box below.

4.4 Concluding remarks

The informal economy, particularly undeclared work, is a deep-rooted problem. Policies for the transition to formality and for the reduction of undeclared work, therefore, require the long-term commitment and continuous efforts of all stakeholders. Above all, there should be a strong political will to change the current situation.

20. An analysis based on a survey of EU countries shows that undeclared work, as measured by the share of envelope wages, is negatively correlated with Government spending on social security, health, and education, and positively correlated with the level of taxpayers' dissatisfaction with public services and social security benefits. See EC (2014a).

4. CONCLUSION

The ILO should assist the Governments and the social partners in developing national strategies for a comprehensive social security system. Such national strategies should aim for universal social security coverage in compliance with the ILO Social Protection Floors Recommendation No. 202. The ILO should also play an important role in promoting formal employment and reducing undeclared work in line with the ILO Transition from the Informal to the Formal Economy Recommendation No. 204.

* * *

Box. Awareness-raising campaign on informal employment and undeclared work in the Republic of Moldova in 2016

The Republic of Moldova is committed to tackling its informal economy through the implementation of the National Action Plan, adopted in 2011. The Plan sets out the country's goals and concrete steps to reduce the informal economy. It aims to address undeclared work, especially the underreporting of wages to avoid tax and social security contributions.

To support this process, the ILO assists the Government and social partners in promoting the formalization of informal employment and in reducing undeclared work in accordance with

- the Social Protection Floors Recommendation, No. 202 (2012); and,
- the Transition from the Informal to the Formal Economy Recommendation, No. 204 (2015).

The main objective of the campaign is to increase awareness among the target groups about the benefits and advantages of formal employment and declared work, thereby promoting a culture of compliance and encouraging the transition to the formal economy.

The campaign has adopted three key messages to educate and inform the target groups, and for generating behavioural and attitude changes. These are:

Message 1: I contribute, therefore I benefit from social security;

Message 2: Ask for your labour contract; and,

Message 3: Say NO to envelope wages.

The campaign broadcasts video and radio clips daily, publicizes billboard panels and posters in public places, and disseminates leaflets to reach a wide range of the population who are currently or potentially involved in informal employment across the country.



Source: ILO (2016b)

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