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THE INFORMAL ECONOMY

IN THE REPUBLIC OF MOLDOVA:
A COMPREHENSIVE REVIEW



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First published 2016

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The informal economy in the Republic of Moldova: a comprehensive review = Economia Informală în Republica Moldova: o analiză cuprinzătoare / Ana Popa, Adrian Lupușor, Iulian Roșca, Kenichi Hirose, Miloslav Hetteş; International Labour Organization; ILO DWT and Country Office for Central and Eastern Europe. - Budapest: ILO, 2016

ISBN: 9789220308554; 9789220308561 (web pdf)

International Labour Organization; ILO DWT and Country Office for Central and Eastern Europe

informal economy / informal employment / demographic aspect / economic implication / precarious employment / temporary employment / self employment / social security / Moldova, Republic

03.01.5

ILO Cataloguing in Publication Data

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Printed in Moldova

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Foreword

The ILO has identified the formalization of the informal economy as an area of critical importance. A standard-setting item on facilitating transitions from the informal to the formal economy was discussed by the International Labour Conference in 2014 and resulted in the adoption of the Recommendation concerning the transition from the informal to the formal economy, 2015 (No. 204).

In this context, the ILO DWT/CO-Budapest implemented a project in 2014-2015 to contribute to the design and implementation of policies that will improve the quality and productivity of jobs in the Republic of Moldova through the formalization of the informal economy. Due to the heterogeneity in the informal economy, transition to formal economy requires an integrated approach that combines incentives with enforcement and compliance measures to i) facilitate the transition of workers and economic units from the informal to the formal economy, ii) promote the creation, preservation and sustainability of enterprises and decent jobs in the formal economy and iii) prevent informalization of formal jobs. The publication of this comprehensive review is intended as a contribution to the ongoing policy debate on the formalization of the informal economy in the country.

The initial assessment of the informal economy was carried out in 2014 by Mr. Adrian Lupusor, Ms. Ana Popa, Mr. Iulian Rosca, Mr. Miroslav Hettes and Mr. Kenichi Hirose, authors of the report. The draft assessment was presented, discussed and validated at a tripartite workshop in Chisinau in March 2015. The study was finalized after the workshop, based on the comments received by representatives of the government, employers' organizations and workers' organizations. It provided the basis for the development of strategies, policy measures and advocacy to address undeclared work, to reach out to entrepreneurs and workers in the informal economy and to facilitate transitions to formality.

This comprehensive review was prepared through the joint collaboration of the ILO Decent Work Technical Support Team and Country Office for Central and Eastern Europe (ILO DWT/CO-Budapest). Ms. Cristina Miheș, Mr. Kenichi Hirose and Ms. Sofia Amaral de Oliveira are the technical editors of the report. Mr. Dragan Radic, Mr. Mauricio Dierckxsens and Mr. Ovidiu Jurca provided technical comments to earlier drafts. Ms. Ildiko Rigo and Ms. Lilian Orz provided administrative assistance. Ms. Athena Bochanis, former intern at ILO DWT/CO-Budapest, provided editorial assistance in finalizing this report.

Special thanks go to Ms. Sandra Yu(INWORK) and Ms. Maria-Luz Vega (EUROPE) for the technical comments provided to earlier drafts and to the final version of the comprehensive review.

I would like to take this opportunity to extend my appreciation to Ms. Ala Lipciu, ILO National Coordinator, Ms. Oxana Lipcanu, National Coordinator *ad interim* and Ms. Cornelia Juncu, project assistant, for their valuable contribution to this comprehensive review, as well as for the support provided in organizing the workshops and project activities in Moldova.

The opinions expressed in this report do not necessarily reflect the views of the ILO.

Budapest, December 2015.

Antonio Graziosi

Director

ILO DWT/CO Budapest

List of Acronyms

CIS	— Commonwealth of Independent States
EU	— European Union
GDP	— Gross Domestic Product
GVA	— Gross Value Added
HBS	— Household Budget Survey
ILO	— International Labour Organization/Office
ISCED	— International Standard Classification of Education
ISCO	— International Standard Classification of Occupations
ISWGNA	— Inter-secretariat Working Group on National Accounts
LFS	— Labour Force Survey
NBS	— National Bureau of Statistics
SNA	— The System of National Accounts
UN	— United Nations
VAT	— Value Added Tax

Executive summary

The informal economy is a complex phenomenon influenced by a wide range of economic, social, institutional and cultural factors, which vary from one country to another. According to the ILO Recommendation concerning the transition from the informal to the formal economy, No. 204, adopted in June 2015,¹ **the informal 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.” It does not cover illicit activities.** The work in the informal economy is frequently accompanied with low-pay and precarious working conditions.

In the context of countries in Central and Eastern Europe, the informal economy is characterized by economic activities outside the formal reach of labour legislation, as well as by economic activities within the formal reach of the law, but for which the law is not effectively enforced or simply not applied in practice. Examples include enterprises operating without business registration, wage workers working without proper employment contract, and self-employed workers in micro-enterprises, operating on their own or with family workers. Under these circumstances, workers lack representation, right to association or social protection. A typical case in the region is undeclared work - also a major component of the informal economy in European countries - which is defined by the European Commission as “any paid activities that are lawful as regards their nature but not declared to public authorities, taking into account differences in the regulatory system of the EU Member States.”²

The informal economy in Moldova is influenced by the costs of formalization compared to the costs of staying or becoming informal. The returns to taxes paid are perceived as being insignificant and the phenomenon of undeclared wages is widespread: a study by the Ministry of Labour, Social Protection and Family in 2011 estimated that 57 per cent of the employed population did not report fully their salaries in 2010. The existing regulatory framework, the relatively high costs of credit, the constraints to technological absorption and innovation, combined with the low probability of being identified and penalized, the low levels of fines and low access to an effective justice system are key factors driving the informal economy in the country.

Informality generates significant losses for the national budget and excludes part of the work force from labour and social protection. According to the methodology for measuring informality used by the National Bureau of Statistics, the “non-observed” economy in Moldova decreased significantly until 2007, followed by a slight increase afterwards up to **23.1 per cent of GDP in 2013**. Informality is highly concentrated in a few sectors. The leading sector is agriculture with high production of households for final use, but high shares are registered in construction and trade as informal sector production and hotels and restaurants as hidden production in the formal sector.

30.9 per cent of the total employed population in the Republic of Moldova had an informal job in 2013. 68.7 per cent of informal jobs are in the agricultural sector. The number of informal jobs decreased in almost all sectors except construction. The most important part of informal employment is represented by own-account workers in informal sector enterprises. While informal employment in formal sector enterprises affected more than 60 thousand people in 2013, it decreased significantly since 2003.

Some segments of the population are more likely to be in informal employment:

- While men and women had the same probability in participating in an informal job in the early 2000s, in 2013 the share of informal employment in total employment was 34.1 per cent for men compared 27.1 per cent for women.

1 Text available at:

http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:R204

2 European Commission (2007), Stepping up the fight against undeclared work. COM(2007) 628 final. [EC 2007].

- Informal employment is more widespread among the youngest population (15-24 years) and graduates of lower levels of education, as a consequence of labour market needs and educational system outputs.
- The largest share of informal jobs are in elementary occupations. Thus, many low skilled enter the labour market on the informal side and are caught in an informal employment trap, since there is no demand for them in the formal labour market.
- The most significant discrepancies in informal employment in Moldova are between rural and urban residents. While only 13.5 per cent of urban employed population had an informal job, this share for rural population was 46.4 per cent in 2013. Most of the informal employment in rural areas is concentrated in the households, specifically in agricultural sector.

Informal employment is more insecure and of shorter duration. 64 per cent of those who reported an informal job were employed in the position less than for 2 years. The population with an informal job seems to be more dissatisfied with their current status as 25.4 per cent reported they wanted to change the situation at their job, compared to 18.8 per cent of those in formal employment.

The general trend of the national labour legislation is to increase the diversity of contracts that serve as the basis for subordinated employment. However, the available types of employment contracts have not played as incentives to formalization of informal employment in Moldova.

Existing statistical data on NSFE indicates a significant share of fixed-term or temporary employment in the informal sector, i.e. 40.2 per cent as compared to 3.6 per cent in the formal one. The highest incidence of fixed-term employment is in the agricultural sector (35.4 per cent) and activities of households as employers (17.5 per cent). At the same time, the share of fixed-term employment contracts is also high in public administration and education.

Seasonal work was reported by 16.5 per cent of fixed-term employees in 2013. These jobs are concentrated in the agricultural sector (77.2 per cent), manufacturing (given the high share of food processing industry which implies seasonality) and construction. Casual work was reported by 5.3 per cent of fixed-term employees in 2013. The employees worked predominantly in construction (35 per cent) and agricultural (32 per cent) sectors.

7.2 per cent of employed population had a part-time schedule in 2013: the incidence was 3.8 per cent in formal employment and 14.7 per cent in informal employment. Part-time employment is more common among own-account workers and contributing family members.

While Moldova has attained nearly universal health insurance coverage, social security benefits aiming at income security are essentially limited to employees in the formal economy. Agricultural workers – notably, farmers in rural areas – represent a typical group not adequately covered by social security. Although a social assistance system for the poor is in place in the country, its scope and level are subject to fiscal constraints due to austerity measures.

Furthermore, under-declaration of income negatively affects the financing of social security systems. If the contribution base represents only a portion of the actual income, then the nominal contribution rates turn out to be relatively high. This not only acts as a higher barrier for participation by the informally employed population but also results in unfair sharing of tax burden between the public and private sector workers within the formally employed population. Regarding pensions, the declining level of benefits and the gap in the coverage of the contributory social insurance systems is expected to result in an increasing number of persons without an adequate income protection.

In this context, the following **conclusion** emerges from the review of the informal economy

Republic of Moldova:

- Social dialogue mechanisms and collective bargaining can play an active role in the design and implementation of policies for the formalization of the informal economy. It is necessary to reactivate and ensure a smoother and more dynamic functioning of the National Commission for Collective Consultations and Bargaining, by involving more actively the trade unions and employers' organizations. The Commission should also have an advisory and monitoring role on issues relating to the informal economy. On the other hand, collective bargaining can promote decent working conditions for workers in the informal economy, namely through negotiation on branch/sector collective agreements in agriculture and construction including measures to promote formalization and by ensuring labour protection to workers in non-standard forms of employment.
- Measures should be in place to reduce the cost of formal economic activities, create incentives for their formalization, promote skills and provide opportunities for those who are more likely to be trapped in the informal economy, namely:
 - Easing the administrative burden on firms by speeding up, simplifying procedures and increasing the transparency for obtaining licenses, authorizations and other documents required for entrepreneurial activity;
 - Easing the access to financing for companies working formally;
 - The fiscal policy should be transparent, well-communicated to and well-understood by the contributors;
 - Providing incentives for small and medium size enterprises, in terms of granting tax exemptions at the beginning of activity, modification of threshold for taxable income, tax incentives for enterprises established and managed by young people, those dealing with education, etc.;
 - Providing incentives for start-ups and for investment in technologies and know-how, Increasing the level of technological readiness and absorption of firms and putting more emphasis on technical specializations in educational institutions;
 - Increasing enrollment young people with low education and skills in education, ensuring better quality of vocational education, implementing a system of recognition of qualifications acquired at work and in non-formal education which would facilitate the advancement of workers with a possible migration to a formal job;
 - Supporting women participation in the labour market: creation of affordable and quality childcare facilities for younger children throughout the country, revising the existing legal framework for childcare leave combining reasonable duration with an increase in the remuneration for such leave to 100 per cent of the previous earnings, encouraging fathers to take up childcare leave and ensuring the possibility for both parents to make use of flexible working time arrangements;
 - Supporting the participation of the rural population in the formal labour market: It is necessary to create more opportunities for investment in the rural areas by enhancing basic infrastructure (e.g. roads, sewage systems, access to electricity etc.). Additionally, the Ministry of Labour and the national Employment Agency, together with the social partners, should devise active labour market measures to address the needs of young people and women in rural areas. Women in villages have less access to information and this is an obstacle in their organization and entrepreneurship development. The rural population should be involved more actively in education and training. Young people should be better informed about the skills that are (and will continue to be in

the future) in demand on the labour market.

- The efficiency and operational monitoring capacity of tax and labour inspections to combat undeclared work should be increased, namely through strengthening the capacities of the institutions responsible for labour and tax inspections, ensuring legal mechanisms through which the cooperation among these institutions would be formalized and enforced, exchanging of information among key institutions responsible for preventing tax evasion, carrying out joint inspections involving several competent bodies and targeting of sectors that are mostly exposed to informal economy.
- There is a need to reform the legal and institutional framework for labour inspection. Although the national legislation contains provisions to identify and combat cases of undeclared work, currently the functional controlling power of the State Inspection of Labour is limited, which causes inefficiency and limited operational and monitoring capacity of this authority. The Government should take the necessary steps to continue to discuss these matters with the social partners at the national level, with a view to bringing the national legal framework into conformity with ILO Convention No. 81. The Government could also consider availing itself of ILO technical assistance to this end.
- The levels of fines for firms not complying with the relevant tax, social security and labour regulations should be increased. As the Contravention Code provides for a ceiling on administrative fines and prevents their further increase for informal work, consideration could also be given to establishing criminal liability for employing undeclared workers along with administrative liability depending on the degree of social harm caused.
- Amending the legal framework in line with international standards on part-time work and on private employment agencies, regulation of the temporary employment relations of seasonal or day workers and simplification of registration procedures of individual labour contracts with employees who perform work of a casual nature, e.g. in domestic work or agriculture, may encourage the formalization of informal employment, ensure access to social protection and bring these workers under the coverage of the law.
- A national strategy for achieving a comprehensive social security in line with ILO Social Protection Floors Recommendation No. 202 (2012) should be developed to progressively extend coverage to the currently uncovered population in the informal economy, as well as to address the issue of undeclared work through measures to improve the compliance and contribution collection. The strategy should formulate and prioritize the course of actions with a road map of implementation defining major milestones in the short- and long-term.
- Moldova has already implemented the unified collection of social security contributions and taxes by the tax authority. Although it is too early to evaluate its long-term effectiveness, it is evident that an effective and closer collaboration between the tax authority and the social security institutions is required in the areas of inspections and controls, as well as the exchange of individual members' records. To supplement specific knowledge on social security legislation, the tax authority can involve social security institutions and jointly conduct inspections and contribution collection.
- Ongoing campaign contributes to combating undeclared work and promoting the formalization of the informal economy by raising awareness of the population in general and of employers and workers on their rights and obligations under the existing legal framework, on the risks of working without a contract or receiving "envelope wages", as well as on the benefits of formalization. Additionally, it should encourage the employees to verify and monitor the social security contributions, by using the electronic system of personal accounts that has been set up by the National Commission for Social Insurance.

Actions include, among others:

- Press releases, notes or thematic articles regularly published in local newspapers;
- Informative programs on local TV stations;
- Information materials the benefits of formalization and existing labour rights
- strengthening trade unions capacity on issues of labour law and how to reach workers in the informal economy;
- Awareness-raising campaigns addressed to the population in general to encourage payment of contributions, taxes and use of electronic means of payment;
- All relevant information for workers and employers in urban and rural areas to be made available through a dedicated webpage of the National Commission on Consultations and Collective Bargaining (NCCCB).

The informal economy is a deep-rooted issue in the country. Policies to promote formalization and to reduce of undeclared work therefore require a long-term commitment and continuous efforts of all stakeholders. The tripartite constituents in Moldova recognize that the informal economy is one of the most serious problems in labour market governance and that it is a major obstacle in creating a comprehensive social security system for all. The Government, in consultation with the social partners, should further engage in designing and implementing an integrated policy framework to support the transition from the informal to the formal economy, in line with ILO Recommendation No. 204. The ILO stands ready to provide further assistance as a follow up to the recommendation.

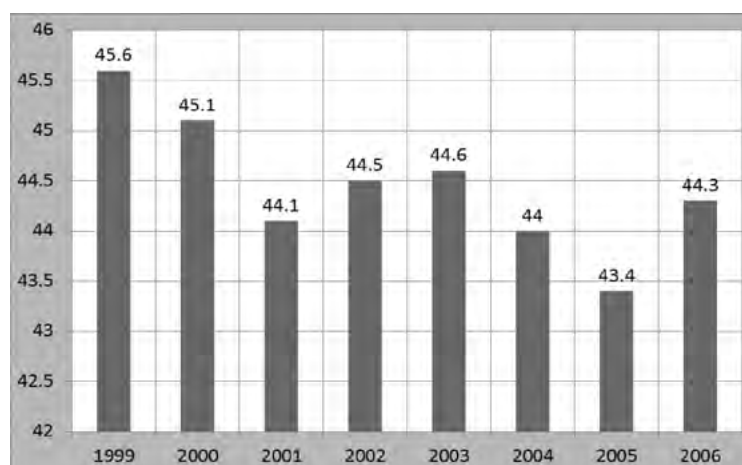
Chapter 1. Trends in the informal economy and informal employment in the Republic of Moldova

1.1. Size and evolution of the informal economy in the Republic of Moldova

The difficult economic period following the collapse of the Soviet Union, including the regional economic and financial crisis that hit Moldova at the end of the first decade of transition, led to bankruptcy and losses for many enterprises. This increased the incentives for fiscal evasion and for establishing informal enterprises. These factors, along with the already widespread practice of subsistence activities with no legal status, rapidly and significantly expanded the size of informal economy in Moldova. Although it is difficult to estimate the exact size of informal economy because of missing, hidden, or uncertain data, and significant differences between the existent methodologies, it is certain that informality is an important part of the economy of the Republic of Moldova. This informal economy generates significant losses for the national budget and creates insecurity among part of the labour force.

An early comparative study of Schneider et al (2010) estimates the size of the shadow economy (which can be used as a proxy for the informal economy) from 1999 to 2006 in 162 countries, including Moldova. The study measures the shadow economy, which includes all market-based legal production of goods and services that are deliberately concealed from the public authorities. It excludes classic economic crime activities, which are illegal, and the informal household economy, which consists of all household services and production. The calculations reveal a high share of shadow economy activities around the millennium: up to 44.5 per cent of the Gross Domestic Product from 1999 to 2007. There is no clear trend identified during this period, as the share of the shadow economy decreased by less than one per cent between 1999 and 2006 (see Chart 1).

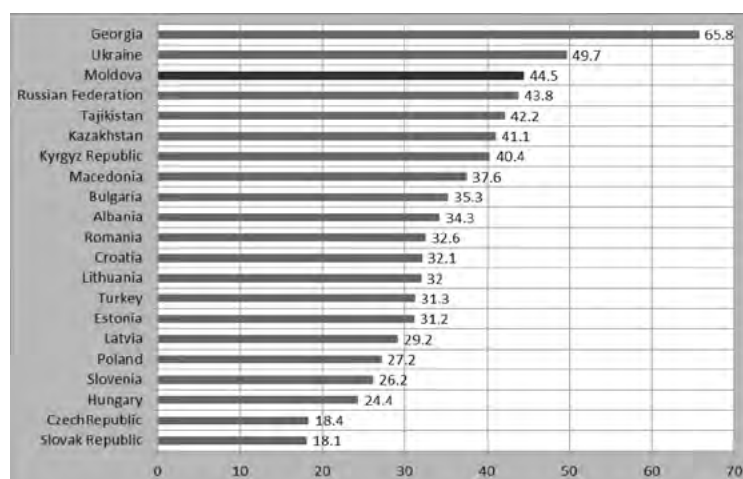
Chart 1. The evolution of the shadow economy in Moldova, % of GDP, 1999–2006



Source: Schneider et al., “Shadow Economies all over the World: New Estimates for 162 Countries from 1999 to 2007”, 2010.

Comparatively, Moldova performed better than some of the CIS countries, with a lower share of the shadow economy in their GDP in the 1999–2007 period. However, the magnitude of the Moldovan shadow economy was significantly higher than in the European transition countries that started their reforms earlier and are currently EU members or candidate countries (see Chart 2).

Chart 2. Size of the shadow economy in transition countries, % of GDP, 1999–2007



Source: Schneider et al., “Shadow Economies all over the World: New Estimates for 162 Countries from 1999 to 2007”, 2010.

While useful for observing the trends of the informal and shadow economies and for making regional comparisons, the estimation of the informal economy based on macro-economic models like the one used by Schneider may yield grossly exaggerated results, according to the Declaration of the ISWGNA (2006).

Therefore, the National Bureau of Statistics (NBS) in Moldova uses both the System of National Accounts, based on the United Nations (UN) recommendations, version 1993 (SNA, UN-1993), and the recommendations included in the “Measurement of Non-Observed Economy” manual to define the non-observed economy. The non-observed economy includes the following components¹:

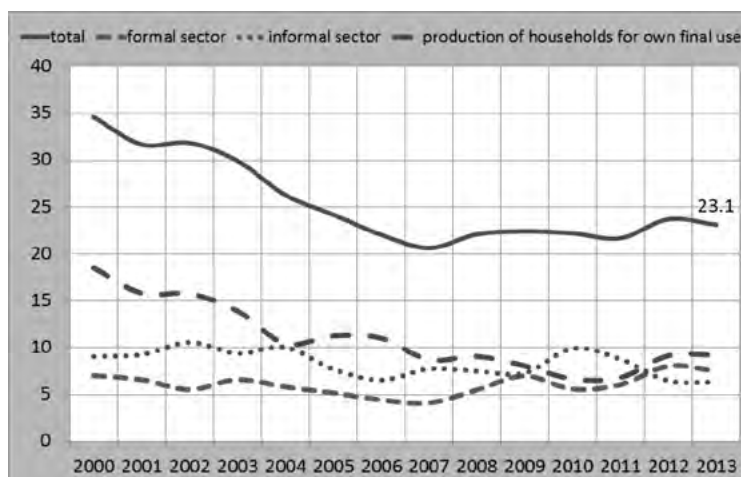
- **informal sector production**, defined as those market activities conducted by unincorporated enterprises in the household sector that are unregistered or are less than a specified size in terms of employment²;
- **household production for own use**, defined as those productive activities that result in goods or services consumed or capitalized by the households that produce them;
- **hidden production in the formal sector**, defined as those activities that are productive and legal but are deliberately concealed from the public authorities to avoid tax payment or regulation compliance; and
- **illegal production**, defined as those productive activities that generate goods and services forbidden by law or that are unlawful when carried out by unauthorized producers.

Currently, the NBS does not calculate illegal production due to unsound existent methodologies. There are few countries that have integrated the illegal sector production estimates into their national accounts. Thus, the non-observed economy that can be estimated comprises only the first three components listed above: informal sector production, household production for one’s own use and hidden production in the formal sector. Based on this methodology, the non-observed economy represented 23.1 per cent of GDP in 2013. This was significantly lower than the 34.6 per cent reported in 2000 (Chart 3).

1 For the full methodology and definitions, see “Measurement of elements of non-observed economy in the Republic of Moldova”, Department for Statistics and Sociology of the Republic Moldova, 2003.

2 Moldova uses only the non-registration criteria, not size criteria, for the estimation of informal sector production.

Chart 3. Size of non-observed economy by main components, % of GDP, 2000–2013



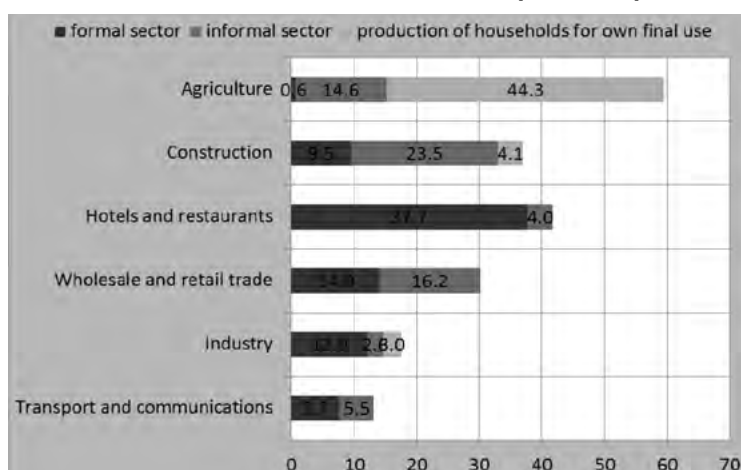
Source: National Bureau of Statistics.

Thus, the major developments from 2003 to 2013 are as follows:

- *There was a significant decline in the household production for own use component.* While the most significant part of the non-observed economy in 2000 was household production for the household's own final use, accounting for over half of the total non-observed economy, its share decreased significantly. Currently, it accounts for 40 per cent of the non-observed economy, slightly above the other two components. Most of this takes place in the agricultural sector, and the share of the agricultural sector in the non-observed economy also decreased from 55.5 per cent in 2000 to 31.7 per cent in 2012. However, informality in agricultural sector is still very high: about 62 per cent of the gross value added (GVA) in the sector was produced in the non-observed economy.
- *The hidden production in the formal sector has not fallen since 2007.* While some progress was made before 2007 in diminishing the size of the informal economy in formal sector, the trend reversed recently. It denotes the inefficiency of some policies and reforms instituted during this period, and new or stronger incentives for undeclared profits, work and activities, as shown in Chapter 2.

The non-observed economy is concentrated in a few sectors. While the agricultural sector is the leading sector, there are other sectors with relatively high shares of non-observed GVA: construction, hotels and restaurants, and trade. In contrast to the agricultural sector, where the highest share is in the household production for their own consumption, these sectors' non-observed production takes place in informal and formal sector enterprises (Chart 4).

Chart 4. Share of the non-observed economy in GVA by economic activities, % of GVA, 2013



Source: National Bureau of Statistics.

While there is no available data on informality by size of enterprise, it seems to be more common in small and medium-sized enterprises, at least in the manufacturing sector. For more about the incentives of smaller enterprises to enter the informal economy, see Chapter 2.

Chart 5. Indicators of informality for manufacturing firms, %, 2013



Source: World Bank Enterprise Survey 2013, available at <http://www.enterprisesurveys.org/data/exploreeconomies/2013/moldova#informality--size>.

The increasing size of the non-observed economy leads to a rising fiscal gap in the Republic of Moldova, referring to the difference between potential and collected fiscal incomes. Based on the estimated size of the informal economy by the National Bureau of Statistics, the fiscal gap, excluding the illegal sector, reached 7.45 per cent of GDP in 2013³. This figure is an approximation only, considering the difficulties in estimating the exact size of the informal economy and the complexity of the fiscal system. Nevertheless, it is useful in depicting the rising trend of the fiscal gap.

1.2 Informal employment

As described above, both the structure of the Moldovan economy (with its high share of agriculture and seasonal activities) and the functioning of the economy (with its less-than-attractive business environment, limited economic opportunities and respectively low incomes) explain the high incidence of informal employment in the country.

According to the NBS methodology, informal employment includes the following six categories⁴:

1. own-account workers, working in informal sector enterprises (see the definition below);
2. employers who work in informal sector enterprises;
3. members of informal production cooperatives;
4. contributing family workers, employed in formal or informal sector enterprises;
5. employees in formal or informal sector enterprises, or in households, who meet at least one of the following criteria:
 - their employer does not pay social contributions for them;
 - they do not benefit from paid annual leave; or

³ The estimated fiscal gap was calculated based on the share of the non-observed economy measured by the National Bureau of Statistics. For calculations and methodology, see "Fiscal Gap – an invisible reality", Expert-Grup, 2014.

⁴ According to the Methodology of the Labour Force Survey in Households, approved through the Decision of the National Bureau of Statistics College No. 5 of 26 December 2008.

- in case of illness, they do not benefit from paid sick leave; and
- 6. persons dealing with agricultural production within their household, exclusively for their household's own consumption, with a working week of 20 hours and more.

Informal employment takes place in three types of production units:

- *formal sector enterprises*, including incorporated enterprises, organizations, and institutions (economic units with status of legal entities) or unincorporated enterprises (with the status of natural persons), which are officially registered;
- *informal sector enterprises*, defined as non-registered unincorporated enterprises (without legal person status); and
- *households* that engage in the production of agricultural goods exclusively for their households' own consumption, or that employ paid domestic workers in their household.

By combining employment status data with production unit data, we can identify trends regarding Informal employment, employment in the informal sector and informal employment outside the informal sector (Table 1).

Table 1. Conceptual Framework: Informal Employment

Production units by type	Jobs by status in employment								
	Own-account workers		Employers		Contributing family workers	Employees		Members of producers' cooperatives	
	Informal	Formal	Informal	Formal	Informal	Informal	Formal	Informal	Formal
Formal sector enterprises					1	2			
Informal sector enterprises ^(a)	3		4		5	6	7	8	
Households ^(b)	9					10			

(a) As defined by the Fifteenth International Conference of Labour Statisticians (excluding households employing paid domestic workers)

(b) Households producing goods exclusively for their own final use and households employing paid domestic workers

Note: Cells shaded in dark grey refer to jobs, which, by definition, do not exist in the type of production unit in question. Cells shaded in light grey refer to formal jobs. White cells represent the various types of informal jobs.

Source: Guidelines endorsed by the Seventeenth International Conference of Labour Statisticians, 2003.

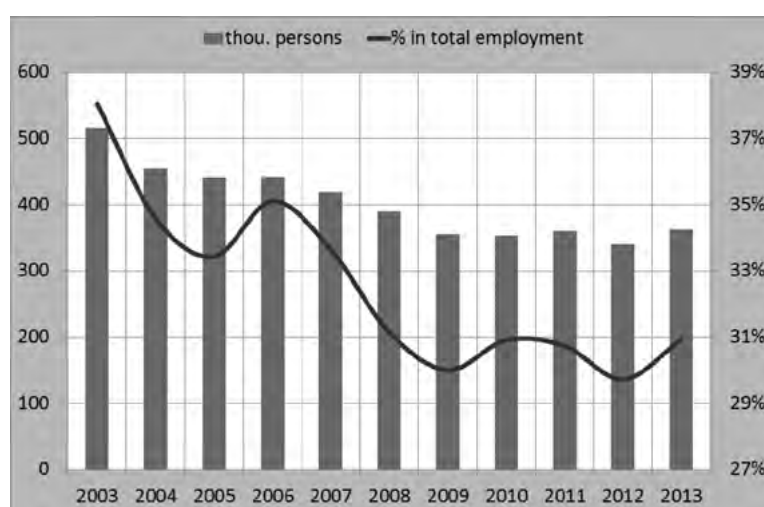
According to the definition above, 362,800 persons had an informal job (as their main or primary job) in 2013 (Table 2), which represented 30.9 per cent of the total employed population in the Republic of Moldova. This share had decreased from 38 per cent in 2003. The total number of informal jobs had also decreased by 30 per cent (Chart 6).

Table 2. Distribution of the employed population according to the Conceptual Framework of Informal Employment in Moldova, in thousands of people and their percentages (in brackets), 2013

Production units by type	Jobs by status in employment						
	Own-account workers		Employers and members of producers' cooperatives		Contributing family workers	Employees	
	Informal	Formal	Informal	Formal	Informal	Informal	Formal
Formal sector enterprises		71.0 (6.1%)		8.5 (0.7%)	8.6 (0.7%)	60.1 (5.1%)	730.5 (62.3%)
Informal sector enterprises	133.9 (11.4%)				16.6 (1.4%)	12.3 (1%)	
Households	127.5 (10.9%)					3.8 (0.3%)	

Source: National Bureau of Statistics.

Chart 6. Number of persons in informal employment (in thousands of persons, primary axis) and their share of total employment (in percentages, secondary axis), 2003–2013



Source: National Bureau of Statistics.

At the same time, the number of formal jobs has not changed dramatically since 2003, decreasing only by 3.6 per cent. There was a six per cent increase in the number of formal employees in formal sector enterprises, and nearly a 50 per cent decrease in formal own-account workers in formal sector enterprises.

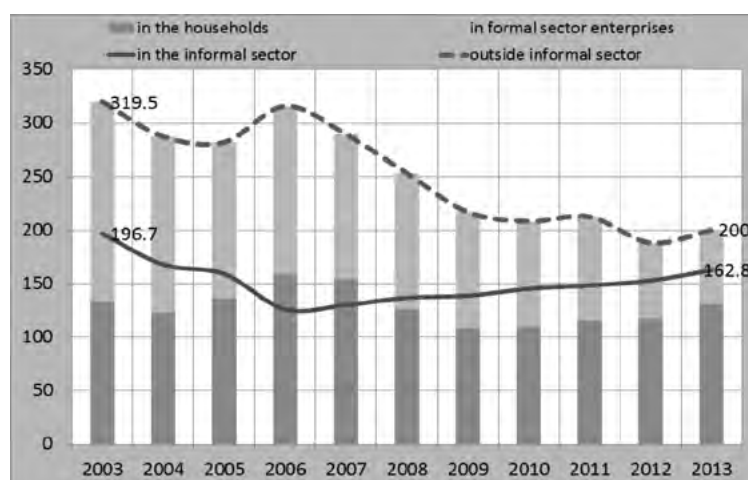
Informal employment by type of production unit and employment status

Informal employment outside the informal sector, referring to informal employment in the formal sector and in the household, has always been more prevalent than informal employment in the informal sector in Moldova (Chart 7). This is the consequence of a high incidence of informal

employment in the household sector – 131,300 persons in 2013 – and has not changed dramatically during the last decade, representing 36.2 per cent of all informal employment. At the same time, informal employment in formal sector enterprises is significantly lower, accounting for only 68,700 persons in 2013. Since 2003 it decreased by 65 per cent, due to the economic recovery in 2000 and the period of economic growth that followed throughout the decade which made more enterprises profitable. This positive economic climate, accompanied by an intensification of labour and fiscal inspections, encouraged more enterprises to declare their profits, employees and wage bills for fiscal purposes.

Informal employment in the informal sector was also on the decline for several years, but since 2006 the trend inverted and this type of employment rose by 30 per cent, accounting for 162,800 persons in 2013. This was caused by an increase in the number of own-account workers, employees and contributing family members in informal sector enterprises. This evolution is marginally explained by the global economic crisis of 2007 that also hit Moldova. For example, during the crisis some returned migrants and former employees who lost their jobs started performing economic activities as own-account workers within non-registered informal sector enterprises. But the continuous rise of informal employment in informal sector enterprises, also after the resumption of economic growth, shows the vulnerability of the economic structure of the Republic of Moldova and its inefficiencies in practice, which create incentives for fiscal evasion as described in Chapter 2. Currently, own-account workers in informal sector enterprises make up the most important sector of informal employment, accounting for 37 per cent of all informal employment. Nevertheless, their number has decreased by 23 per cent since 2003.

Chart 7. Informal employment in the informal sector and outside the informal sector, in thousands of persons, 2003–2013

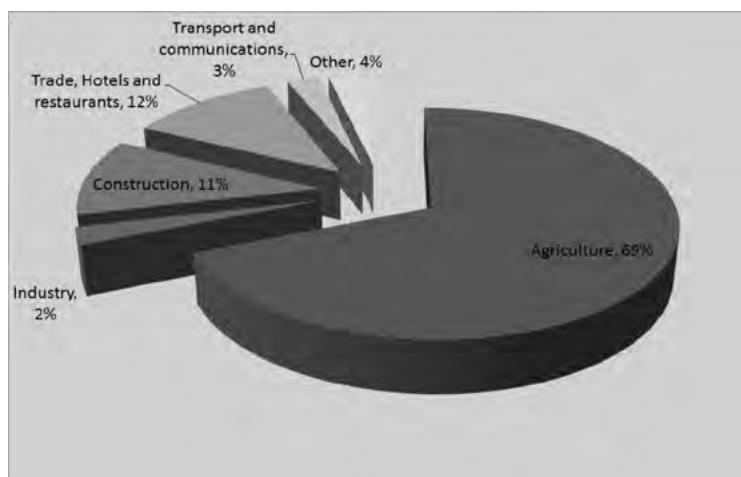


Source: National Bureau of Statistics.

Informal employment by economic activity

The decline in informal employment was primarily due to the contraction of the agricultural sector during the last two decades, where the most significant part of informal employment still takes place. Thus, 63 per cent of the 153,200 informal jobs that were eradicated since 2003 were in the agricultural sector. The contraction of employment in the agricultural sector is partially the result of the diminishing share of the sector overall, but is also due to its modernization, albeit at a slow pace. However, in 2013, 68.7 per cent of informal jobs were still in the agricultural sector (see Chart 8). Informal employment in the agricultural sector is also related to the wide possession of small agricultural plots. Given a lack of other opportunities, the rural population often works the land for their own consumption.

Chart 8. Informal employment by economic activity, in percentage, 2013



Source: National Bureau of Statistics.

In the industrial and service sectors, informal employment also shrank. However, informal employment in these sectors is mainly concentrated in formal and informal enterprises, rather than in households. Only in the construction sector did informal employment increase considerably since 2003, by 26.9 per cent. It is worth mentioning that the construction sector started to grow in 2003 and boomed from 2006 to 2008, and the number of employees increased significantly, both with formal and informal jobs. In 2013, 61.7 per cent of employment in the construction sector was informal.

Case study: Transition from formal to informal jobs in the construction sector

Some employers in the construction sector complain about a high turnover of employees in the sector, and of shortages of both high- and medium-skilled employees, for two main reasons:

1. Migration for work abroad. Employers are incapable of offering competitive wages with foreign companies, which makes it difficult for many companies to find and keep employees. This is especially true during the fall, when many workers go abroad, mainly to Russia, for seasonal work.

2. Migration to informal employment. Some employers indicated that the high turnover is also due to the fact that employees often leave their formal job if they are offered an informal, but better paid, job. These jobs are for fixed-term or casual work, and are mostly offered by individual persons or households who can offer higher remuneration because they are not paying taxes or social contributions. Employers also stated that this type of employment is often convenient for some of the workers, as it provides them with more flexible schedules or allows them to combine their short-term work in the country with seasonal migration.

On the one hand, the second reason seems to be credible; informal employment is very high in the construction sector at 61.7 per cent, and most of them are own-account workers in informal sector enterprises. On the other hand, it does not fully correspond to the personal assessments of workers in their current jobs. According to the Labour Force Survey data, 30 per cent of all own-account workers working in construction in informal sector enterprises want to change their current job, mostly because of its casual or fixed-term status. They want formal employment contracts and want to work longer hours with a corresponding increase in their income.

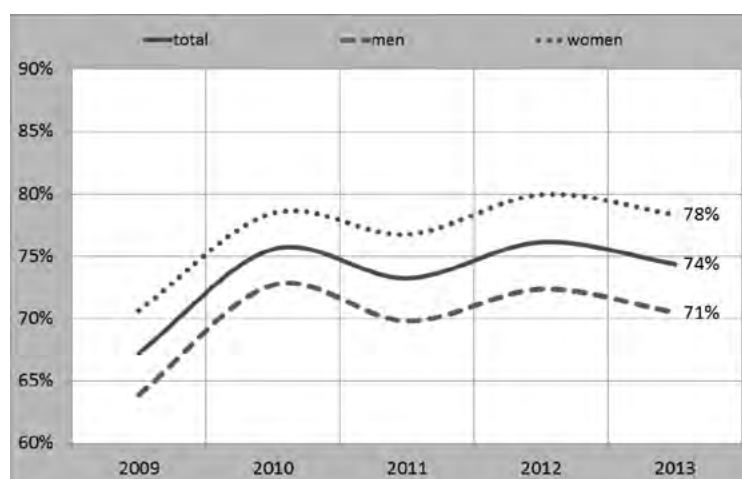
In several interviews with own-account workers in the construction sector, they revealed a preference for jobs abroad because of their higher revenues, but they did not mention any significant differences in the salaries or incomes between formal and informal sector enterprises in the country. They reported that they would prefer formal jobs when not abroad because of the disadvantages of casual or short-term informal jobs. It seems that opting for an informal job is often the result of more jobs offered by individuals rather than companies, especially outside the capital city. Because it takes more time to find a formal job in a registered company, many workers opt for the first job available, which is often an informal one.

These own-account workers also usually perform finishing and repairing jobs. There are few companies specializing in these fields in the country. For example, many apartments in residential buildings (built by formal enterprises) are being sold unfinished and as-is, with any finishing and repair works left to the customer. Usually individual workers are hired for these jobs directly by the apartment owners, often without a contract. However, there is a rise in the demand for skilled workers working under a contract, so that the quality of these jobs can be guaranteed (ILO, 2013).

Informal employment by gender

While men and women participated equally in the informal job sector in the early 2000s, in 2013 the share of informal employment as a part of total employment was 34.7 per cent for men compared to 27.1 per cent for women. This is mainly due to the higher share of informality in sectors traditionally employing more men: agriculture and construction. In this regard, Moldova differs from other countries with high shares of informal employment in the Western Balkans and the CIS, where informal employment is more prevalent for women (ILO, 2011; Bernabe, 2002). Consequently, women's participation in social security schemes through contributions to the National Pension House (Casa Nationala de de Asigurari Sociale) is higher than men's participation. About 78 per cent of employed women (455,100 out of 580,700) contributed to the social security fund in 2013, compared to 71 per cent of men (417,500 out of 592,100) (Chart 9).

Chart 9. Share of employed population contributing to social security funds by gender, in percentages, 2009–2013



Source: National Bureau of Statistics.

Even though informal employment is more characteristic for men, women are still disadvantaged in the labour market, as the employment rate is lower for women than for men (by 4.8 per cent in 2013). While men with informal jobs are employed mostly in formal and informal sector enterprises, women have fewer opportunities for such jobs and often work as own-account

workers in their own households producing for their own consumption, where the incomes are lower (Table 3).

Table 3. Informal employment by gender and sector of employment, in thousand persons and shares in total employment (in percentages), 2013

	Informal employment		In informal sector		In formal sector enterprises		In households	
	thousand	%	thousand	%	thousand	%	Thousand	%
Men	205.5	34.7	106.5	18	35.4	6	63.5	10.7
Women	157.3	27.1	56.3	9.7	33.2	5.7	67.9	11.7

Source: Authors' calculations based on NBS data.

Informal employment by age

When it comes to age, the population most vulnerable to informal employment are persons over 65 years of age (60 per cent). But their number is small and most of them are retired persons performing short-term, casual or seasonal work, so it is not relevant for further analysis. Another age group highly involved in informal work is the youngest cohort, aged 15–24 years old, where 36.9 per cent of employed persons have an informal job (Table 4). The high share of informal employment in this cohort is caused by the difficult transition from education to the labour market. A lack of work experience and a lack of qualifications acquired during formal education make employers reluctant to hire young persons, especially graduates of general secondary education without any specialization⁵. These difficulties create incentives for young people to accept informal jobs. This is accentuated by their tendency to disregard longer-term concerns related to future benefits, especially from pensions.

Table 4. Informal employment by age and sector of employment, in thousands of persons and shares in total employment (in percentages), 2013

	Informal employment		In informal sector		In formal sector enterprises		In households	
	thousand	%	thousand	%	thousand	%	thousand	%
15-24	38.5	36.9	15.6	15.0	12.1	11.6	10.8	10.3
25-34	85.8	28.7	41.1	13.8	19.6	6.6	25.1	8.4
35-44	83.0	29.9	39.5	14.2	16.4	5.9	27.1	9.8
45-54	89.6	30.0	41.0	13.7	13.4	4.5	35.2	11.8
55-64	51.2	30.4	20.1	11.9	6.8	4.0	24.4	14.4
65+	14.7	60.0	5.5	22.6	0.4	1.7	8.7	35.8

Source: Authors' calculations based on NBS data.

The number of informal jobs decreased most significantly in this cohort between 2003 and 2013 (by 40.5 per cent), due to a slight increase in the school enrolment rates for persons aged 16–23 years. This led to the delayed entrance of many youths into the labour market, and helped prepare more youths for a modernized economy that requires greater skills and abilities.

In this group, informal employment is concentrated in informal sector enterprises and is more characteristic for men (43.3 per cent) than for women (27.4 per cent). The high gender discrepancy for informal jobs in this cohort is explained by the fact that girls usually pursue higher levels of education and enter the labour market later. Informal employment is lower among women aged

5 Public Policy Proposal "Stimulation of youth employment on the labour market", Ministry of Labour, Social Protection and Family, 2012.

24–34 years (24.8 per cent). This is probably because this is a fertile age for women, and they might be less inclined to accept informal jobs that do not ensure access to health insurance and maternity protection.

Informal employment by qualifications

Most informal jobs are in elementary occupations (66 per cent), followed by service and sales workers (11.1 per cent), and then crafts and related trades workers (10.8 per cent) (Table 5). Studies show that workers with higher qualifications are able to find and enrol in formal jobs more easily than those with lower qualifications (ILO, 2011).

Many low-skilled workers (oftentimes young persons, as described above) enter the labour market informally. Some of them acquire practical skills and manage to migrate to formal employment later, but many of them are caught in an informal employment trap. There is no demand for them in the formal labour market, and the skills they have acquired in informal employment are not recognized. They often have no proof of training or specialized coursework, and there are no systems in place to validate informal learning. This appears to be especially true for informal workers employed by informal businesses and for own-account workers, since they are not formally employed and cannot enter any training schemes (which are underdeveloped even in formal sector enterprises, as explained in Chapter 2). The lack of training taking place in the informal sector prohibits these employees from claiming better-paid positions in the formal sector (ILO, 2011).

Table 5. Structure of formal and informal employment by groups of occupations (ISCO classifications⁶), by percentages, 2013

Group	Formal jobs	Informal jobs
1 – Managers	11.3%	0.2%
2 – Professionals	20.0%	0.7%
3 – Technicians and Associate Professionals	11.2%	1.0%
4 – Clerical Support Workers	2.9%	0.2%
5 – Service and Sales Workers	16.7%	11.1%
6 – Skilled Agricultural, Forestry and Fishery Workers	2.0%	6.4%
7 – Craft and Related Trades Workers	9.2%	10.8%
8 – Plant and Machine Operators and Assemblers	8.7%	3.6%
9 – Elementary Occupations	17.1%	66.0%

Source: Author's calculations based on National Bureau of Statistics data.

Informal employment by level of education

Informal employment is more widespread among persons with low levels of education. Of all informal jobs, 59 per cent are held by people with no specialization (primary, lower secondary and upper secondary general education) who work mainly in their own households. However, 26 per cent of informal jobs belong to vocational school graduates (Table 6). This is partially because of the deteriorating quality of the vocational educational system during the two decades of transition, and the broken link between the labour market needs and the educational system output in this period. Thus, the skills acquired in these institutions are typically inadequate to allow them to directly enter into the formal labour market. Graduates usually enter some elementary occupation in the agricultural sector, often in their own household. This is also because of the high informality in the sectors employing most vocational school graduates, such as construction, wholesale and retail trade.

6 See the ILO International Standard Classification of Occupations (ISCO-08), available at <http://www.ilo.org/public/english/bureau/stat/isco/>.

Despite their level of specializations, there is no significant difference in the type of informal jobs by status of employment or production unit. However, there is a higher share of own-account workers in informal sector enterprises with vocational studies, and a higher share of informal employees in formal sector enterprises with no specialized studies.

Table 6. Structure of formal and informal employment by levels of education (ISCED classification), in percentages, 2013

Highest level of education graduated	Formal jobs	Informal jobs
no education + ISCED 1	0.2%	1.8%
ISCED 2	10.7%	33.7%
ISCED 3 (secondary general education)	17.0%	24.3%
ISCED 3 (vocational education)	20.6%	25.7%
ISCED 4	17.3%	8.8%
ISCED 5-6	32.9%	5.6%
MA and PhD	1.3%	0.1%

Source: Author's calculations based on National Bureau of Statistics data.

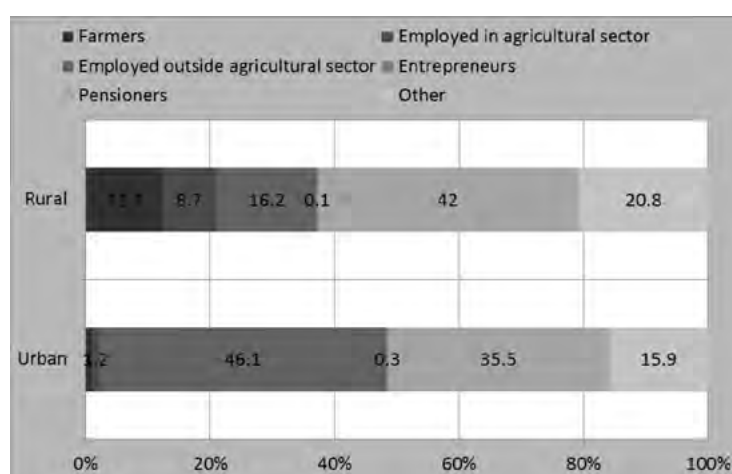
Informal employment by area of residence

The most significant discrepancies in informal employment in Moldova are between rural and urban residents. While only 13.5 per cent of urban employed persons have informal jobs, 46.4 per cent of rural employed persons were working informally in 2013. Thus, not only is the employment rate in rural areas significantly lower compared to urban areas (36.6 per cent compared to 42.8 per cent in 2013), but about half of the population in rural areas has an informal job and does not benefit from social security schemes. This makes the rural population even more vulnerable, as they do not have access to jobs with high incomes and cannot fully benefit from public and social services (including health services, unemployment benefits and pensions).

Most of the informal employment in rural areas is concentrated in the households: 42 per cent of the population with informal jobs work in their own households producing for their own consumption, mostly in the agricultural sector.

Generally, rural populations differ significantly from urban populations, with high discrepancies in their socioeconomic statuses and incomes. In Moldova, 42 per cent of the rural population is retired⁷. Another large portion of the rural population are farmers and persons employed in the agricultural sector (21 per cent) (Chart 10).

Chart 10. Rural and urban population by socio-economic status, by percentages, 2013

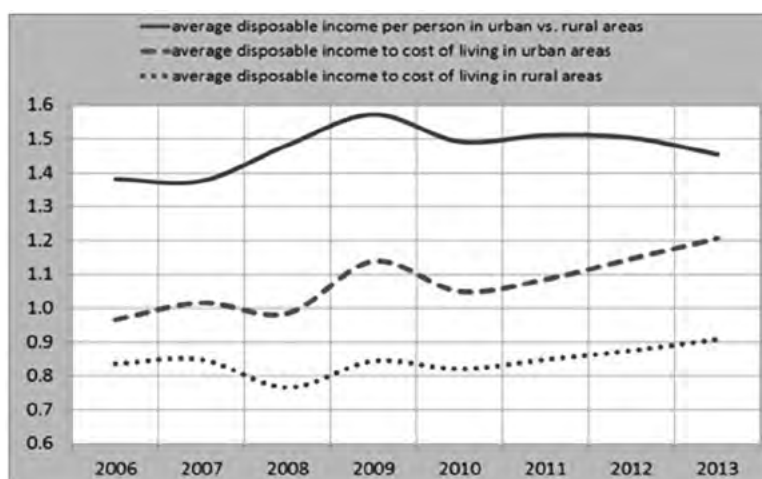


Source: National Bureau of Statistics.

⁷ The retirement age in Moldova is 62 years old for men and 57 year old for women.

As these large socioeconomic groups have relatively low incomes, the average disposable income per person in the rural areas was significantly lower – by 45 per cent – than in the urban areas in 2013. The most important income sources for the rural population are social payments (21 per cent), wages (28.3 per cent) and individual agricultural activity incomes (17.8 per cent), compared to 18.6 per cent, 53.8 per cent, and 1.1 per cent in urban areas, respectively. The average disposable income in rural areas was almost ten per cent lower than the cost of living in 2013, although the gap has been decreasing since 2010 (Chart 11).

Chart 11. The ratio between the average disposable income in urban and rural areas and the cost of living, 2006-2013



Source: National Bureau of Statistics.

The information presented in the chart above suggests higher revenues in formal employment than in informal employment. Thus, the rural-urban gap in the ratio of disposable income compared to the cost of living has more than doubled from 2006 to 2013. In this period, the incidence of informal employment has decreased significantly in urban areas, from 19.5 per cent to 13.5 per cent, with no significant changes in total employment levels (only a 1.9 per cent decrease). In rural areas, informal employment decreased only from 47.7 per cent to 46.4 per cent, and total employment reduced by 10.7 per cent during seven years.

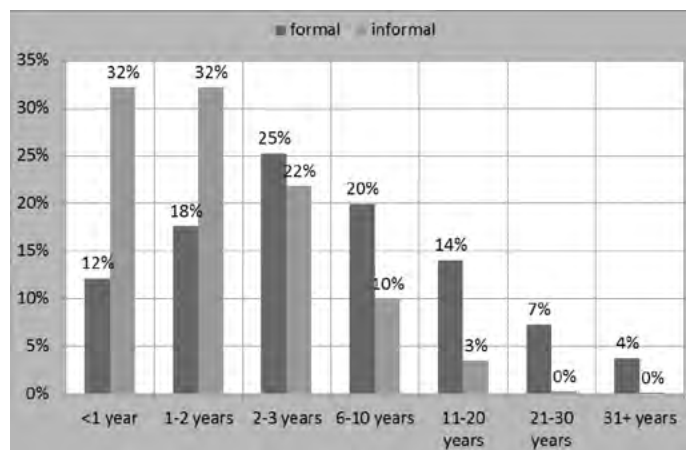
Other characteristics of informal employment

Jobs in informal employment can also be considered more insecure not only because the employed population does not benefit from social security schemes, but because the jobs are uncertain and shorter in duration. For example, in 2013, 64 per cent of those who reported having an informal job were employed in their position for less than two years. For those with formal jobs, the share was much lower at 30 per cent (Chart 12). The gap persists for all of the ten-year age cohorts, with the lowest levels obviously reported for the youngest population (15–24), as they are new in the labour market and their job durations are shorter by default.

Another characteristic of informal employment is shorter working hours. On average, employed persons with informal jobs work 3.3 hours a week less than those with formal jobs. The population working in the household, mostly in the agricultural sector, generally has the shortest working week. At the same time, informal workers in the construction, trade, hotel and restaurant sectors have longer working weeks than the formally employed population (Table 7). These are sectors with high informal employment outside the households, mainly own-account workers in informal sector enterprises. While shorter working hours and lower salaries in informal jobs would suggest more incentives for secondary activity, 78 per cent of the

population with a secondary job has their primary job in formal employment. Secondary jobs are mostly concentrated in the informal agricultural sector (77 per cent), and are more common among rural populations over 35 years old.

Chart 12. Years reported in one's current position by formal and informal occupations, in percentages, 2013



Source: Author's calculations based on National Bureau of Statistics data.

Table 7. Average duration of working week by type of job and economic sector, hours per week, 2013

Economic activity	Formal job	Informal job
Agriculture	36.7	32.9
Industry	39.8	38.9
Construction	39.9	40.7
Trade, Hotel and Restaurants	41.7	42.0
Transport and Communications	41.9	39.1
Total	38.5	35.2

Source: Author's calculations based on National Bureau of Statistics data.

Given all of the disadvantages of informal employment, the population with an informal job seems to be more dissatisfied with their current status; 25.4 per cent reported that they wanted to change their job, compared to 18.8 per cent of those in formal employment. The reasons they want to change their current jobs also differ significantly between the formal and informal employed populations (Table 8). For persons formally employed, the biggest reason (77.4 per cent) was the desire for a higher hourly salary. For persons informally employed, this reason was given by only 31.3 per cent of those surveyed. But there are more informal workers who would like longer working hours with a corresponding increase in salary, which is linked to the average length of the working week described above.

Other important reasons fuelling informal employees' desire to change their job situations are as follows: the job is temporary or casual (20.7 per cent), they wish to have an employment contract or fully declare their salary (17.9 per cent), and they desire better qualifications and skills (15 per cent).

Table 8. Main reasons given by the employed population who want to change their job situation, in percentages, 2013

Reasons for wanting to change the situation at the current job	Formal job	Informal job
Longer working hours with a corresponding increase in salary	11.0%	13.2%
Higher salary per hour worked	77.4%	31.3%
Fear of losing their job	0.5%	0.6%
The job is temporary/casual	1.3%	20.7%
Better use of skills and abilities	4.5%	15.0%
More convenient working schedule / shorter travel time to work	1.2%	0.8%
Inadequate work conditions	1.1%	0.4%
Shorter working hours with a corresponding decrease in salary	0.0%	0.1%
Wish to have an employment contract / fully declare their salary	2.9%	17.9%

Source: Authors calculations based on National Bureau of Statistics data.

One's motivation to change their informal job situation differs significantly depending on the production unit in which they are employed. For those with an informal job in a formal sector enterprise, the determining factor is the desire for higher remuneration per hour (43.2 per cent) compared to those informally employed in the household sector (35 per cent) and informal sector enterprises (23.2 per cent). On the other hand, more persons employed in informal sector enterprises wish to work longer hours and have a corresponding increase in their income (16.7 per cent). In informal sector enterprises, more employed persons want to change their job because it is casual or temporary (29.6 per cent), while in formal sector enterprises this is only cited by 13.9 of employees. The desire to use better skills and abilities is more often mentioned by the population employed informally in the household (21 per cent) compared to those employed in formal sector enterprises (18.4 per cent) or informal sector enterprises (15.8 per cent).

LFS data confirm lower salaries in informal employment. The average monthly salary of informal employees⁸ was 2,990 leu (MDL) (equivalent to 179 euro (EUR)) compared to 3,311 MDL (198 EUR) for formal employees in 2013, a 10 per cent difference. This discrepancy has halved since 2010. Among informal jobs, the salaries were the lowest for employees in informal sector enterprises and the highest for employees in households hired by people. These data should be used with caution, however, since they do not consider how informal workers' working weeks or salaries may differ significantly, or how there is a greater unwillingness to report the salaries of employees with informal jobs.

Only 17.9 per cent of informally employed persons quoted their desire to work with an employment contract or to fully declare their wages as reasons they were dissatisfied with their job, though it is still the third most important reason mentioned. It is also the third most important reason why unemployed people reject a job offer: 11 per cent of unemployed workers would not accept a job without an employment contract. These data reveal the advantages of formal work, as well as workers' desires to migrate from informal to formal jobs. At the same time, people think less about fiscal morality (as shown in the next section), and are often ready to accept under-declared wages and consider them legitimate. They seem to prefer higher pay, more secure jobs, and better uses of their skills and abilities.

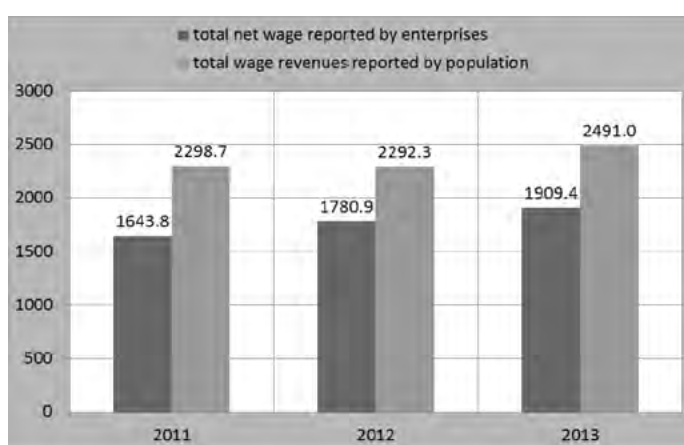
⁸ According to the methodology of the Labour Force Survey in the Households, an employee is considered a person carrying out an activity under a working contract within an economic or social unit – irrespective of its ownership type – or for private persons (under a contract or verbal agreement), receiving remuneration in the form of salary, in cash or in kind, or through commission. People in military service were also registered with the same status.

Undeclared work and losses for the State

On the one hand, some forms of informal employment protect the State from high unemployment rates and additional short-term social spending. On the other hand, the tax evasion associated with informal employment causes damage to the State. This subchapter will analyse undeclared work, including informal employment with undeclared salaries and formal employment with part of one's salary undeclared for fiscal reasons, and the associated losses for the State.

While it is difficult to estimate the exact level of undeclared wages in the economy, the difference between the wage revenues reported by the population in the Household Budget Survey (HBS) and the wages reported by enterprises in the establishment surveys may serve as a proxy⁹. This shows a consistent discrepancy between wage revenues for three consecutive years (Chart 13), with 30–40 per cent of the total net wage appearing to consist of undeclared wage revenues from either informal employment or formal employment with under-reported salaries¹⁰.

Chart 13. Estimation of monthly net wages per economy based on Household Budget Survey and Enterprise Establishment Surveys data, million MDL, 2011–2013



Source: Author's calculations based on NBS data.

Economic growth, the diminishing agricultural sector, and the intensification of labour and fiscal inspections all led to decreases in informal employment outside the informal sector, as shown earlier in this chapter. However, while undeclared employment decreased, with most employees in the formal sector enterprises being legally employed, companies started to look for new ways to save. The number of companies that now employ workers partially formally and partially informally has increased, due to unfriendly business regulations, the low risk of being sanctioned, and the low levels of fines and other factors mentioned in Chapter 2. Although the employees in these companies have employment contracts, they are formally paid only a part of their total salary (often the minimum wage), receiving the rest of their salary “in envelope”.

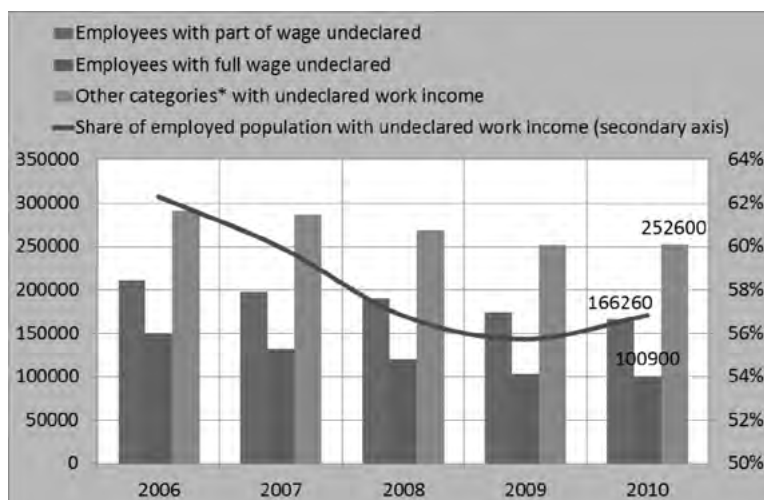
Under-declared wages are common, and some estimates show that it is even more widespread than undeclared employment in Moldova. Research conducted by the Ministry of Labour, Social Protection and Family in 2011 estimated that 57 per cent of the employed population did not fully report their salaries in 2010¹¹. While the number of persons who did not fully declare their salaries and work incomes decreased from 2006 to 2010 by 1.36 per cent on average (Chart 14), the value of these undeclared salaries has increased by six per cent annually.

9 The National Bureau of Statistics publishes data on the number of employees and average net salary declared by any type of enterprise since 2011. These facts are based on two establishment surveys: (i) one containing all establishments with 20 or more employees and all budgetary institutions irrespective of the number of employees, and (ii) one containing all establishments with less than 20 employees.

10 This proxy should be used cautiously, as there is high probability of over- and under-reporting in the HBS. While the gap may suggest undeclared work revenues, the exact estimated numbers may be largely erroneous.

11 For more data and methodology, see “Public Policy Proposal: Reducing the phenomenon of informal employment” Ministry of Labour, Social Protection and Family, 2011.

Chart 14. Incidence of undeclared work, 2006–2010



*Other categories include own-account workers, contributing family members, employers, members of producers' cooperatives.

Source: Public Policy Proposal: *Reducing the phenomenon of informal employment*, Ministry of Labour, Social Protection and Family, 2011.

In 2010, the value of all undeclared salaries and incomes totalled 9.3 billion MDL (5.7 billion EUR), and the share of undeclared wages was 29.6 per cent of the total wage bill and 13 per cent of GDP. This resulted in losses for the national public budget of 4.7 billion MDL (2.9 billion EUR), or 17.1 per cent of its total revenues. These include 2.1 billion MDL (or 25 per cent) of the revenues for the social security budget, 1.6 billion (or 13.5 per cent) of revenues for the state budget as income tax, and 1 billion MDL (or 29 per cent) for the health insurance fund.

1.3. Incentives for undeclared work on the supply side

High informal employment in the Republic of Moldova is a consequence of both the structure of the national economy and the functioning of the economic system, which will be described in Chapter 2. This subchapter will analyse the incentives on the supply side to not declare or under-declare wages. The conclusions are partially based on the results of a national representative survey conducted in 2014¹². The survey shows that the population is generally aware of the existence of undeclared wages, with 51.5 per cent of the respondents confirming that the phenomenon is present in almost every company or at least occurs very often. Of the total respondents, 19.5 per cent consider it justifiable to under-report wages for fiscal purposes. These respondents are mostly male, from the youngest cohort, or urban residents (Chart 15).

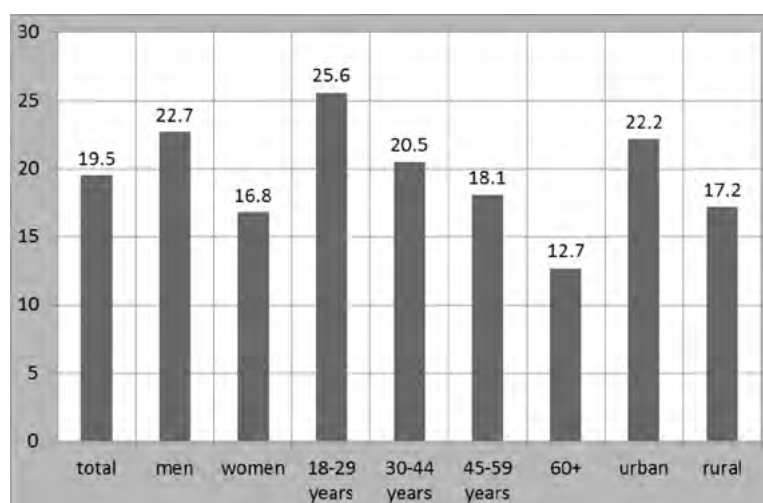
Thus, based on the survey data and the pre-existing research on informal employment in the Republic of Moldova, the main determinants for undeclared wages are as follows:

- **Low quality of public goods and services.** Empirical studies show that corruption and efficiency of governance, which measure the quality of public services, are considered to have the most significant impact on the size of undeclared work. A decrease by one point in the corruption index may lead to a decrease of 12 per cent to 21 per cent of the entire informal economy. The efficiency of governance, though it does not have a direct impact on informal employment, may reduce the informal economy in interaction with the level of taxation and labour protection legislation (ILO, 2008). Undeclared work could be seen as a larger moral failure than partly under-declaring wages, explaining why undeclared

¹² From the national representative survey on fiscal morality, conducted for the Expert-Grup study "Fiscal gap – an invisible reality" in 2014. The survey was conducted with 1,218 (18+) respondents and has a sample error of 3 per cent. The stratification criteria are: 13 geographical regions, urban/rural and size of community.

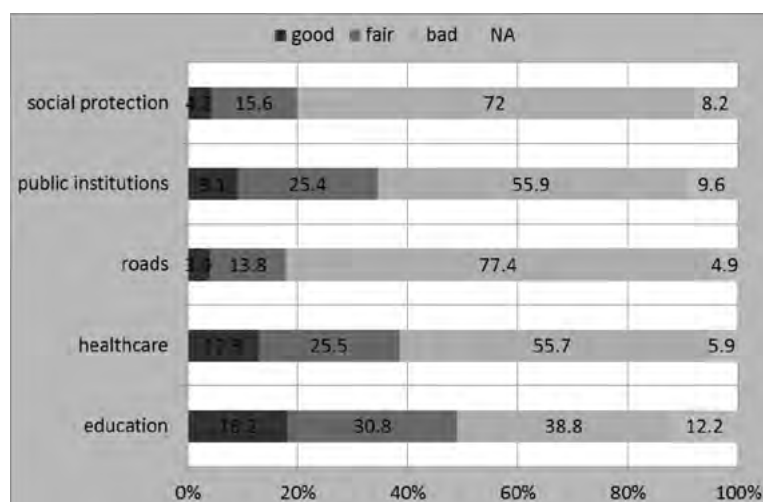
wages in Moldova are more widespread than undeclared workers. Thus, one of the triggers for accepting undeclared payments is the general dissatisfaction with public services. The survey data show that most people are dissatisfied with the quality of public services when considering the level of taxes they pay. The most significant dissatisfaction is related to the quality of roads (77 per cent), the social protection system (72 per cent), public institutions (55.9 per cent), health care (55.7 per cent) and to a lesser extent the education system (38.8 per cent) (Chart 16). However, a direct correlation between the level of satisfaction with the public services and the justification of undeclared wages and incomes was found only in relation to the quality of social protection, public institutions and roads. For education and health systems, those mostly dissatisfied with the quality of the services were less inclined to consider it legitimate to under-report income or salary.

Chart 15. Share of respondents who consider it justifiable to under-report wages for fiscal purposes by different disaggregation criteria, in percentages, 2014



Source: Author's calculations based on the survey data.

Chart 16. Distribution of answers to the question: "How do you appreciate the quality of the following public services given the level of taxes paid?", in percentages, 2014



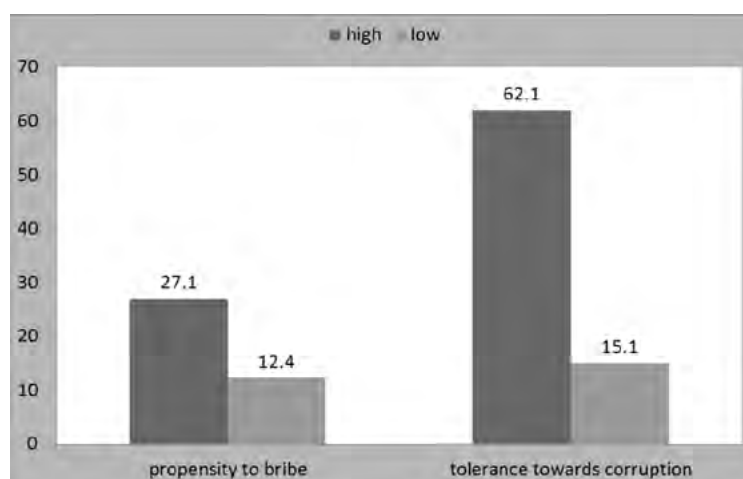
Source: Author's calculations based on the survey data.

- **Transparency of public spending.** In theory, the incentives to under-declare salaries and incomes are higher when taxpayers are not fully informed of how their money is used. In Moldova, it is certain that the State does not fulfil its duties and that budgetary

resources are often used inefficiently and non-transparently, as revealed by many reports of the Court of Accounts¹³. The results of the survey show that only 11.4 per cent of the population is highly informed about how the public money is being spent, while 79.4 per cent consider themselves poorly informed. This correlates with respondents considering undeclared salaries to be justified: 19.1 per cent of the population poorly informed about public spending consider under-declared salaries justifiable, compared to 15.1 per cent of the population highly informed on the matter.

- **Non-conforming culture.** There is also a relationship between under-reported income and a widespread tolerance of corruption and tax evasion. The survey data indicates that this is an aspect of the national system, with 46.8 per cent of the population willing to pay bribes if they cannot otherwise solve a problem, and 11.9 per cent of the population considering corruption justifiable. Obviously this finding correlates to the justification of undeclared wages and income. Only 12 per cent of those not ready to pay bribes consider undeclared wages legitimate, while 27.1 per cent of those ready to pay bribes consider them justifiable. Also, 62.1 per cent of those who tolerate corruption consider undeclared salaries justifiable compared to only 15.1 per cent of those who have a lower tolerance towards corruption (Chart 17).

Chart 17. Share of population considering undeclared wages justifiable based on their propensity to bribe and tolerance towards corruption, in percentages, 2014



Source: Author's calculations based on the survey data.

- **Low incomes and few employment opportunities.** This argument is especially valid for the rural population, where there are few employment opportunities, especially well-paid jobs. In most circumstances, the population is ready to accept any employment conditions. We should also take into consideration that many persons in Moldova have very low incomes and some jobs are very poorly paid, failing to cover the living cost of a household. In this case, a worker's immediate needs prevail over their future safety and they are more willing to accept an undeclared salary. As long as wages and pensions are low, there will always be an inclination to fiscal evasion. However, in Moldova there is a high propensity to under-declare high wages as well. This means that it cannot be considered a determinant factor, given the size of undeclared work.

Other factors that may be considered when a person accepts an undeclared job or undeclared salary were shown to be insignificant in the survey.

13 Court of Accounts Reports on administration and the use of public finances since 2001 can be found at <http://www.ccrm.md/tabview.php?l=ro&idc=24&t=/Publicatii/Rapoarte&>.

1.4. Non-standard forms of employment

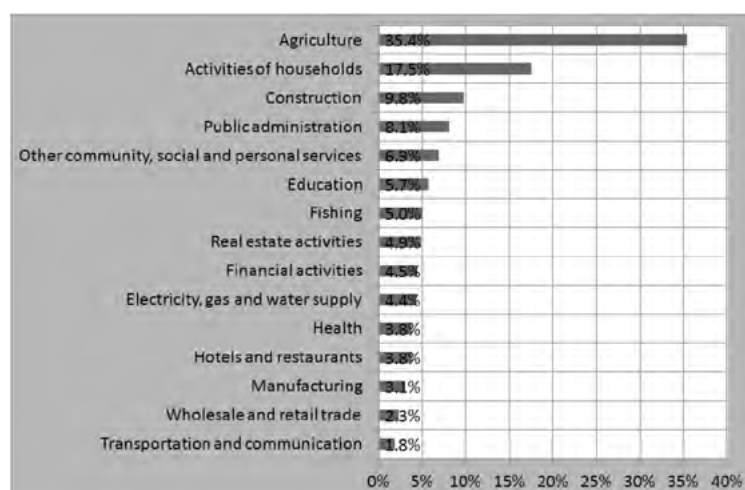
According to the ILO definition, non-standard work refers to jobs that fall outside the realm of standard work arrangements, including temporary or fixed-term contracts, temporary agency or dispatched work, dependent self-employment, as well as part-time work, including marginal part-time work, which is characterized by short, variable, and often unpredictable hours. The World of Work Report 2012 analyses non-standard employment, including temporary employment or precarious work (involuntary part-time and temporary employment) for advanced countries and informal employment for developing countries. It finds a high correlation between some forms of non-standard employment and informal employment in developing countries, as described below.

Though national statistics do not include information on non-standard forms of employment, the Labour Force Survey (LFS) offer some valuable information on several forms of non-standard employment.

Fixed-term employment

In the LFS, only employees¹⁴ specify whether their employment is fixed-term or permanent. The assessment of the employment type is left to the discretion of the respondents, and does not necessarily refer to the legal definition for fixed-term employment described in Chapter 3. According to the survey, the share of fixed-term employees increased from 5.1 per cent in 2003 to 7.1 per cent in 2013. These numbers vary significantly by economic activity, with the highest shares in the agricultural sector (35.4 per cent) and in household work (17.5 per cent). At the same time, the share of fixed-term employment contracts or verbal agreements is also high in some public sectors, such as public administration and education (Chart 18).

Chart 18. Share of fixed-term employment for employees by economic activities, in percentages, 2013



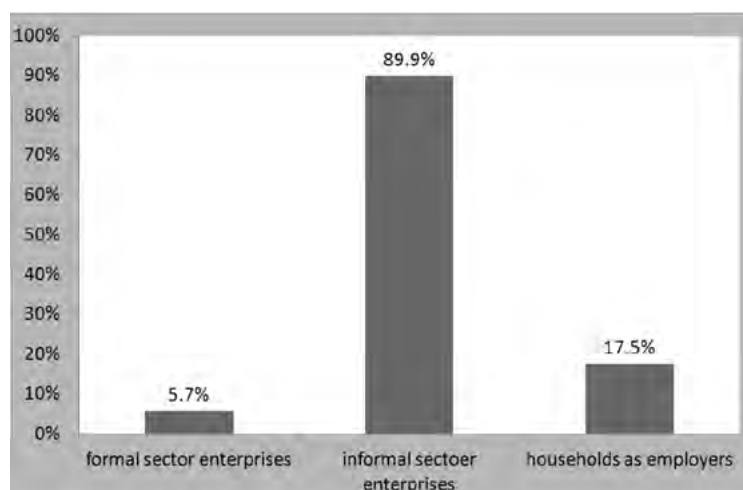
Source: Author's calculations based on National Bureau of Statistics data.

Fixed-term employment is slightly more common for males (8.3 per cent of men compared to six per cent of women) and for rural inhabitants (10.7 per cent from rural areas compared to 4.6 from urban areas), which corresponds to the employment of these groups in the sectors specified above. Also, the youngest and the oldest cohorts are more often engaged in fixed-term jobs: 35.7 per cent of employees above 65, 10.3 per cent of employees between 55 and 64 years old, and 11.8 per cent of those from 15 to 24 years old.

¹⁴ According to the methodology of the Labour Force Survey in the Households, an employee is considered a person carrying out an activity under a working contract within an economic or social unit – irrespective of its ownership type – or for private persons (under a contract or verbal agreement), receiving remuneration in the form of salary, in cash or in kind, or through commission. People in military service were also registered with the same status.

Fixed-term employment is highly correlated to informal employment. In 2013, the share of fixed-term employment was 3.6 per cent of formal employees compared to 40.2 per cent of informal employees. However, the share of fixed-term employees has grown since 2003, while the share of informal employees decreased from 2003 to 2013. As seen in the disaggregation by economic activity, some fixed-term employees work in households, but their share is much higher in the informal sector enterprises, which reached 89.9 per cent in 2013 (Chart 19).

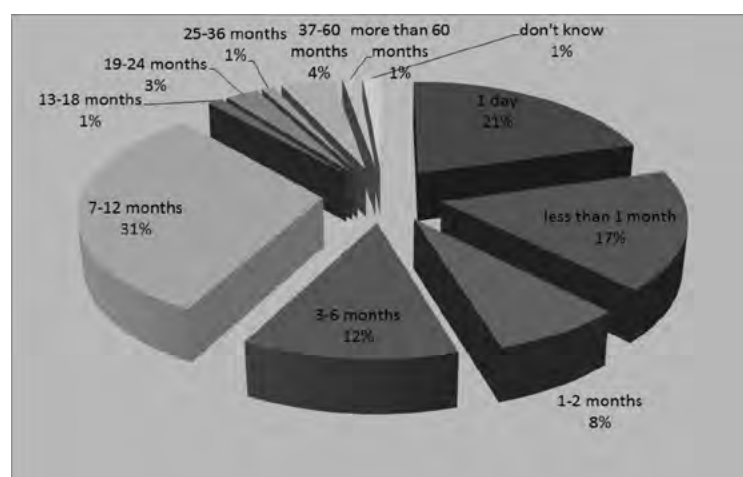
Chart 19. Share of fixed-term employees by type of production unit, in percentages, 2013



Source: Author's calculations based on National Bureau of Statistics data.

Most often the fixed-term employment duration is quite short, not longer than one year (Chart 20). Those employees with longer fixed-term employment are mainly concentrated in public administration, education and the health care system (73.1 per cent), and almost all of them are formal employees. The shortest fixed-term employment periods are in the agricultural sector, with 96.3 per cent constituting only one-day jobs.

Chart 20. Duration of fixed-term employment, in percentages, 2013

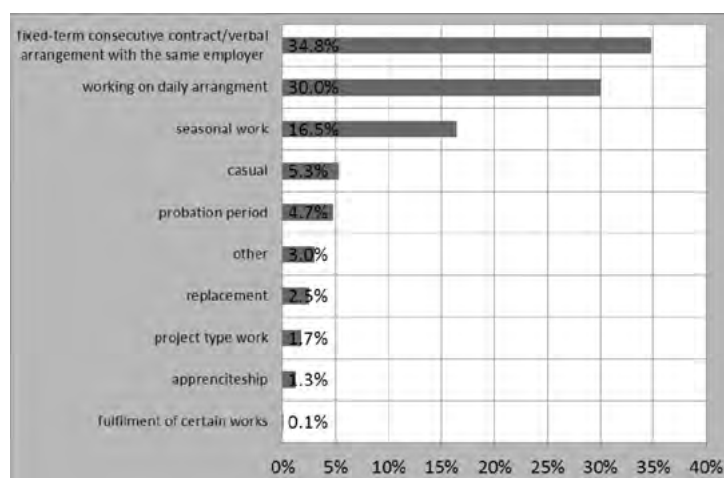


Source: Author's calculations based on National Bureau of Statistics data.

There are several reasons why employees say they choose to engage in fixed-term employment, which also may help us detect other forms of non-standard employment. Typically this is a fixed-term consecutive employment contract or verbal agreement with the same employer, 34.8 per cent of the time (Chart 21). This situation is more common in public administration, health, manufacturing, real estate and trade. It is mainly concentrated in formal and informal sector enterprises, and is very rare in household employment. Another major reason for fixed-term

employment is because they depend on daily arrangements. Almost all employees stating this reason are in the agricultural sector (92.5 per cent) or in the construction sector (5.6 per cent).

Chart 21. Reasons for fixed-term employment, in percentages, 2013



Source: Author's calculations based on National Bureau of Statistics data.

Seasonal work was reported by 16.5 per cent of fixed-term employees in 2013, lower than in the previous years, when its level was over 20 per cent. Seasonal employees work mainly in informal jobs (81 per cent), employed mostly in formal sector enterprises (79.2 per cent). These jobs are concentrated in the agricultural sector (77.2 per cent), but also occur in manufacturing (given the high share of the food processing industry, which implies seasonality), construction and education. The dissatisfaction with the seasonal job is higher than the average reported in the economy, as 30 per cent of the seasonal employees want to change their current job situation.

Another reason for a fixed-term job is **casual work**. In 2013, most casual employees (90.5 per cent) had an informal job, 53.7 per cent in formal sector enterprises and 39.9 per cent in informal sector enterprises. The employees worked predominantly in the construction (35 per cent) and agricultural (32 per cent) sectors. This explains the higher share of male (77.8 per cent) and rural inhabitants (73.5 per cent) with casual jobs. The dissatisfaction with casual work is even higher than for seasonal work, with 42.7 per cent of casual employees reporting they want to change the situation at their current job. One positive evolution may be the decline of casual jobs among the total fixed-term jobs over the last decade, from over 20 per cent to 5.3 per cent.

Other less important reasons for fixed-term employment are probation periods, replacement, project-type work and apprenticeships.

Part-time work

NBS defines part-time employment for employees when their working week, as stipulated in the employment contract, is significantly shorter than the normal working week¹⁵ in their specific economic activity. However, using the ILO recommendations, the LFS considered part-time employment any working program at the discretion of the respondent, meaning that it does not necessarily refer to the duration of working week, but to the perception of the respondent of their job as part-time or full-time. For other legal provisions on part-time employment, see Chapter 3. In 2013, 7.2 per cent of the employed population had a part-time schedule. This incidence of part-time employment decreased from 11.8 per cent in 2003. As with fixed-term employment, part-time employment is also more typical within informal employment: the incidence was 3.8 per cent in formal employment and 14.7 per cent in informal employment. Part-time employment is more

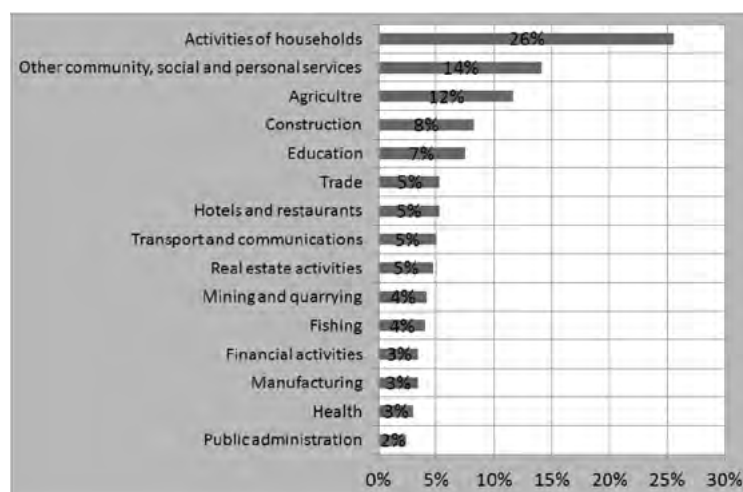
¹⁵ Working week duration according to the Labour Code.

common among own-account workers (14.3 per cent), contributing family members (13.5 per cent), workers employed in households (25.6 per cent), informal sector employees (16 per cent), and workers in households producing for their own consumption (15.8 per cent).

There are no significant gender differences in part-time work (7.4 per cent of women compared to seven per cent of men), but there are significant rural-urban discrepancies (4.9 per cent of rural workers compared to 9.2 per cent of urban workers). However, many women report full-time employment with a working week shorter than 40 hours, as required by the national legislation. This is why their share is 37.6 per cent compared to 25.3 per cent for men. This is more specific to women who have at least one child of preschool age.

There are also significant differences among economic activities, with high incidences of part-time work in households that employ workers (26 per cent), other community, social and personal service organizations (14 per cent), agriculture (12 per cent) and construction (12 per cent) (Chart 22). The share of part-time employees increased from 2.5 per cent in 2003 to four per cent in 2013, predominantly in the education, agriculture, construction, and other community, social and personal service sectors.

Chart 22. Share of part-time employment by economic activities, by percentages, 2013



Source: Authors' calculations based on NBS data.

The population employed part-time is more dissatisfied with their jobs. While only 20 per cent of full-time employees want to change their current job situation, 31.6 per cent of part-time employed persons want to change their job situation. Considering that the working week is significantly shorter for part-time employees (22.4 hours on average compared to 38.6 hours per week), the most important reason for the complaint is their desire to work longer hours for a corresponding increase in salary or income. Respondents also cited their desire to change a job that is seasonal or casual, their desire for higher remuneration per hour, and their desire to have an employment contract or to report their salary.

Therefore, it can be concluded that there is a high correlation between part-time work and seasonal or occasional work. Indeed, 13.7 per cent of fixed-term employees work part-time, compared to only 3.3 per cent of permanent employees. 17.8 per cent of employees performing casual jobs are part-time, compared to 5.6 per cent of those performing seasonal jobs.

1.5. Conclusions

Informality is an important part of the Moldovan economy that generates significant losses for the national budget and renders a part of the labour force insecure. The methodology for measuring informality used by the National Bureau of Statistics estimates the “non-observed” economy,

which includes informal sector production, production of households for their own use, and hidden production within the formal sector. The main features of the non-observed economy in Moldova are as follows:

- It decreased significantly until 2007, followed by a slight increase up to 23.1 per cent of GDP in 2013. The initial decline was due to the fall in household production for their own use. The reverse trend was due to an increase in the formal sector hidden production, in the informal sector production between 2007 and 2010, and in the own-use production of households between 2010 and 2013.
- The non-observed economy is highly concentrated in few sectors. The leading sector is agriculture, with a high incidence of household production for their own use. However, high shares of non-observed GVA are also registered in construction and trade, as informal sector production, and in hotels and restaurants as hidden production in the formal sector.

Such a large informal economy implies correspondingly high shares of informal employment. Over 30 per cent of the employed population in the Republic of Moldova had an informal job in 2013. The main features of this informal employment are as follows:

- 362,800 persons had an informal job in 2013, which represented 30.9 per cent of the total employed population in the Republic of Moldova. This share decreased from 38 per cent in 2003, along with a decrease in the total number of informal jobs by 30 per cent. This was due to the reduction of informal employees in formal sector enterprises (by 65 per cent) and the reduction of own-account workers in informal sector enterprises (by 23 per cent).
- At the same time, the number of formal jobs has not changed dramatically since 2003, decreasing by only 3.6 per cent. The number of formal employees in formal sector enterprises has increased by 6 per cent, and formal own-account workers in formal sector enterprises has decreased by almost 50 per cent.
- Informal employment outside the informal sector, i.e. in the formal sector and in households, has always prevailed in Moldova over informal employment in the informal sector due to the high share of own-account workers in the household sector. Both informal employment in households and formal sector enterprises declined during the last decade. Informal employment in the informal sector was also on the decline for several years. However, the trend inverted and informal employment has risen by 30 per cent since 2006. Currently, 37 per cent of informal employees in the informal sector are own-account workers.
- Most informal jobs, 68.7 per cent, are in the agricultural sector. The number of informal jobs decreased in almost every sector except construction.
- While men and women had the same probability of participating in an informal job in the early 2000s, the share of informal employment as a part of total employment was 34.1 per cent for men compared 27.1 per cent for women in 2013.
- The involvement of the youngest age group (15–24 years) in informal employment is the highest, determined by the difficult transition they face from education to the labour market. Informal employment is more widespread among persons with lower levels of education (primary, lower secondary and upper secondary general education), but also graduates of vocational education. This is the result of the deteriorating quality of

the vocational education system, and the broken link between the labour market needs and the educational system output. At the same time, the number of informal jobs decreased most significantly in this cohort from 2003 to 2013 (by 40.5 per cent). This is due to a slight increase in the educational enrolment rate of the population aged 16–23 years, their delayed entrance into the labour market, and a modernized economy that requires more skills and abilities.

- Most of the informal jobs are in elementary occupations. Thus, many low-skilled workers enter the labour market informally and are caught in an informal employment trap, since there is no demand for them in the formal labour market.
- The most significant discrepancies in informal employment in Moldova are between rural and urban residents. In 2013, while only 13.5 per cent of urban employees have an informal job, 46.4 per cent of rural employees work informally. Most of the informal employment in rural areas is concentrated in the households, specifically in agricultural sector.
- Informal jobs are more insecure due to their uncertain nature and their shorter duration. Of the people who reported having an informal job, 64 per cent were employed in their position for less than two years. For those with formal jobs, this share was only 30 per cent.
- The population with informal jobs seems to be more dissatisfied with their current status, as 25.4 per cent reported that they wanted to change their job situation, compared to 18.8 per cent of those in formal employment. The most important reason cited was the desire to have a higher salary or work longer hours with a corresponding increase in salary, quoted by 44.5 per cent of those dissatisfied with their informal job. LFS data confirm that lower salaries are common in informal employment sectors.
- Research from the Ministry of Labour, Social Protection and Family in 2011 shows that the phenomenon of undeclared wages is even more widespread than undeclared employment per se. They estimate that 57 per cent of the employed population did not fully report their salaries in 2010. The value of all undeclared salaries and incomes totalled 5.7 billion EUR, and the share of undeclared wages was 29.6 per cent of the total wage bill and 13 per cent of GDP.

High informal employment in the Republic of Moldova is a consequence of both the structure of the national economy and the functioning of the economic system. In a national representative survey, 19.5 per cent of the respondents consider it justifiable to under-report wages for fiscal purposes. The low quality of public goods and services, a low confidence in the pension system and low levels of pension benefits, poor transparency of public spending, the non-conforming culture, low incomes and few employment opportunities are all cited as reasons for the under-reporting of wages and income.

The national statistics do not yet reflect all non-standard forms of employment, but several aspects can be analysed thus far:

- Only employees specify their type of employment, fixed-term or permanent, in the national LFS. The self-reported share of fixed-term employees was 7.1 per cent in 2013. The share was 3.6 per cent for formal employees compared to 40.2 per cent for informal employees.
- The highest incidence of fixed-term employment is in the agricultural sector (35.4 per

cent) and in households as employers (17.5 per cent). The proportion of fixed-term employment contracts is also high in some public sectors, such as public administration and education.

- Seasonal work was reported by 16.5 per cent of fixed-term employees in 2013. These jobs are concentrated in the agricultural sector (77.2 per cent), manufacturing (given the high share of the food processing industry, which implies seasonality), and construction.
- Casual work was reported by 5.3 per cent of fixed-term employees in 2013. The employees worked predominantly in construction (35 per cent) and agriculture (32 per cent).
- In 2013, 7.2 per cent of employed persons worked part time. Part-time work is also more typical for informal employment: it was reported by 3.8 per cent of formal employees and 14.7 per cent of informal employees. Part-time work is more common among own-account workers and contributing family members, workers employed in households, informal sector employees, and workers in households producing for their own consumption.

Chapter 2. The key factors of the informal economy: Overview of the domestic business climate in the Republic of Moldova

As shown in Chapter 1, the informal sector makes up a significant share of the Moldovan economy, undermining the competitiveness of firms and the security of their employees. This requires a clear understanding of the incentives of firms to resort to informality, and of employees to accept or even request to be hired or paid informally. One fundamental cause is that the costs of formal activities are higher than the costs for informal ones. The costs of formal activities can include both direct costs (taxes, various administrative payments, and credit) and indirect costs (time needed to achieve regulatory compliance, access to justice, the pressures of competition, and access to technology). When these costs exceed the costs of informal activity, which largely depend on the cost of fines and the likelihood of being caught, there is a natural incentive to go informal. Hence, any solution to the problem of the informal economy must address the need to decrease the costs of formal activity and to increase the benefits of formality over those of informality.

An additional factor shaping the decision to go informal relates to the return on taxes. If the Government fails to provide public goods and services of decent quality or spends public money in a non-transparent manner, firms and households have no motivation to pay taxes. This chapter will examine the incentives driving firms and households in Moldova to choose informal activities instead of formal ones, and will provide recommendations for dealing with this problem. Moreover, since the empirical analyses have proven that the informality is largely induced by employers rather than by employees, we will focus our attention on the incentives of firms and the issue of employee security.

2.1 Desk research

A recent report commissioned by the Expert-Grup (an economic think-tank based in Moldova) in 2014 argues that the main determinants for the high share of informality in the Moldovan economy are the high fiscal burden¹⁶, the low tax morality, the poor coordination of the institutions involved in dealing with the informal economy, and the deficient regulatory framework in which these institutions operate. The authors explain tax morality as the internal incentives of individuals to pay or avoid taxes. Based on a country-wide representative survey, Expert-Grup argues that, in Moldova, the level of tax morality is lower than in other countries in Central and Eastern Europe. This is the result of weak institutions, a widespread perception of corruption, and low confidence in the pension and budgetary systems overall, issues that were analysed in Chapter 1. Additionally, the study reveals that the fiscal regulatory framework is ambiguous, which undermines the efficiency of the relevant institutions and creates additional administrative pressures on firms. The responsibilities of the key institutions that deal with tax collections overlap with each other in many cases, especially those of the Tax Inspection and Customs Service. There is also poor coordination between the Tax Inspection Office and other regulatory agencies. These factors negatively influence the capacity of these institutions to prevent, identify and penalize firms' avoidance practices.

¹⁶ Although the fiscal burden is not high compared to other countries in the region, it is perceived by the entrepreneurs to be an important constraint. It can be explained by the weaknesses in the private sector (e.g. low productivity and weak financial conditions), as well as by the inefficient fiscal administration.

In a public policy proposal from 2011 dealing with informal employment, the MLSP argues that firms working in the formal sector employ informal workers to save on labour costs, to benefit from their greater bargaining power compared to their employees, and to benefit from regulatory failures. The latter refers to the inefficient penalization system for employers and employees who act informally. Particularly, the Labour Inspection agents have limited competencies to unveil informal employment practices, and the fines levied on firms are very low.

The most recent studies commissioned by governmental and non-governmental agencies point to another core determinant of the high informality in Moldova: the relatively low costs of informal activities compared to formal ones. This is due to the significant administrative burdens on firms, low fines, and the low probability of one's informal economic activities being detected. Obviously, Moldova is not alone in this regard. The quality of the legal framework is crucially important in limiting the size of the informal sector in developing countries (Dabla-Norris et al., 2008). Other factors, such as the fiscal burden, difficult regulations and financial constraints are also relevant in determining firms' propensity to go informal. Another relevant study emphasizes the importance of these administrative burdens, stating that entrepreneurs go underground not just to avoid official taxes but to reduce the burden of bureaucracy and corruption (Friedman et al., 2000). The rather broad consensus in this matter is confirmed by a World Bank working paper: based on the estimates of the shadow economies of 162 countries, it finds that the driving forces of the shadow economy are an increased burden of taxation (both direct and indirect), the labour market regulations and the quality of public goods and services, as well as the state of the "official" economy (2010).

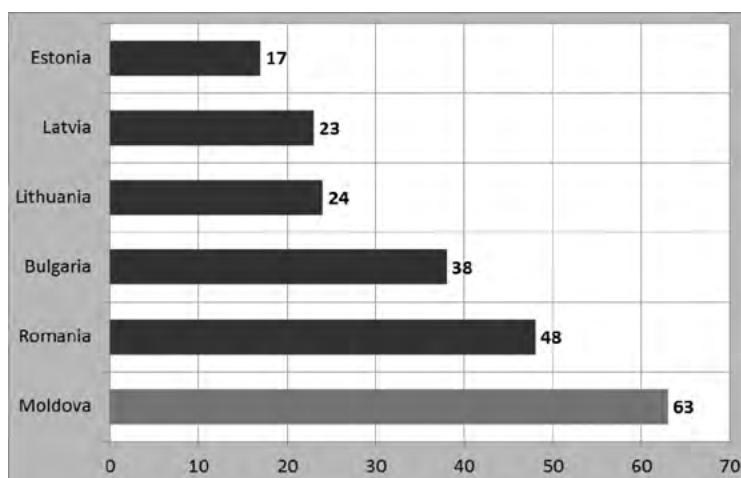
Indeed, legal and regulatory failures also explain firms' propensity to go informal in Moldova. Another study commissioned in 2013 by the Expert-Grup for the National Employers' Confederation of Moldova, based on a nationally representative survey among firms, suggests that managers perceive that the time spent complying with government regulations is a key developmental constraint for their enterprises. The study also finds that the fiscal burden and complicated fiscal administration is another major issue hampering the activity of enterprises. These business regulatory framework problems have also been emphasized by the most recent National Human Development Report (2014), commissioned by the UNDP in Moldova. It argues that, despite the progress achieved so far, the reform launched by the Government of Moldova in 2004 aimed at enhancing the business environment has brought only half of the expected results. Moldova subsequently progressed more slowly than many countries in the region (especially the Baltic States) in the field of business regulation, and the private sector share of the Moldovan economy remained relatively low.

All in all, the empirical evidence, both at the domestic and international level, suggests that the quality of the regulatory framework, the institutional setting and the fiscal burdens play a fundamental role in explaining the propensity of firms to go informal. Simply put, these incentives are driven by the lower costs of informal activities compared to formal activities. When it is less costly and more profitable to activate informally than formally, both employers and employees have a natural incentive to go informal. Although it seems rational, this decision reveals the short-sightedness of firms and employees, making everyone worse off in the long run (a sort of "prisoners' dilemma"). In the next sections, we will explore the determinants of the informal economy in more detail.

2.2 Business regulatory framework

The regulatory framework for enterprises defines the rules established by the Government that are to be followed by firms. Theoretically, these regulations should discourage any negative externalities and encourage positive externalities, so that entrepreneurs may be unconstrained in their core activities and can contribute, in all possible ways, to the country's development. However, when these rules are non-transparent, unpredictable, too costly, abusive, or applied unequally and discretionarily to different participants, everyone will look for ways to avoid them. This is why the quality of the regulatory framework is instrumental in explaining firms' propensity to go informal. The most reliable (but far from ideal) measure for the quality of business regulation is the World Bank's Doing Business Index. According to the 2015 results, Moldova is ranked 63rd out of 189 countries, reflecting an improvement by 19 positions compared to the previous year (when it was ranked 89th out of 189 countries).

Chart 23. Doing Business 2015 rankings of Moldova and other reference countries



Source: *Doing Business 2014 and 2015*, World Bank.

However, this progress has been concentrated in only three policy interventions:

- (i) the abolishment of minimal capital requirements when registering a new firm, which pushed Moldova up 16 positions (from 51th in 2014 to 35th in 2015) in the “Starting a Business” component of the Doing Business Index;¹⁷
- (ii) the implementation of an electronic system for filing and paying social security contributions, which lifted Moldova by 35 positions (from 105 in 2014 to 70 in 2015) in the “Paying Taxes” component of the Doing Business Index; and
- (iii) the improved functioning of the private credit bureau, which moved Moldova up 76 positions (from 99 in 2014 to 23 in 2015) in the “Getting Credit” component of the Doing Business Index.

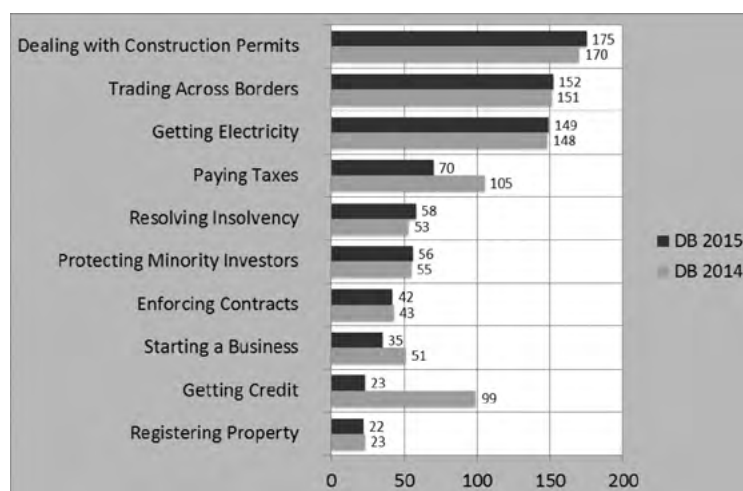
While the aforementioned policy interventions had a positive effect on the business regulatory framework, these effects have had only a marginal impact in practice, while the most problematic sectors have not seen similar improvement. Indeed, despite the impressive progress in the “Starting a Business”, “Paying Taxes” and “Getting Credit” components, Moldova regressed in the other three components, which can be considered their “Achilles Heel” in the current domestic business environment¹⁸. They moved down in “Dealing with Construction Permits” (from 170 in 2014 to

¹⁷ The rights of employees are guaranteed by the insolvency law, according to which wage liabilities are considered to be the top priority liabilities in case of a firm's insolvency. According to article 43, (2), the wage liabilities are the second priority (the health costs or costs associated with the death of the employees are the first priority), and third are any liabilities against the Government.

¹⁸ Moldova registers the lowest scores in these areas.

175 in 2015), “Trading Across Borders” (from 151 in 2014 to 152 in 2015) and “Getting Electricity” (from 148 in 2014 to 149 in 2015). Compared to other countries, these conditions worsened in Moldova since 2014 (Chart 24).

Chart 24. Moldova’s ranking according to key Doing Business components



Source: *Doing Business 2014 and 2015*, World Bank.

As shown in Chapter 1, the construction sector, which relies heavily on construction permits, and the trade and transportation sector, which depends on documents authorizing export and import procedures, are among the mostly exposed industries to the informal economy¹⁹. Moreover, Chapter 1 reveals that construction is the only sector where informal employment increased considerably since 2003, by 26.9 per cent. Obviously, there are other factors that relate to the specifics of this sector, such as the low probability that informal employees will be detected on construction sites. Still, it is reasonable to assume that these harsh administrative barriers and burdensome business regulations specific to this sector motivate firms to resort to informality. Interestingly enough, the cost of getting construction permits and the documents to export or import, which appear to be the most difficult to obtain, is relatively low: a construction permit is 0.8 per cent of the average warehouse value (compared to 5 per cent in Europe and Central Asia), and export or import costs are typically 1,510 dollars (USD)/1,870 USD per container (compared to 2,154 USD/2,435 USD per container in Europe and Central Asia).

Thus, the administrative burden appears to be much higher than the cost. In order to obtain a construction permit in Moldova, it is necessary to complete 27 procedures (compared to 16.1 procedures in Europe and Central Asia). These require 247 days on average, as compared to 176.8 days in Europe and Central Asia. A firm must collect nine documents to export and 11 documents to complete an import procedure, while European and Central Asian countries require, on average, seven documents for export and eight documents for import.

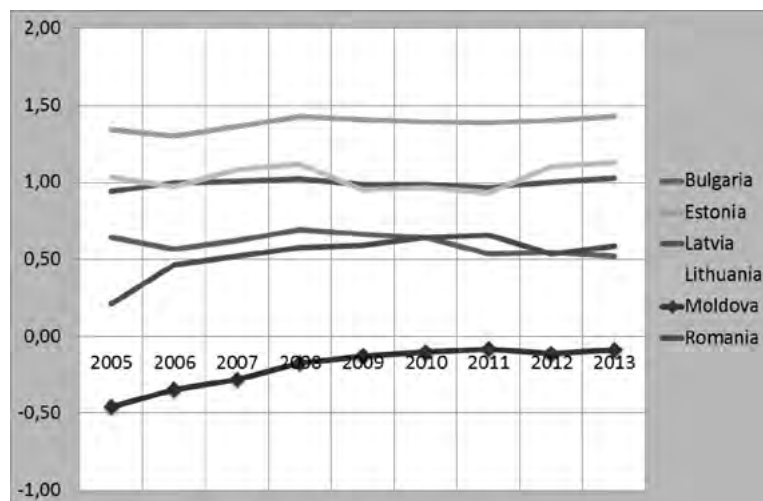
The burdensome and inefficient bureaucracy hampering entrepreneurial activity influenced the Moldovan firms’ perceptions about the overall regulatory quality index, as estimated by the World Bank²⁰. This reflects people’s perceptions as to how well the Government formulates and

19 Obviously, these are not the only factors explaining the high share of informality in these sectors. Other reasons are related to the specifics of these industries, where it is much more complicated for the Labour Inspection to depict informal economic activities.

20 The Worldwide Governance Indicators (WGI) are sets of research data summarizing the views on the quality of governance provided by a large number of enterprises, citizens and expert survey respondents in industrial and developing countries. This data is gathered from a number of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

implements sound policies and regulations that permit and promote private sector development. It is based on a scale from -2.5 to 2.5, with higher values indicating better performance. Chart 25 reveals that, despite a marginal improvement over last year, the regulatory quality in Moldova is much lower compared to other reference countries²¹.

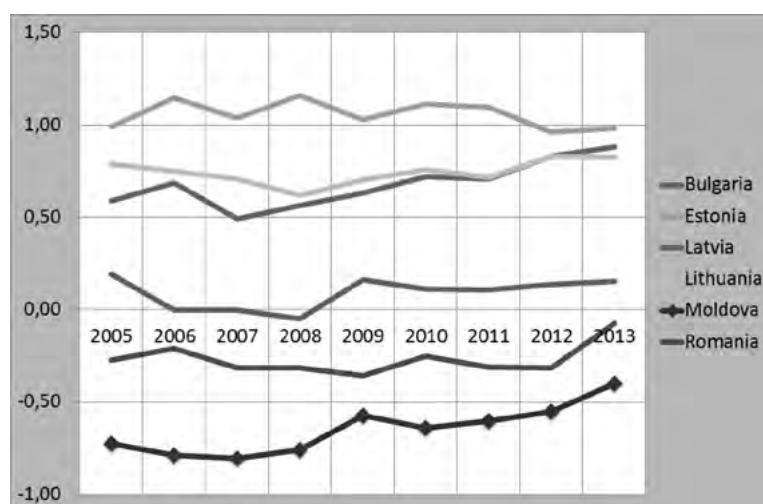
Chart 25. Regulatory Quality Index in Moldova and other reference countries



Source: *The Worldwide Governance Indicators, World Bank, 2014.*

This poor regulatory quality is directly connected to people's negative perception of the Government's efficiency. Chart 26 reveals that Moldova lags behind the reference countries with regards to the domestic perception of the quality of public services, the quality of the civil service, its degree of independence from political pressures, the quality of policy formulation and implementation, and the credibility of the Government's commitment to such policies (definition of the Governance Effectiveness Index as measured by the World Bank).

Chart 26. Government Effectiveness Index in Moldova and other reference countries



Source: *The Worldwide Governance Indicators, World Bank, 2014.*

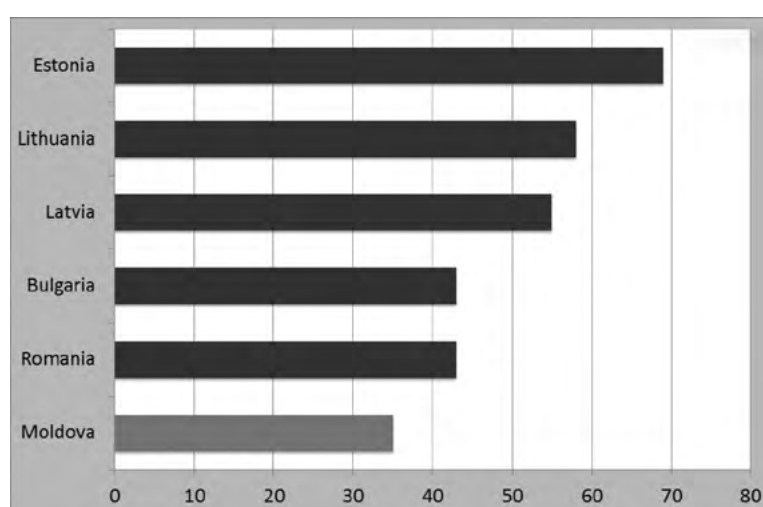
As a result of Moldova's large bureaucracy, coupled with its poor regulatory quality and governmental inefficiency, firms are forced to spend a significant amount of time attempting to comply with the existing regulations. The survey conducted by the Expert-Grup for the National

²¹ The reference countries have been selected based on their territorial proximity and similarities in their economic structure.

Confederation of Employers of Moldova in 2013 finds that 62.4 per cent of managers or owners surveyed consider the time they spend satisfying business regulations to be a major problem for their firm. This problem is especially acute for enterprises that operate outside the capital city, suggesting that the regulatory quality is worsened by the weak institutional framework in the regions.

The combination of a large bureaucracy, the poor regulatory quality and the rather inefficient Government fuelled²² a high corruption perception index²³ (Chart 27). According to the survey mentioned earlier, corruption and bribery are considered by firms to be among the top five most problematic factors for business development in Moldova; the other four are political instability, a high fiscal burden, the shortage of properly trained workers and poor access to finance. According to the 2012–2013 WEF Global Competitiveness Report, corruption is perceived to be the greatest challenge for doing business in Moldova.

Chart 27. Corruption Perception Index 2014 in Moldova and other reference countries



Source: Transparency International.

Note: A country or territory's score indicates the perceived level of public sector corruption on a scale of 0 (highly corrupt) to 100 (very clean).

Such a high perception of corruption in Moldova is also explained by the ineffectiveness of policies aimed at reducing it. According to the aforementioned survey, 87.3 per cent of respondents state that the Government is not sufficiently dedicated to combating corruption. The “Control of Corruption” indicator measures the extent to which public power is exercised for private gains, and the extent to which the State is captured by elites and private interests, on a scale from -2.5 and 2.5 (where higher values reflect better performance). Moldova has the lowest index compared to its reference countries, and performed quite badly in recent years (Chart 28).

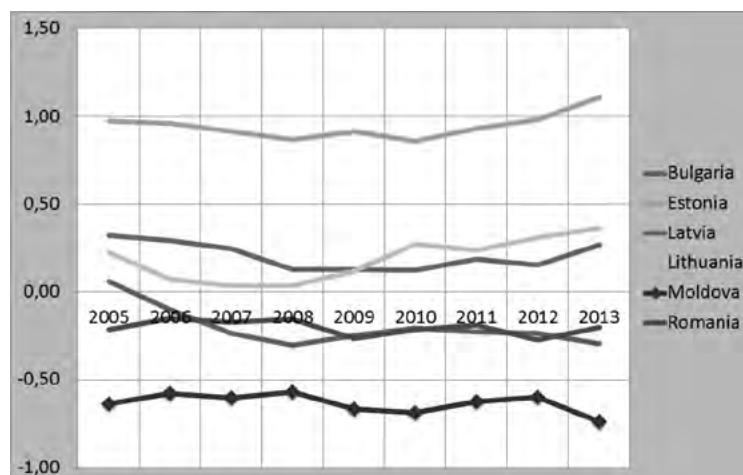
A weak and unfriendly business regulatory framework is not only the problem the employers but of employees as well. The poor business climate undermines the financial conditions of firms and thus their ability to provide decent jobs. As a result, Moldova has both the lowest average wage and the lowest employment rate in the region. With such scarce employment opportunities, people are also unable to set up their own small businesses. Hence, both the employment rate and the density

22 Government inefficiency could also be made evident by the fact that Moldova spends about 7 per cent of its GDP on education and about 5 per cent of its GDP for health sectors (relatively high shares compared to other CEE countries), whereas the education and health indexes calculated by the UNDP are among the lowest in the CEE countries. See the State of the Country Report, “Republic of Moldova 2013”, Expert-Grup.

23 The Corruption Perception Index is calculated by Transparency International and is based on a scale from 0 (“highly corrupt”) to 10 (“highly clean”).

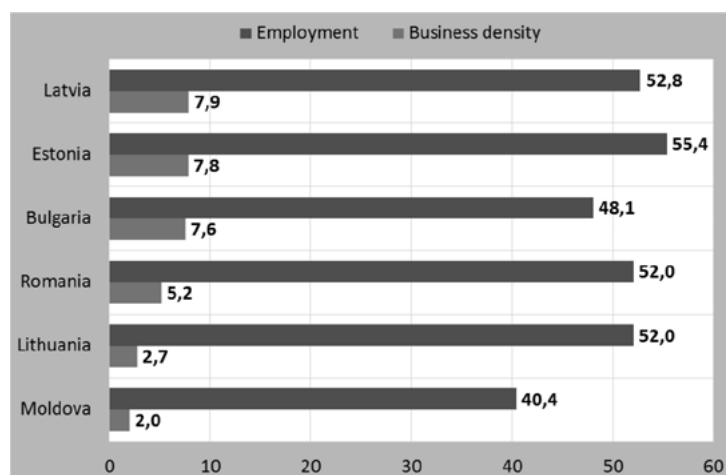
of new businesses are among the lowest in the region. This explains the poor labour absorption of the Moldovan economy, which is a fundamental factor driving the informal economy²⁴ (Chart 29).

Chart 28. Control of Corruption Index in Moldova and other reference countries



Source: *The Worldwide Governance Indicators*, World Bank, 2014.

Chart 29. New business density (new registrations per 1,000 people ages 15-64) and employment to population ratio, 15+, total (%) (modelled ILO estimate) in Moldova and other reference countries, on average, 2005-2013



Source: *World Development Indicators*, World Bank.

In conclusion, despite some improvements, the Moldovan business environment remains hostile and functions more poorly than in the reference countries. This is partially related to the large, inefficient bureaucracy in Moldova, and the poor quality and clarity of its business regulations. It places significant administrative burdens on firms and causes many opportunity costs, due to the large amount of time firms waste when complying with existing regulations. As a result, the corruption perception is relatively high, and firms have strong incentives to go informal. These regulatory constraints turn into problems for the entire population, since firms are unable to create decent jobs and the economic opportunities for future entrepreneurs are drastically curtailed.

24 "The Informal Economy: Fact Finding Study", Department for Infrastructure and Economic Cooperation.

2.3 Fiscal and para-fiscal burdens

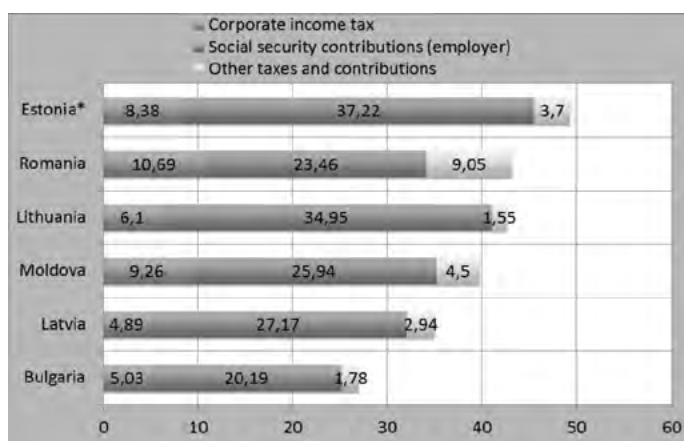
The success of any social contract largely depends on the mutual engagement of firms and households paying taxes in full, while the Government distributes them in a transparent, equitable and efficient manner. However, when taxes are perceived to be too high, fiscal procedures too complicated and time-consuming, or the Government is inefficient, non-transparent and abusive in collecting and using this money, the firms and employees have a natural incentive to avoid taxation. It is thus correlated to the returns on taxes that the firm and its employees receive, which depends on the quality of the state infrastructure and other public goods and services, the quality of regulation, transparency and governmental efficiency. The propensity to go informal will be stronger when these returns are lower than the level of taxes combined with the direct and indirect costs of fiscal compliance.

In Moldova, the fiscal and para-fiscal burdens appear to be non-trivial for both employers and employees. According to the survey conducted by Expert-Grup in 2013, many firms reported that they oftentimes offer bribes when controlled by the tax authorities (45 per cent of respondents). Such a high exposure to corruption in matters related to fiscal controls can be explained by: (i) high perceived fiscal pressure, motivating companies to avoid taxation; (ii) unclear and burdensome tax regulations, which lead firms to waste time and make mistakes when calculating their taxes, while the tax authorities have a discretionary and often abusive power; or (iii) the high likelihood that a bribe will be effective and result in no sanctions. In Moldova, all three factors are valid.

High fiscal pressure

The survey conducted by Expert-Grup in 2013 revealed that firms perceive the high fiscal burden as the second biggest factor constraining their development, the first cited as political instability. The highest taxes paid by employers are the 12 per cent corporate profit tax, the 23 per cent social insurance tax and the 4 per cent health insurance contributions. Nevertheless, compared to other reference countries, the fiscal burden appears to be moderate. According to Doing Business 2015, the total taxes of firms make up 39.7 per cent of their total commercial profits in Moldova, whereas in Romania the same figure is 43.2 per cent, Lithuania 42.6 per cent, and Estonia 49.3 per cent (Chart 30). This negative perception of Moldovans regarding the fiscal pressure could rather be explained by the poor and unstable financial conditions of many firms in Moldova (Moldova ranked 124th out of 144 countries in business sophistication), and by the lack of trust and negative feelings people have towards public institutions and the returns on taxes (such as the poor quality of public services or the inefficient regulatory framework).

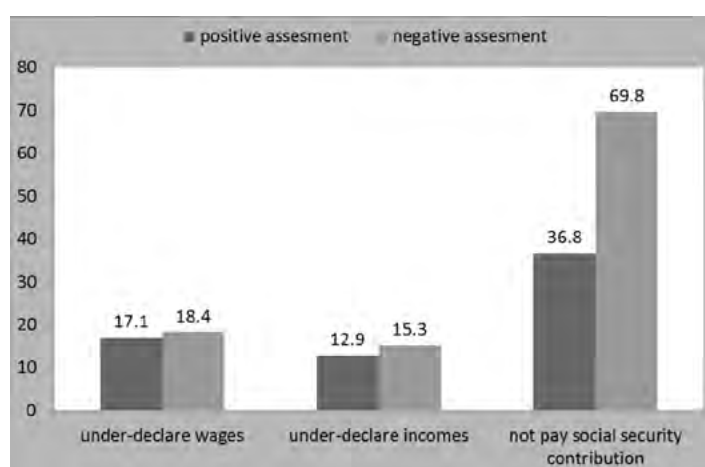
Chart 30. Main taxes paid by firms (% of commercial profit)



Source: Doing Business 2015, World Bank. *Dividend tax is applied

Because of their very low confidence in the pension system, households share a similar perception. Though this factor may be analysed alongside other public services, the problem is of greater magnitude in the Republic of Moldova and needs to be stressed independently. According to the survey, only 17.5 per cent of the population has any trust in the pension system. Almost all respondents (93.7 per cent) believe that the pension level in Moldova is not enough to survive on, which is true: the average pension represented only 65 per cent of the cost of living in 2013. At the same time, the social security contributions are quite high, especially for employers, as shown in Chapter 2. Additionally, 70.8 per cent of the respondents think that there is no equity in the pension system, and 59.2 per cent of the respondents do not believe that they will receive a pension at their retirement age based on their contributions. In total, 30.9 per cent of the population believes that it is not worth it to pay social security contributions; 18.2 per cent did not answer, and only 50.9 per cent of the respondents consider the pension system to be worth contributing to. This influences the willingness of the population to declare their wages and incomes for fiscal purposes (Chart 31).

Chart 31. Share of respondents who consider it justifiable to under-declare wages and incomes and not pay social security contribution based on their trust in the pension system, %, 2014



Source: Author's calculations based on the survey data.

Such low levels of trust in the public pension system make some people indifferent to their own pensions. Only 47.5 per cent of the population has often thought about their pension, while 23 per cent has rarely thought about it and 25.5 per cent has never thought about it. Though this indifference is more common within the youngest cohort, it is present in the other age groups too. The likelihood that people will accept informal wages is higher if they are not considering their future pensions. Thus, 31.3 per cent of the respondents who thought rarely or never thought of their pensions consider undeclared wages to be legitimate. The share is much lower (20.7 per cent) for those who have thought about their pensions.

As in other countries, the highest burden comes from the taxes related to labour costs. Particularly, the levels of compulsory social and health insurance contributions are perceived to be a powerful constraint on business development for 52.2 per cent of respondents. As a result, they create strong incentives for firms to avoid these labour costs by resorting to informal employment and remuneration.

Overall, the taxes in Moldova are not high compared to other reference countries. The negative perception held by Moldovans regarding the national fiscal pressure stems from (i) the low productivity and sophistication of Moldovan firms, which cause poor and unstable financial conditions, and (ii) the low returns on taxes paid. These are the key factors fuelling a firm's decision to avoid taxes and go informal.

The fiscal burden appears to be a problem for employees as well. A recent survey revealed that the institutional and regulatory framework creates incentives for many employees to accept or even look for informal payments in order to maximize their net remuneration. These results corroborate the findings from Chapter 1, where many employers reported that employees often leave their formal job if they are offered an informal but better paid job in the construction sector. The survey identified the key factors encouraging employees to go informal as: the poor quality of public goods and services (low returns on taxes), and a low confidence in the sustainability of the pension system and in the key government institutions (fiscal institutions, the Government and the Parliament). An additional explanation is related to cultural factors: Moldovan society has a low tax morality and is intrinsically tolerant of corruption and tax evasion, which again stems from low confidence in the Government (Expert-Grup, 2014). These are the key triggering factors of the informal economy and are extensively explained in Chapter 1.

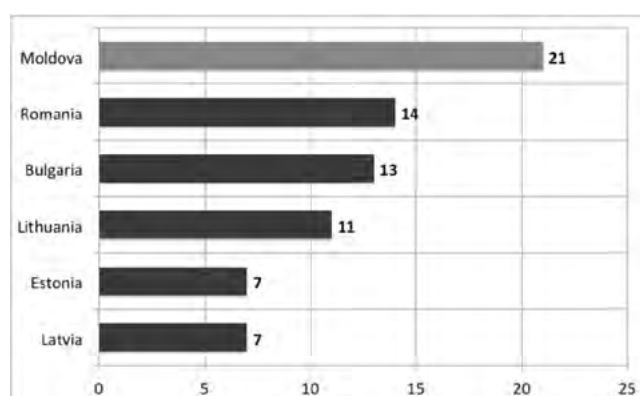
Burdensome tax regulations

The tax legislation is often ambiguous and hampers the efficiency of the fiscal administration. It consists of two sets of regulatory acts that often overlap with each other. The first act is the Fiscal Code, which stipulates rather general provisions, and the second act consists of a series of more detailed laws aimed at describing and enforcing the Fiscal Code. This legislation also creates uncertainty as to which institutions are responsible for particular forms of tax collection. For example, most of the taxes collected by the Customs Service are not custom duties, but different types of taxes that should be collected by the Fiscal Service. These ambiguities create additional pressures on firms and complicate the fiscal administration (Expert-Grup, 2014).

This complexity and, particularly, the instability of the tax regulations complicates accounting procedures and leads to error when firms calculate their taxes. As a result, fiscal administration, including the calculation, recording and payment of taxes, is considered an important constraint for business development by 54.1 per cent of sampled enterprises (Expert-Grup et al., 2013). Recently created firms have an even worse perception, with 67.8 per cent of firms created after 2005 believing fiscal administration to be a constraint for enterprise development (compared to only 47.1 per cent of the firms created before 2000).

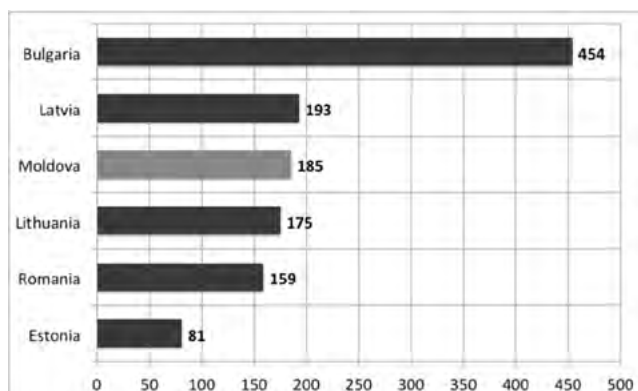
According to Doing Business 2015, Moldovan firms need to complete a total of 21 fiscal payments, the most among the reference countries. Although the amount of time required to make these payments is similar to that in other countries, this high number of fiscal payments means firms must interact with a larger number of public authorities, which is considered a burden for most firms. It also exposes firms to the risk of corruption: according to the survey, enterprises are forced to offer bribes 45.4 per cent of the time when controlled by the tax authorities.

Chart 32. Fiscal payments (number per year)



Source: *Doing Business 2015*, World Bank.

Chart 33. Time needed to deal with fiscal payments (hours per year)



Source: *Doing Business 2015*, World Bank.

Overall, the fiscal administration appears to be quite deficient compared to the fiscal burden. This means that Moldovan firms are forced to make several fiscal payments, although the ambiguous tax regulations expose many entrepreneurs to the risk of corruption. As a result, the majority of businesspersons interviewed stated that the fiscal administration poses a significant constraint on business development. This is one of the high costs of conducting formal business in Moldova, creating an additional powerful incentive for firms to go informal.

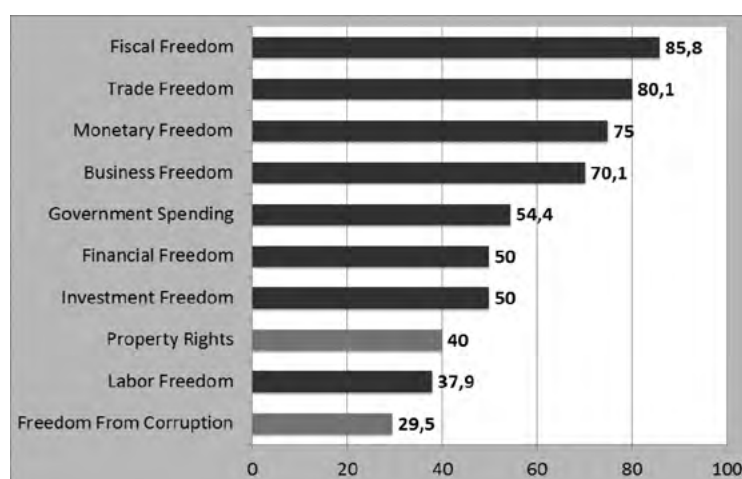
2.4 Access to justice and the rule of law

Creating a friendly business environment for enterprise development is very simple. Before analysing the market size, fiscal burden, degree of competition and other important factors that determine the investment attractiveness of a country, entrepreneurs have three basic needs: security, predictability and equitable treatment. The strong rule of law, an independent and respectable judicial system, and unrestricted access to fair justice all encourage entrepreneurship. This helps firms feel certain about the security of their investments, their property rights, and their interaction with public authorities, suppliers, customers and competitors, and their business environment overall is more predictable, equitable and secure. At the same time, the weak rule of law, a discretionary judicial system, and limited or unequal access to fair justice lead to uncertainty and red-tape, which discourage investments (especially long-term ones), competition, productivity, and ultimately the competitiveness of the entire economy. Therefore, access to justice and the rule of law are among the most fundamental building blocks of any State and are probably the most important determinants of business development. From the employee's perspective, access to fair justice increases their bargaining power with their employers and their security against potential abuses. Access to justice and the rule of law not only contribute to solving labour disputes in an equitable manner, but they also place pressure on firms to work formally.

In Moldova, two of the most problematic factors still hindering growth are corruption and judicial access (Institute for Security Studies, 2013). The weak rule of law undermines the investment attractiveness of the country, while access to fair justice is limited. Thus, Moldova ranks the lowest (144th out of 144 countries) in the "Irregular payments and bribes: Obtaining favourable judicial decisions" component of the Global Competitiveness Report 2014–2015. Moldova also performs poorly in the "Property rights" component, ranking 125th in terms of the strength of its property rights and 118th in terms of the strength of its intellectual property rights protection. These indicators form a hazardous combination for the domestic business environment. Due to the weak rule of law, property rights are not properly protected, and these failures are multiplied by a dependent and seemingly corrupt judicial system, as Moldova ranks 141st out of 144 countries in terms of judicial independence.

Another relevant international ranking confirms the above-mentioned concerns. According to the 2014 Index of Economic Freedom, computed by the Heritage Foundation, Moldova received some of the lowest scores for the components “Property Rights” and “Freedom from Corruption” (Chart 34). According to the report, the judiciary is constitutionally independent, but the legal framework is ineffective and any reform efforts suffer from a lack of funding. Moreover, the enforcement of intellectual property rights is sporadic. The report also underlines the problem of corruption, which is especially acute in law enforcement, the judicial system, the public service, political parties, the educational system, and the legislature.

Chart 34. 2014 Index of Economic Freedom, score per components



Source: The Heritage Foundation.

Note: The Index has a scale from 0 to 100 and is derived by averaging ten quantitative and qualitative factors of economic freedom, with an equal weight given to each.

Last but not least, the International Monetary Fund recently stated that judicial reform is essential to protect investors and foster investments, and this was one of the key recommendations addressed to the Moldovan Government to enhance their business environment (IMF, 2014). Employees, who have fewer resources and administrative tools than companies do, are vulnerable to abuses from and disputes with their employers. The weak enforcement of the legal framework and the poor, inefficient judicial system does not ensure the adequate protection of employees against informal employment, especially considering the low bargaining power of employees compared to their employers.

The failure of the Government to provide equitable access to fair justice and a strong rule of law are the key weaknesses of the Moldovan business climate that hamper the sustainable development of enterprises. The by-product of these failures is corruption, which, as shown by the surveys and international rankings, is perceived to be the biggest threat for entrepreneurial activity²⁵. Under these circumstances, if firms can bribe public officials to solve their problems or to get favourable judicial decisions, the incentives to go informal are very strong, while the benefits of formality are perceived as trivial. This atmosphere undermines the mutual confidence between employers and employees. The legal framework for settling any labour disputes is inefficient (UNDP et al., 2014), and the judicial system is oftentimes incapable of solving these disputes in an equitable and efficient manner.

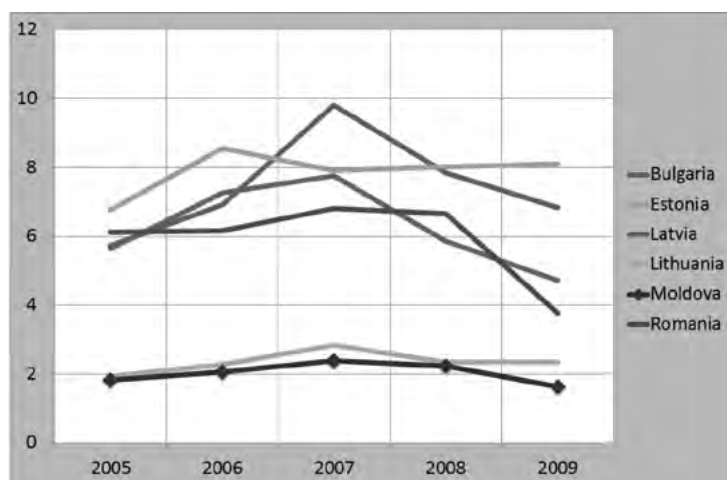
25 Global Competitiveness Report 2012-2013, World Economic Forum.

2.5 Fair competition

One of the most important factors that must be ensured by the market economy is competition. Fair competition allows companies to specialize in sectors where they have competitive advantages and incentivizes them to be more efficient, innovative, and to provide better goods or services. Ensuring a robust competitive environment brings about optimal outcomes for everyone: firms, with greater productivity; employees, as their higher productivity generates higher wages; consumers, with better quality, lower-priced goods and services; and the State, with its larger expected tax base. Fair competition encourages the entrance of new players in the market, and makes it difficult for inefficient firms to remain for long. Fair competition also tends to eliminate companies that work in the informal sector, since they have more access to capital, technologies and labour to remain competitive.

As shown by the “New business density” index, used internationally to indicate the number of newly registered limited liability companies per 1,000 working-aged people (15–64 years old) in a given year, the competition framework in Moldova is the worst compared to its reference countries (along with Lithuania). This reveals an abundance of entry barriers in many economic sectors, discouraging the entrance of new firms and entrepreneurial activity as a whole. As discussed earlier, such a low new business density also points to the limited self-employment opportunities for the population as a whole, especially considering the scarcity of jobs in the economy.

Chart 35. New business density (new registrations per 1,000 people ages 15–64)



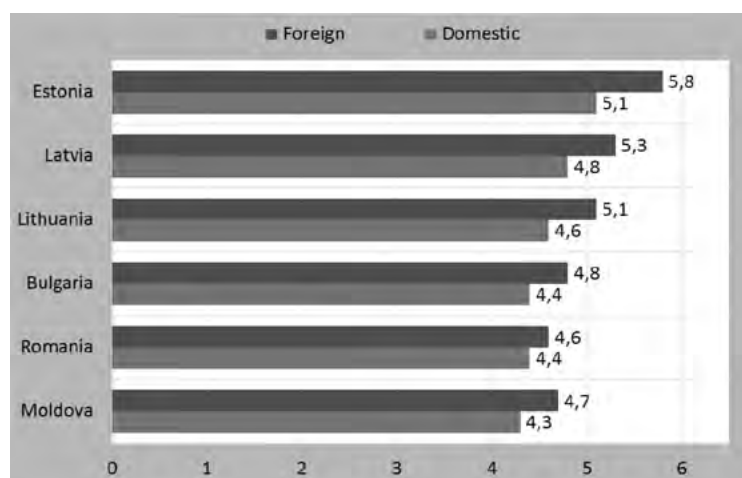
Source: World Development Indicators, World Bank.

The most recent Global Competitiveness Report confirms these flaws in the competition framework. Moldova ranked 97th out of 144 countries under the “Competition” component, being given a score of 4.3 (with one the lowest and seven the best). This score is relatively low compared to other reference countries, with the worst results in the area of domestic competition (Chart 36).

Moldova scored very poorly in terms of domestic competition, ranking 117 out of 144 countries. As shown by Chart 14, this is mainly due to the burdensome agricultural policy, the low effectiveness of anti-monopoly policies, a high concentration of corporate activity for a small number of large producers (market dominance), reduced incentives to invest due to taxation, and a low intensity of domestic competition. At the same time, Moldova performed relatively well in terms of the number of procedures needed to start a business and time required to complete them, ranked 57th and 36th, respectively, out of the 144 countries included. Nevertheless, new business density is relatively low

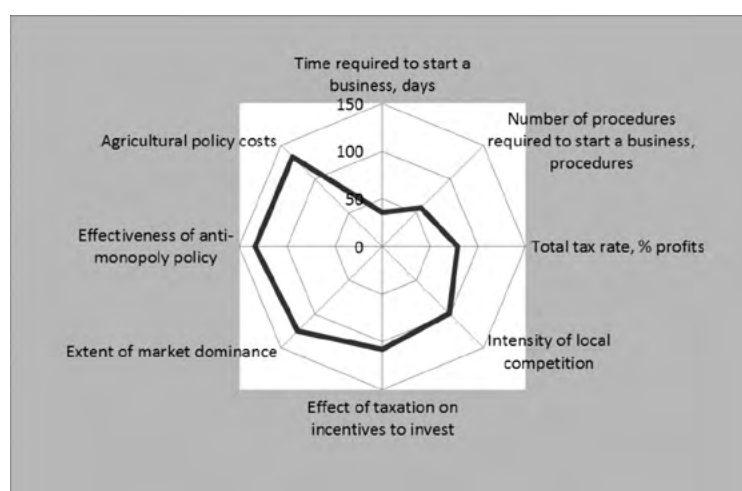
(Chart 37), suggesting that, despite the relative ease to start a business, there are many direct and indirect barriers that discourage entrepreneurial activity and competition in particular.

Chart 36. Domestic and foreign competition, 1-7 (best)



Source: *Global Competitiveness Report 2014–2015*, World Economic Forum.

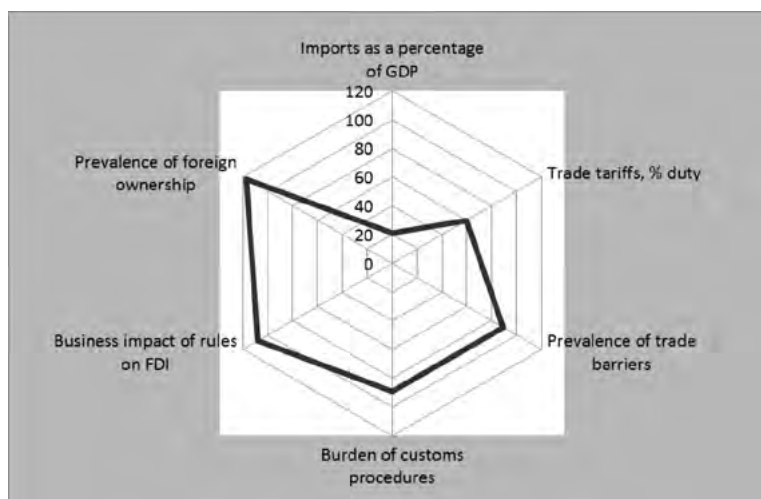
Chart 37. Components of domestic competition (higher rankings mean worse position)



Source: *Global Competitiveness Report 2014–2015*, World Economic Forum.

Moldova's ranking in terms of foreign competition is much better compared to domestic competition; Moldova ranked 57th out of the 144 countries in the Global Competitiveness Report for 2014–2015. However, a closer look at this component reveals that this score is mainly due to two interrelated factors: low trade tariffs and a high share of imports to GDP. Obviously, such a high level of trade liberalization is important for ensuring fair competition. Still, it is not sufficient to ensure a proper competitive framework, considering other non-tariff barriers to trade, the high burden of customs procedures, the weak business regulatory framework, and the low prevalence of FDI and foreign ownership (Chart 38). These latter factors are instrumental for assessing the long-term performance of the Moldovan competition framework, as anti-competitive practices, coupled with the weak rule of law, make foreign investors reluctant to place their assets in the country.

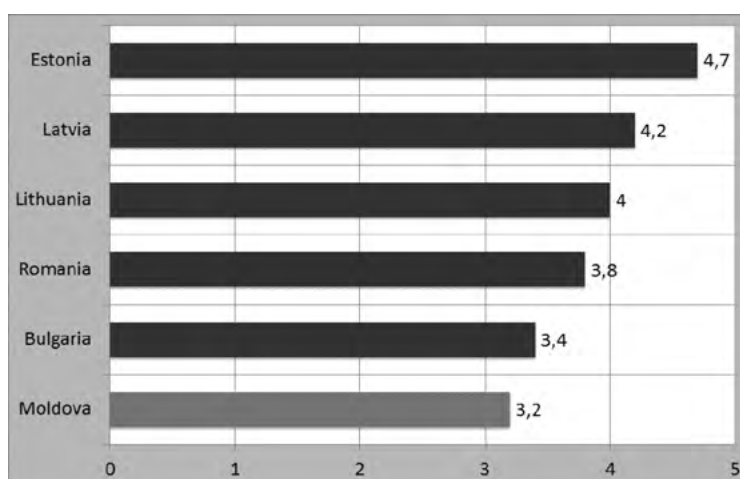
Chart 38. Components of foreign competition (higher rankings mean worse position)



Source: *Global Competitiveness Report 2014-2015, World Economic Forum.*

The ineffectiveness of anti-monopoly policies plays a crucial role in weakening the Moldovan competition framework. According to the Global Competitiveness Report 2014–2015, Moldova is ranked 133rd out of 144 countries for this component, the lowest among the reference countries (Chart 39). This is confirmed by the survey conducted by Expert-Grup in 2013 among firms, which showed that 59.5 per cent of businesspeople find the legislation inefficient in combating unfair competition. The worst perceptions are observed among companies involved in trade. Moreover, 54.6 per cent of respondents believe that the current legal framework is disadvantageous for small enterprises, and this perception is especially strong among micro-enterprises (63 per cent of respondents).

Chart 39. Effectiveness of anti-monopoly policy, 1-7 (best)



Source: *Global Competitiveness Report 2014-2015, World Economic Forum.*

In conclusion, the competition framework in Moldova is very weak, due to burdensome business regulations and the concentration of economic activity within a small number of large companies. The taxation system in particular creates disincentives to invest, there are high non-tariff trade barriers, the customs procedures are burdensome, business regulations do not encourage entrepreneurship or FDI, and the efficiency of antitrust policies is relatively low. As a result, entrepreneurs – especially foreign ones – are reluctant to place their investments in Moldova, which is revealed by the low prevalence of foreign ownership and FDI. This helps explain the

low business density and the low intensity of domestic competition. Under such circumstances, the market forces do not appear to be strong enough to eliminate firms that operate informally, as business competition is too weak to increase the costs of informal activity and create incentives for firms to go formal.

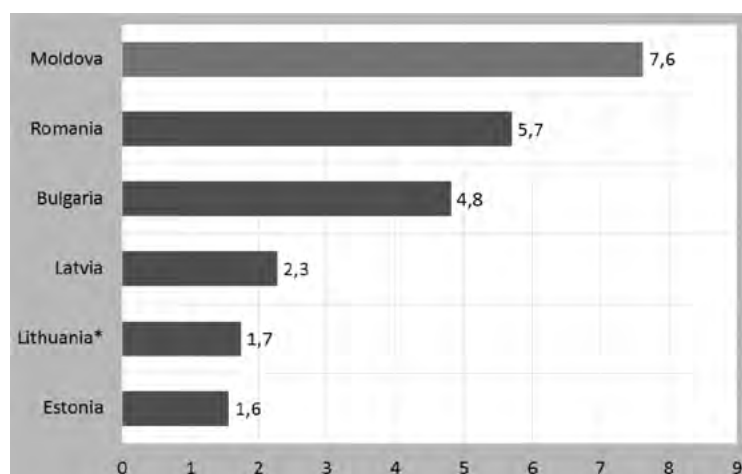
2.6 Access to financial services

Access to credit and other financial services is crucial for the formation, operation and long-term development of any enterprise. It mobilizes the necessary liquidity to cover firms' short-term needs, and can finance long-term investment projects that attract technologies and know-how. Hence, it is of great benefit for employees as well, as greater access to technology helps improve productivity and wages. It ensures a company's smooth operation, as well as stimulates their competitiveness and sustainable development. Also, greater access to financial services is one of the most important advantages that formally operating firms have over those operating informally.

In Moldova, poor access to finance is perceived as one of the top-five most problematic factors for business development (Expert-Grup et al., 2013). About 59 per cent of capital investments in 2013 were personally financed by firms and individuals, and these types of funds are usually scarce. This could explain the poor capital endowment of the country, the low new business density (discussed above), and the population's limited access to technology. Poor access to financial services stems from both the *demand*-side (from firms and households) and the *supply*-side (from the financial sector). Thus, going back to the Global Competitiveness Report 2014-2015, Moldova ranks very low in terms of the *affordability* of financial services (103rd out of 144 countries) and in the *availability* of financial services (109th out of 144 countries). Particularly, access to capital is a crucial problem. Moldova ranks 104th in the ease of accessing loans. The situation is even worse when financing start-ups and other innovative projects, ranking 116th in the availability of venture capital.

This affordability problem in Moldova is rooted in the high cost of credit available. Indeed, the real lending interest rate (adjusted for inflation) is relatively high compared to the reference countries (Chart 40). Consequently, this creates demand-side problems, as few firms and households can afford such a high cost of credit; it also leads to supply-side problems, as banks use adverse selection by accepting credit applications only from large companies and households with good credit histories, rejecting SMEs, start-ups and other riskier projects.

Chart 40. Real lending rate²⁶, simple average for 2005-2013, in percentages



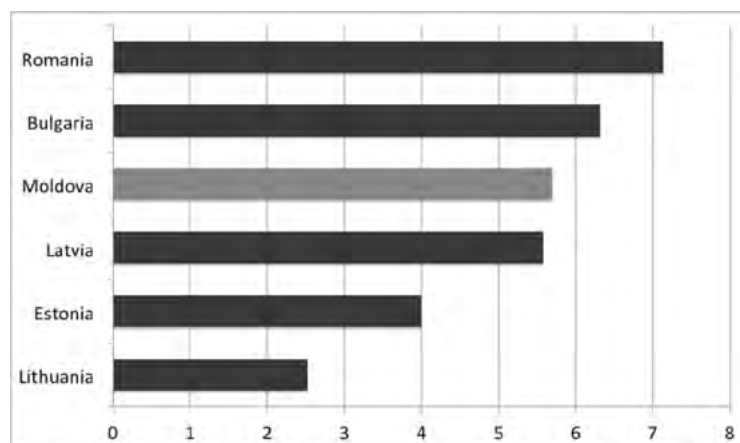
Source: World Development Indicators, World Bank.

*average is computed for the period 2005–2011, based on available data.

26 The real interest rate is the lending interest rate adjusted for inflation as measured by the GDP deflator. The terms and conditions attached to lending rates differ by country, limiting their comparability.

The high cost of credit is said to stem from the high cost of attracted resources (deposits). If that were the only factor, the banking spread (difference between the lending and deposit rates) would be small, because the deposit rate would also be much higher compared to the reference countries. However, interestingly enough, the banking spread appears to be neither particularly high nor low (Chart 41).

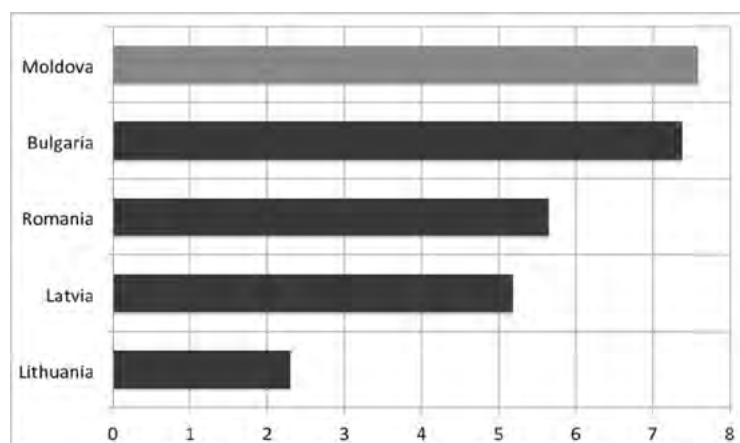
Chart 41. Interest rate spread (lending rate minus deposit rate) (in percentages)



Source: World Development Indicators, World Bank.

This suggests that, besides the deposit rates (which remain an important factor driving the cost of credit in Moldova), there are additional relevant factors which should not be neglected. The most important one is the risk premium attached to each loan, which appears to be relatively high (Chart 42).

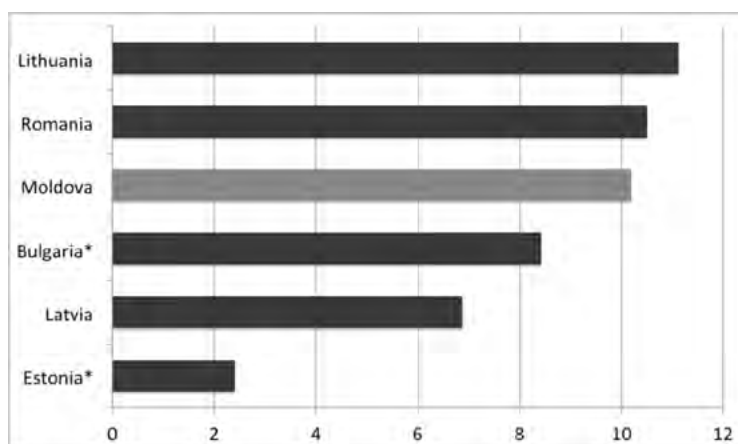
Chart 42. Risk premium on lending (lending rate minus the Treasury bill rate) (in percentages)



Source: World Development Indicators, World Bank.

The risk premiums are directly related to the probability of default of the bank's debtors, as well as to the complicated procedures of debt restructuring and collateral execution. The share of non-performing loans in total bank portfolios in Moldova is relatively high (Chart 43). On the one hand, this is caused by the weaknesses of the domestic private sector, whose share of GDP is one of the lowest in the region (around 70 per cent) (Expert-Grup et al., 2013) and suffers from low productivity. On the other hand, inefficient underwriting practices and poor risk management undertaken by most Moldovan banks are also to blame. The problem is aggravated by lengthy and time-consuming judicial cases, due to the weak rule of law and inefficient judiciary (see the subchapter on access to justice and the rule of law). Such poor credit portfolios undermine the soundness of commercial banks as well: Moldova ranked 124th out of 144 countries in the Global Competitiveness Report 2014–2015 in terms of the soundness of their banks.

Chart 43. Bank nonperforming loans to total gross loans (in percentages)

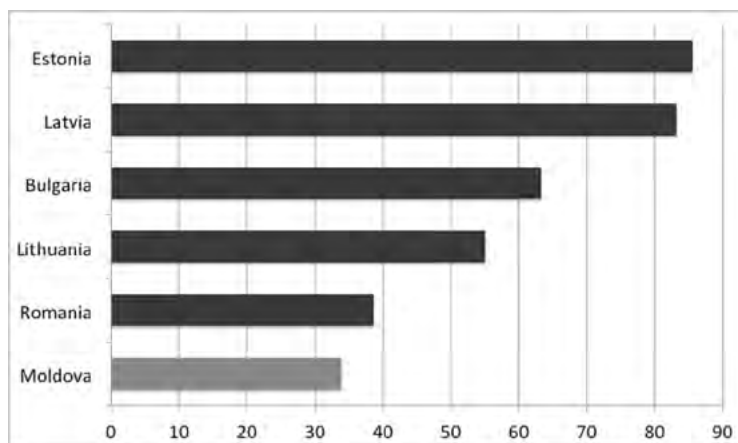


Source: World Development Indicators, World Bank.

As a result of these factors, Moldova is trapped into a vicious circle undermining their access to credit. The weaknesses of the private sector undermine the creditworthiness of firms and households, which causes banks to increase their risk premiums, leading to higher interest rates. These high rates make the private sector and households even more vulnerable to negative financial shocks, which increase the total share of non-performing loans. As a result, banks apply even more rigid adverse selection, further limiting access to loans.

This chain of cause and effect leads to the private sector having very little access to banking and non-banking loans. The share of domestic credit in the private sector represents only 34 per cent of GDP (average for 2005–2013), which is much lower than in other reference countries (Chart 44).

Chart 44. Domestic credit to private sector (percent of GDP)



Source: World Development Indicators, World Bank.

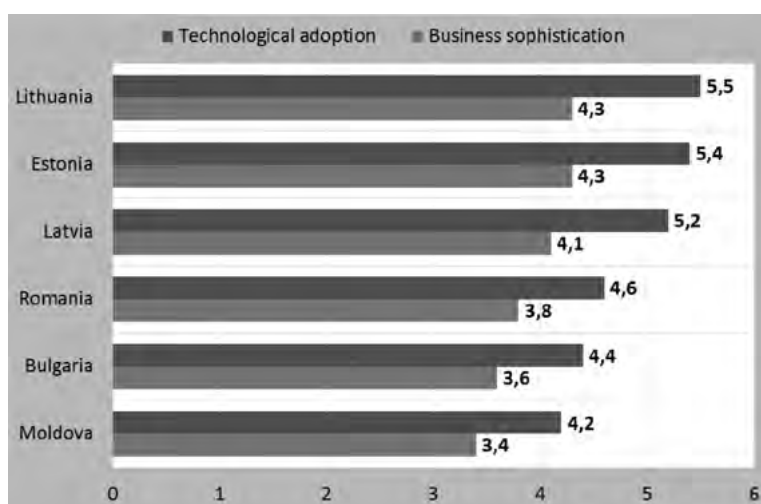
Theoretically, access to financial services is one of the most important advantages enjoyed by firms that work formally. However, this advantage becomes less obvious in countries like Moldova, where even companies abiding by the law can incur serious difficulties when looking for external sources of financing. These constraints serve as an additional factor incentivizing firms to go informal. The employees also suffer from this, because a firm with limited access to financing is less likely to invest in new technologies that would empower employees to improve productivity and raise their wages. Moreover, the restricted access to credit limits the incentives of the population to embark on entrepreneurial activities. Narrow economic opportunities and few employment alternatives also weaken the bargaining power of employees against their employers, which makes the workers more exposed to informal activities.

2.7 Access to technology

The most important factor driving the long-term development of any economy is the ability to remain competitive, which is directly linked to productivity. This is influenced by the economy's access to technology. Access to technology is usually linked to one's access to credit, as firms often do not have sufficient funds to cover such long-term investments. The demand for technology is also related to the country's attractiveness to foreign investors and to competition among local firms. All in all, access to technology depends on a large set of determinants of systemic origin, including access to finance, a positive business climate and FDI attractiveness, competitiveness, as well as the rule of law and access to justice, which provide security for the lenders' activities and investments.

As shown in the previous subchapters, Moldova does not score well in any determinants regarding access to technology. It has the lowest score of technological adoption among the reference countries according to the Global Competitiveness Report 2014–2015, ranking 104th out of 144 countries (Chart 45). This low score is explained both by supply-side and demand-side constraints. Indeed, the same Report ranks Moldova as 96th in the availability of the latest technologies and 109th in firm-level technological adoption.

Chart 45. Scores of technological adoption and business sophistication, 1-7 (best)

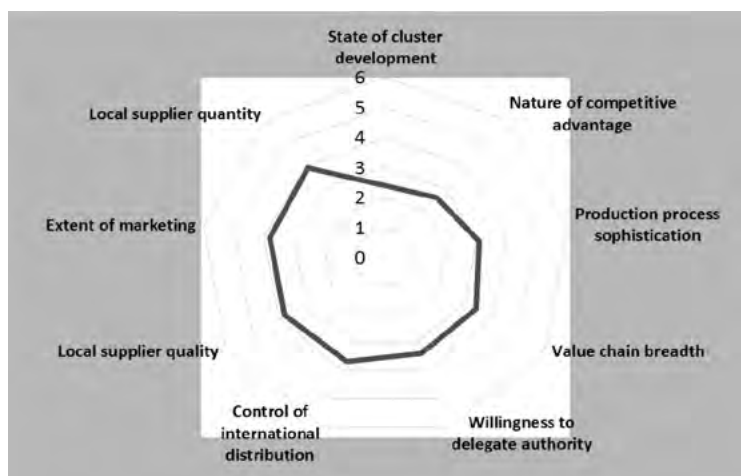


Source: Global Competitiveness Report 2014-2015, World Economic Forum.

Low technological adoption is connected to poor business sophistication, which appears to be another problem of the Moldovan private sector, scoring the lowest in this category among the reference countries according to the Global Competitiveness Report 2014–2015. In fact, both issues form a vicious circle: low technological adoption undermines business sophistication, which in turn leads to low demand for and an incapacity to absorb new technologies.

This vicious circle, coupled with the weak competition framework discussed earlier, undermines the sophistication of the production process and the development of clusters. As a result, the Moldovan firms lose their competitive edge in foreign markets, being constrained by the domestic market size. In fact, these are the major factors that explain the poor business sophistication in Moldova according to the Global Competitiveness Report 2014-2015 (Chart 46).

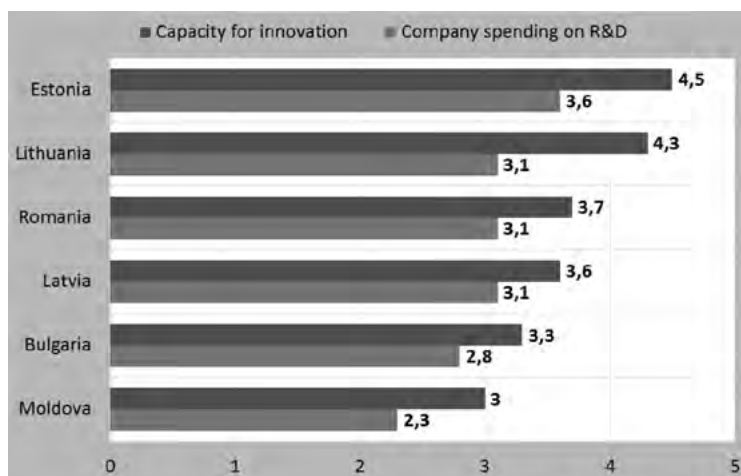
Chart 46. Scores of key components of business sophistication in Moldova, 1-7 (best)



Source: Global Competitiveness Report 2014-2015, World Economic Forum.

Another important factor explaining the poor access to technology in Moldova is the low capacity of firms to innovate, which is directly related to insufficient company spending on research and development (R&D) and production complexity. As shown by Chart 47, Moldova has the lowest scores in these areas according to the Global Competitiveness Report 2014-2015, compared to the reference countries. This again relates to the poor business sophistication, low productivity and limited access to finance in the country, which hamper firms in their capacity to invest in new technologies and innovations. The legal and institutional frameworks also create more constraints than incentives for firms to innovate and invest in R&D (Expert-Grup, 2011). The Government has recognized this issue by adopting the Research and Development Strategy of the Republic of Moldova until 2020.

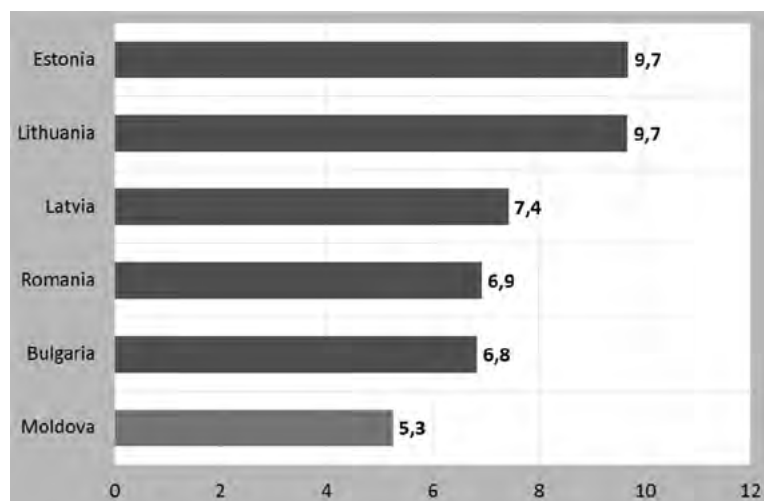
Chart 47. Scores of capacity for innovation and company spending on R&D, 1-7 (best)



Source: Global Competitiveness Report 2014-2015, World Economic Forum.

As an obvious result of the existing constraints on innovation and technological absorption, Moldova registers the lowest share of high-technology products among all manufactured exports compared to the reference countries (Chart 48). This may also be related to the low skill levels of the labour force and the low labour costs relative to the costs of capital, which reduce the incentives to innovate. These undermine the foreign competitiveness for the Moldovan economy, and ultimately serve as a fundamental constraint for sustainable economic development within the country.

Chart 48. High-technology exports (% of manufactured exports), average for 2005-2012



Source: World Development Indicators, World Bank.

In conclusion, Moldovan firms are trapped in a vicious circle of technological starvation: low productivity, poor financial conditions and a lack of sophistication undermine the capacity of companies to innovate and absorb new technologies, which makes them even less likely to remain competitive. This vicious circle is aggravated by the legal framework, which does not provide enough incentives for firms to invest in R&D. The adoption of new technologies is further complicated by the weak competitive framework and narrow access to finances. Given these constraints, the firms that act legally do not have significant advantages in terms of access to technology compared to companies working informally. This simply adds to a firm's incentives to go informal.

2.8 Labour and other inspections

Another important factor that increases the costs of informal economic activity, thereby discouraging employers and employees to go informal, is the efficiency of the inspections aimed at preventing and penalizing such practices. Of course, the legal and institutional framework should not be abusive either, which could undermine formal entrepreneurial activity. Balancing these considerations is one of the biggest challenges faced by the Government.

In Moldova, the legal and institutional setting is far from efficient in preventing and penalizing informal economic activities. One telling example is in the Labour Inspection. The State Labour Inspectorate has a central office and ten territorial offices with 87 inspectors total, including six inspectors performing managerial jobs. The labour inspectors annually conduct 6,300 visits of 5,200 enterprises that hire a total of 240,000 workers, or 40 per cent of all formally employed workers. The Labour Inspectorate collaborates with the police, the tax authority and the social security institutions²⁷. Despite the Action Plan for minimizing informal remuneration and employment adopted by the Government in 2011²⁸ and the Contravention Code provisions²⁹, the Labour Inspectorate is constrained by the provision of a separate law³⁰, which obliges the Inspection to notify any firm five days prior to an inspection. This regulatory framework contradicts the best international practices and ILO standards³¹, and is also inconsistent, with some laws stipulating penalties for informal employment and others limiting their enforcement.

27 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 affects the planning of inspections.

28 Government Decision no. 477 of 28 July 2011.

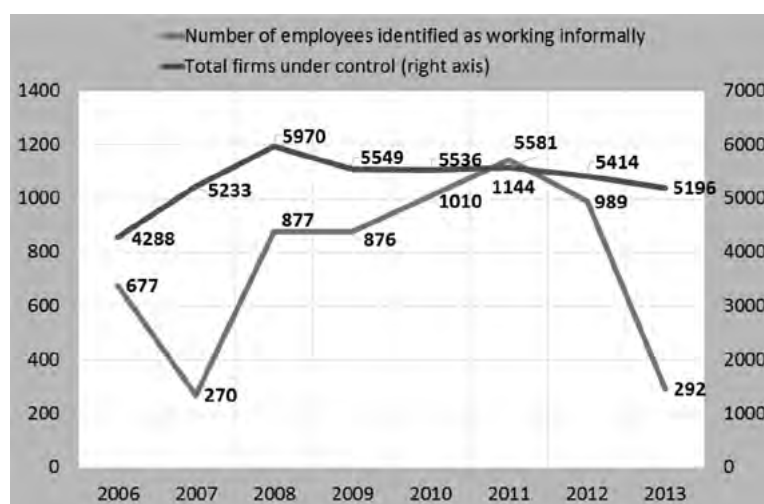
29 Article 55 of the Contravention Code on the use of undeclared work.

30 Law no. 131 of 8 June 2012 regarding the state control of the entrepreneurial activity.

31 This provision contravenes the ILO Conventions No. 81 and No. 129 that Moldova is bound to.

These legal inconsistencies significantly undermine the Labour Inspectorate's efficiency in detecting and penalizing informal employment practices. After the implementation in June 2012 of the Law regarding the state control of entrepreneurial activity, which obliges the Labour Inspection to notify a firm five days in advance of an inspection, the number of employees identified as working informally declined. As shown by Chart 49, after the Law had been in place for six months in 2012, the number of reported informal workers declined by 14 per cent; in 2013, when the Law had been active for the whole year, the number of informal employees reported by the Labour Inspection dropped 3.4 times compared to 2012. At the same time, the number of inspections declined very modestly (-3 per cent in 2012 and -4 per cent in 2013).

Chart 49. Number of firms verified by the Labour Inspection and the number of employees identified as working informally as a result of verifications



Source: Labour Inspection of the Republic of Moldova.

While remarkably restrictive against the Labour Inspection, the legal framework remains relatively mild in terms of fine levels. According to the Contravention Code of the Republic of Moldova, the fines for each identified employee working informally range from 7,000 MDL to 10,000 MDL. Although the Government raised the level of fines in 2012, they continue to represent only 1.6–2.2 times the average monthly wage, a relatively low level compared to other European countries (IDIS Viitorul, 2012)³². Moreover, the fines refer only to employers and do not cover any forgone public revenues that resulted from tax avoidance.

Besides being too low, the penalties against informal employment are hardly enforced because of the weak rule of law and the inefficient judicial system. In order to impose a fine, the Labour Inspection must send the identified cases to the prosecutor's office – a procedure which, in many cases, takes too much time and allows many firms to avoid punishment due to the limited capacity of the Labour Inspection to prove the case. In a recent public policy proposal, the Ministry of Labour, Social Protection and Family stated that the Labour Inspection has limited capacities to collect the proof necessary to prove informal employment, and that oftentimes the only way they could prove their case would be to actually catch the employer paying an informal salary, which is almost impossible to manage.³³ The same holds true for other forms of abuses by employers against their employees. Box 1 presents an example of how the legal framework keeps the Labour Inspection's hands tied in preventing and penalizing insecure working conditions.

³² For example, in Romania, in addition to criminal liability, employers with up to five identified employees working informally are fined from 10,000 to 20,000 RON.

³³ Public policy proposal "Diminishing the informal employment phenomenon in the Republic of Moldova", Ministry of Labour, Social Protection and Family, 2011.

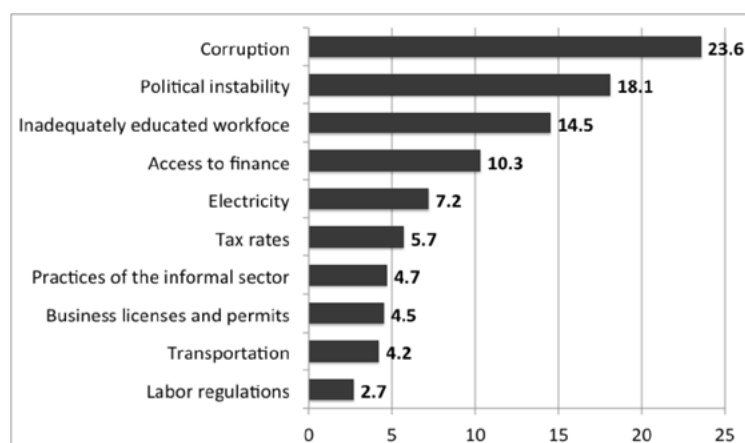
Box 1. The case of limited capacities of the Labour Inspection to prevent and penalize insecure working conditions

A series of severe work accidents that caught the public attention occurred on a construction site in 2014 in Chisinau, the capital of Moldova. The Labour Inspection started investigating the case, but its efforts were undermined by a series of legal restrictions. Particularly, the Inspection has limited access to the construction site, because – according to the law – all visits must be planned, and prior notice must be given to the location to be inspected. The only exceptions apply when employees file a complaint against the company, when the labour disability benefits exceed a certain maximum threshold, or when there is a fatal accident at the workplace. These restrictions have been imposed to prevent corruption within the Labour Inspection. However, they undermine the capacity of this institution to enforce the labour legislation, and thereby limit the security of employees, allowing employers to abuse the legal and institutional setting.

Source: http://www.noi.md/md/news_id/48232.

Overall, this situation diminishes the costs of informal activities and creates disincentives for firms to act formally. Given the weak enforcement of the labour legislation, the labour regulations are considered another obstacle for business activity (Chart 50).

Chart 50. Top 10 Business Environment Constraints



Source: Enterprise Surveys, 2013, World Bank.

To a large extent, the informal economy exists because the institutions that should combat informal economic activities are very dispersed. The State Fiscal Service, which should be the leading institution in fighting the informal economy, is particularly constrained by the ambiguous and inconsistent legal framework. The institution is burdened with many responsibilities that are not related to its core functions, whereas some of the functions that should be exercised by the State Fiscal Service are, in fact, delegated to other institutions (such as the Customs' Service and the National Office of Social Insurance of Moldova).

This situation creates ambiguities, undermines accountability and, as a result, induces inefficiency in the key institutions' response to the informal economy. Another major problem that also derives from the deficient legal and institutional framework is the poor cooperation between these institutions. Even the law itself states that cooperation among the State institutions in fighting the informal economy is voluntary. This provision appears to be insufficient, given the governance problems within the Moldovan public institutions and the lack of communicative culture between the public and private sectors.

Another fact that undermines the State Fiscal Service's fight against the informal economy is that the legal framework does not provide any investigative functions for the State Fiscal Service (Expert-Grup, 2014). While the annual activity reports of the State Fiscal Service include evidence that informal activities are being practiced by firms, these claims are then submitted to the relevant legal institutions (such as the Prosecutor's Office or the National Anticorruption Centre) for further investigation, where the cases are usually put on hold or even closed completely.

In conclusion, the efforts of key institutions in preventing and fighting informal economic practices are undermined by an inconsistent and ambiguous legal framework. This creates an institutional setting that is rather dispersed. Many institutions have overlapping responsibilities and fail to communicate or coordinate with one another, whereas the State Fiscal Service is constrained from undertaking a leadership role in fighting the informal economy. As a result, labour and other types of inspections are inefficient in discovering and penalizing informal economic practices. These constraints diminish the potential costs of the informal economy, creating perverse incentives for firms to go informal, whereby employees do not receive the proper protections against informal employment.

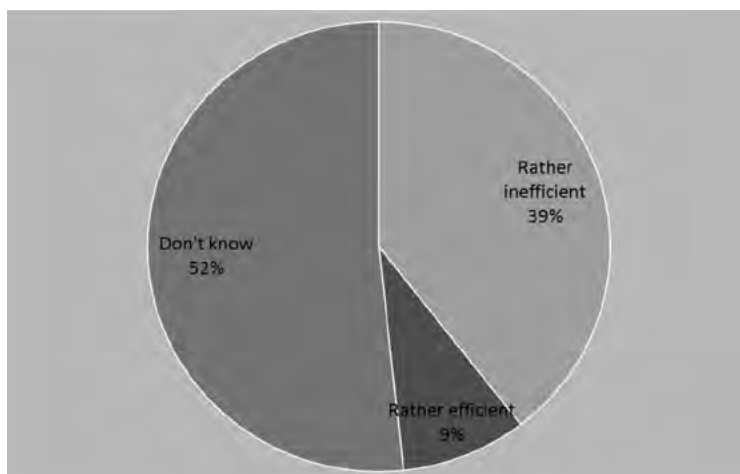
2.9 Social dialogue

Although the employers and employees are usually part of the same entity, be it a small firm or a large corporation, their views very often diverge. Employers are typically profit-oriented, interested in more flexible labour legislation and lower labour costs, while the employees demand higher wages and more security from the Labour Code. Hence, in order to defend and promote their interests, employers enter professional associations, and employees join trade unions. The Government usually acts as a mediator in the negotiations between employers and employees and ensures that these disputes do not result in a zero-sum game, making someone better off to make someone else worse off. Ensuring an efficient dialogue helps improve the regulatory framework that affects both counterparts, and can curtail the incentives of firms and employees to choose informal economic activities.

In Moldova, the employers are represented by sector-specific professional organizations, which are gathered under the umbrella of the National Confederation of Employers of Moldova. The employees are represented by sector-specific trade unions, which are part of the National Confederation of Trade Unions of Moldova. This social dialogue is regulated at the national and local levels by the Labour Code and by the Law No. 245 of 21 July 2006 on the organization and functioning of the national commission for collective consultations and negotiations. The tripartite national commission provides a forum for collective discussions and bargaining between the social partners and the Government, and is a means by which the members can promote initiatives and draft laws for economic and social reform.

Still, firms perceive the social dialogue as inefficient and non-representative. According to a recent survey, only 17.1 per cent of enterprises are members of an employers' association, and only 13.2 per cent of the surveyed enterprises' employees are reportedly members of trade unions. Moreover, the smaller the company is, the lower the probability that it is a member of an employers' association or trade union. This means that the SME sector is usually marginalized in the social dialogue, which exposes it to informal economic activities. According to the same survey, 39.5 per cent of respondents stated that the social dialogue is rather inefficient, and 51.7 per cent did not know if it was efficient or not. This reveals a negative perception of and a lack of interest in the social dialogue, two factors which are unsurprisingly correlated.

Chart 51. Survey results about firms' perception about the social dialogue efficiency



Source: National Confederation of Employers of Moldova, 2013.

In conclusion, although the social dialogue is meant to ensure the full representation of employers and employees, it excludes an important share of interested stakeholders in Moldova. The most affected are the small and medium enterprises, which form a fundamental component of the economy. Considering that SMEs usually have different needs and constraints than large companies, this inclusion problem is even more acute. This creates two distinct problems. First, it gives big companies a stronger voice in shaping government policies according to their interests (which often do not converge with those of SMEs). Second, it gives the SMEs only a modest stake in policy decision-making, exposing them to the bulk of the business regulatory pressures. This also creates significant development constraints for the SME sector as a whole, which represents about 97 per cent of all enterprises and employs about 57 per cent of all employees in the country³⁴. Under such circumstances, the smaller companies have greater incentives to go informal to stay competitive, whereas their employees are more prone to accept informal contracts in order to get higher net wages.

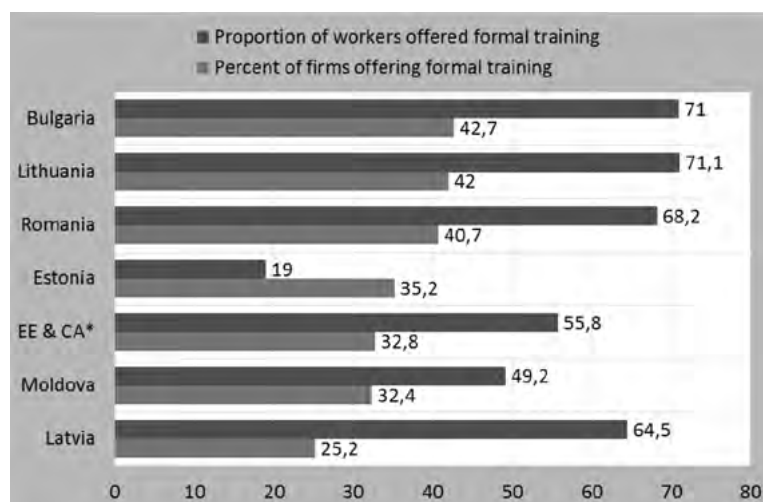
2.10 Education and training

Human capital is a crucial factor in ensuring the competitiveness of a firm or an economy, especially when other forms of capital and resources are very scarce. Investments in human capital not only enhance basic production, but also contribute to innovation and the absorption of technology. However, this type of investment requires substantial time, resources and a proper managerial approach, which are usually not present in enterprises that work informally. Hence, besides undermining the long-term competitiveness of firms and the national economy in general, informal activities also limit the education and training opportunities available for employees.

In Moldova, the inadequately educated workforce represents one of the top-three business environment constraints, being cited by 31.2 per cent of all enterprises (World Bank, 2013). Despite this fact, firms are reluctant to invest in human capital. According to the same study, only 32.4 per cent of companies offer formal training to their employees, and more than one half of all full-time employees have never received formal training at their workplace, a much lower number than in the reference countries (Chart 52). The situation is the worst in small enterprises (with five to 19 employees), where only 25.7 per cent of firms offer formal training. In large enterprises, the share is twice as high, at 53.5 per cent.

³⁴ According to the statistical data for 2013.

Chart 52. The participation of firms and employees in formal training



Source: Enterprise Surveys data for Moldova for 2013, World Bank.

Considering the inadequately educated workforce, the reluctance of firms to invest in the education and training of their personnel seems to be paradoxical. However, as shown by a national survey (Expert-Grup et al., 2013), the main factor dissuading firms from investing more in human capital is a financial one. Almost 63 per cent of enterprises have no budget for training, and 40.4 per cent of enterprises perceive training costs to be unaffordable, especially for small firms.

Another factor hampering the investments of firms in education and training is the high turnover of employees. Of all firms surveyed, 27.3 per cent consider this to be a major barrier. This relates to a lack of legal tools that would allow companies to force employees to stay after they were trained or to repay their training costs, and the lack of proper human resource strategies adopted by firms that would increase employees' willingness to stay. Obviously, the most effective measure to decrease employee turnover is to enhance the attractiveness of one's working conditions, including wages, security, comfort, and predictability in career promotion. In fact, by investing more in human capital, firms might facilitate a virtuous circle: more attractive working conditions decrease employee turnover and make them more productive, which allows companies to repay their investment expenditures, increase wages and improve working conditions even further. In this way, firms could enhance their competitiveness in both the labour and the consumer markets.

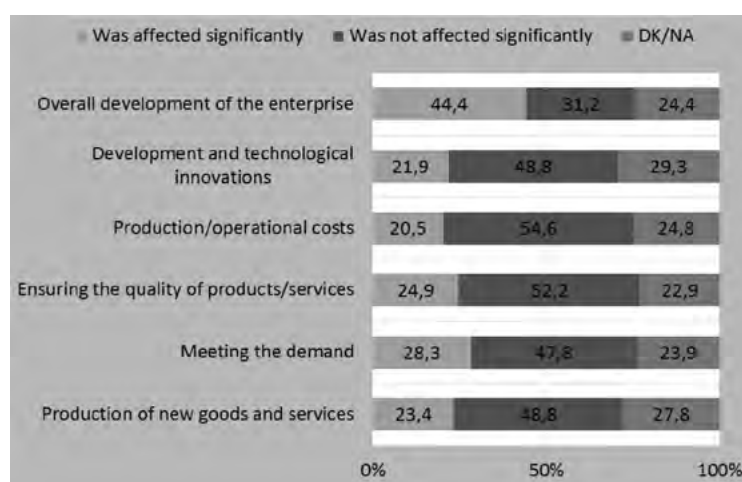
While the Government could assist in promoting this virtuous series of events, the same survey finds that only 20 per cent of firms know about the availability of governmental training programs. For the other 56.3 per cent of enterprises, governmental training programs seem to be unavailable.

Currently, firms report a shortage of adequately trained workers, which undermines the overall development of their enterprise (according to 44.4 per cent of interviewed companies). This confirms the deep impact of this constraint, and highlights its systemic nature (Chart 53).

In conclusion, human capital constraints are some of the key barriers to enterprise development in Moldova. Moldovan firms do not have sufficient financial and managerial capacities to fix this problem, and access to government-led educational and training programs is narrow. As a result, most firms, especially the small ones, are trapped in a vicious circle: their poor competitiveness undermines their capacity to invest in human capital, which worsens their competitiveness even further. Under such constraints, firms chose to go informal in order to compensate these losses with fiscal savings. Although this strategy allows many firms to remain in the market, it erodes their competitiveness and economic viability in the long run.

The biggest losers are the employees, who remain disconnected from technological developments and find it increasingly harder to integrate into the labour market. As shown in Chapter 1, this is especially the case for the younger population. They are more prone to accept an informal job (36.9 per cent of 15-24 year old employed persons have an informal job), due to the difficulties they face when transitioning from education to the labour market. Persons with low levels of education are also particularly exposed to informal employment. They often become trapped in informal employment due to the high reluctance of firms working in the informal sector to invest in training (which is discussed more extensively in Chapter 1).

Chart 53. Firms' perception about the perceived impact of the labour force shortage, in percentages



Source: National Confederation of Employers of Moldova, 2013.

2.11 Conclusions

This section offers a broad answer to the question of why the share of the informal economy is so high in Moldova. We analyse the incentives that drive the decision of employers and employees to go informal. This boils down to the relationship between the costs of formal and informal economic activity. The analysis revealed that, in Moldova, the costs of informal activity are not particularly high, due to inefficient inspections, a low probability of being identified or even penalized, and the low levels of fines. At the same time, the costs of formal economic activities are relatively high. There are high fiscal compliance costs, a weak competition framework and antitrust policies, poor business regulations and a weak rule of law. Moreover, the usual advantages of the formal economy, which include the greater access to finance, technology and fair justice, are undermined by high costs of credit, low technological readiness and absorption, and an inefficient justice system. Under such circumstances, the incentives to go informal are strong, while employers have disproportionately large bargaining power when negotiating with their employees. Due to the inefficient social dialogue, the weak rule of law and insufficient access to fair justice, employees are highly exposed to informal work, while the labour disputes are rarely solved in an equitable manner. Last but not least, the fiscal implications of the informal economy are not trivial. As shown in Chapter 1, the difference between the potential and the actually collected fiscal incomes (fiscal gap) reached 7.75 per cent of GDP in 2012.

Below we will summarize the key factors driving the informal activities in Moldova.

- The Moldovan business climate is not friendly to or supportive of enterprise development. Despite the marginal improvement of the country's Doing Business index, which resulted from a few policy interventions, the main systemic problems remain unsolved and continue to worsen. Particularly, Moldova regressed within three components of the

Doing Business index, where it constantly receives the lowest scores compared to the other components of the index: “Dealing with Construction Permits” (from 170th place in 2014 to 175th in 2015), “Trading Across Borders” (from 151th place in 2014 to 152th in 2015) and “Getting Electricity” (from 148th place in 2014 to 149th in 2015). These issues undermine the competitiveness of the construction, transportation and industrial sectors, which also appear to face significant exposure to the informal economy. Overall, these reduce the labour force absorption, which is one of the fundamental factors driving informal employment.

- The administrative burden of business regulations on firms appears to be much higher than the financial burden. This is primarily related to the large and inefficient government bureaucracy, as well as the low-quality regulatory framework that requires firms to waste significant time on compliance, causing large opportunity costs. An obvious by-product of such regulatory and institutional constraints is the high corruption perception index, which is perceived to be one of the key limitations on enterprise activity.
- Due to the low returns on taxes, both employers and employees have a strong incentive to go informal. From a firm’s perspective, the fiscal burden is perceived to be too high (although it is not high compared to other countries in the region), the fiscal administration is seen as burdensome and time-consuming, and the regulatory and government frameworks are considered inefficient. This perception of a high fiscal burden comes from labour taxes and their distribution, which is skewed too much towards employers. Firms are responsible for 80 per cent of the aggregate social insurance contributions, while 23 per cent is paid by employers and 6 per cent is paid by employees. Nevertheless, compared to other reference countries, the fiscal burden appears to be moderate, with the main problems relating to the fiscal administration. From a household’s perspective, the quality of public goods and services is low, people are poorly informed about the way the public money is managed, and the confidence in the pension system is low. These factors fuel an intrinsic reluctance, both for employers and employees, to pay taxes.
- A fundamental weakness of the Moldovan economy that hampers the security of investors and employees is the weak rule of law and the inefficient judicial system. Moldova performs extremely poorly in international rankings according to property rights protection, enforcement of the rule of law and judicial independence. As a result, entrepreneurs, especially foreign ones, are reluctant to make investments in Moldova, and Moldova’s FDI attractiveness is one of the lowest in the region. This again undermines the advantages of the formal economy, creating incentives for firms to go informal. These incentives are even stronger given the weak justice system and the low security of employees, who are unable to put enough pressure on their employers to oppose informal activity.
- The competition framework in Moldova is very weak, particularly because of the prevalence of many direct and indirect entry barriers. The barriers include a burdensome agricultural policy, the low effectiveness of anti-monopoly policies, a high concentration of corporate activity for a small number of producers (the extent of market dominance), reduced incentives to invest due to taxation, and weak domestic competition. Additionally, non-tariff barriers to trade, burdensome customs procedures, a weak business regulatory framework and the resulting low prevalence of FDI and foreign ownership all hinder foreign competition. Under such circumstances, the market forces do not appear to be strong enough to eliminate firms that operate informally.
- Access to finance is very constrained, which undermines an additional theoretical advantage of formal economic activity. Poor access to financial services is due to both demand-side

factors (like the low creditworthiness of firms) and supply-side factors (including the unsoundness of banks and the poorly developed financial sector). Particularly, high real interest rates on loans undermine their affordability for firms, so banks often apply adverse selection when granting those loans. SMEs, start-ups and other risky projects suffer the most from this practice. One important factor driving the cost of credit is the relatively high-risk premium attached to interest rates by banks and other financial institutions. This is due to the weak private sector that has a greater likelihood of default, the inefficient underwriting procedures applied by the lending institutions, as well as the complicated procedures of debt restructuring and collateral execution. Therefore, institutional and legal failures, coupled with weaknesses in the private and financial sectors, undermine another hypothetical advantage of formal economic activity: easier access to finance.

- The systemic failures discussed above (weak rule of law, inefficient justice, restricted access to finance, the poor competition framework, low investment attractiveness and low-quality business regulations), coupled with the low skills of the labour force and the low labour force costs relative to capital costs, undermine companies' access to technology, which is a key constraint on Moldova's long-term sustainable development. According to the international rankings, Moldova has one of the lowest levels of access to technology in the world. Technology is largely unavailable, and Moldovan firms lack the capacity to adopt the technologies that do exist. Thus, poor business sophistication and low technological adoption form a vicious circle. This is worsened by the restricted access to finance and the weak rule of law, dissuading firms from investing in new technologies.
- The constraints discussed above increase the costs and undermine the advantages of formal activities. Firms' and households' propensities to go informal are additionally fuelled by the low costs of informal economic activities. The Labour Inspection, a key institution in preventing and penalizing informal employment, and the State Fiscal Service, a key institution in preventing and penalizing different forms of informal economic activity, are constrained by the legal framework in properly exercising their functions. For instance, they must give a firm at least five days notice before an inspection, which diminishes the probability that informal activity will be identified. These institutions are also not entitled with investigation functions. This means that when a firm is believed to act informally, the institutions must engage the Prosecutor's Office and other judicial authorities for further investigation, and the communication between these offices is often deficient. As a result, these cases drag on for far too long. Moreover, the institutions responsible for investigations often claim to have insufficient or low quality evidence. Finally, the legal provisions that penalize informal economic activities are hardly enforced. Firms are not sufficiently constrained, by the legal framework or by their employees, to exclusively practice formal economic activities.

2.12 Recommendations

In order to effectively address the informal economy, we must target its fundamental causes, which are directly linked to the incentives of both employers and employees. As seen in the previous subchapters, firms choose to go informal for three main reasons: (i) the costs of formal activity are too high; (ii) the costs of informal activity are too low; and (iii) the advantages of formal activity as opposed to informal activity are not obvious. Hence, any policy solutions aimed at targeting the informal economy should make the formal economy more attractive to employers and employees by diminishing the formal activity costs, increasing the penalties for informal activity, increasing the likelihood of informal activity being detected, and encouraging employers and employees to act formally in all realms. Last but not least, the Government should strive to increase the

security of employers and employees by improving the business regulations, increasing the costs of informal employment and enforcing labour regulations more efficiently.

Policies aimed at diminishing the costs of formal economic activities

- *Easing the administrative burden on firms.* This includes simplifying the procedures for obtaining licenses, authorizations and other forms of permissive documents. Particularly, this could be achieved by speeding up the process of issuing documents necessary for entrepreneurial activity, reducing the bureaucratic barriers to getting these documents, and by increasing the transparency of the entire process by implementing the “tacit approval” principle. The Government should implement these “one-stop shops” and ICT tools more broadly to diminish the amount of discretion exercised by public servants, eliminate the potential for bureaucratic abuse, and diminish corruption. These measures should target most of the permissive documents, focusing on construction permits and import and export documentation.
- *Making the fiscal policy pro-dividend and pro-profit.* The Government should change its general approach to its tax policies. Particularly, the tax system should not simply be used as a collection tool to cover public spending, but should encourage entrepreneurial activity and discourage its potential negative spillovers. The fiscal policy should provide proper incentives for start-ups and technological investments, and should ensure sufficient tax deductions for private contributions to public services (such as investments in employee education, training and health care). Last but not least, the fiscal policy should be transparent, properly communicated and well understood by its contributors.
- *Ensuring partial tax deductibility for employees’ benefits.* This straightforward measure would increase the incentives for employers to pay wages formally, and for employees to demand official payments. In countries like Romania or the Czech Republic, for example, employers can benefit from tax deductibility up to a certain threshold on meal tickets, which are offered to their employees in addition to their core wages. Besides meal tickets, expenditures on education, health care and sports might also be considered as tax deductible up to a certain threshold.
- *Taking specific actions for those most likely to accept an informal job.* As most informal workers are young people with low education levels and skills, broader actions to increase enrolment in specialized education and to increase the quality of education, especially at the vocational level, may reduce informal employment. Additionally, creating incentives for private sector investment in training or qualification systems for employees would facilitate the advancement of workers into higher positions, increasing the possibility that they might migrate to a formal job.
- *Supporting female participation on the labour market.* Measures should be taken to facilitate women’s access to the labour market. This includes creating affordable, quality childcare for younger children throughout the country, and taking measures to reduce gender discrimination in the labour market. The Government should also consider revising the existing legal framework for childcare leave, making it of a shorter duration (e.g. 1.5 years) while increasing the remuneration to 100 per cent of the worker’s previous earnings. Fathers should also be encouraged to take childcare leave. Finally, parents must be given more opportunities to make use of flexible working time arrangements.
- *Supporting the rural population’s participation in the formal labour market.* It is necessary to invest more in the rural areas by making improvements to basic infrastructure (such

as roads, sewage systems, and access to electricity). Additionally, the Ministry of Labour and the national Employment Agency, together with the social partners, should devise active labour market measures to address the needs of young people and women in rural areas. Women in villages have less access to information, and this is an obstacle to their organization and entrepreneurial development. The rural population should be more actively educated and trained for the labour market. Young people should be better informed about the skills that are (and will continue to be) required in the labour market.

- *Reactivating and increasing the efficiency of the social dialogue mechanisms and collective bargaining.* The National Commission for Collective Consultations and Bargaining should function more smoothly and dynamically by engaging with the trade unions and employers' organizations. It should play an advisory and monitoring role on issues related to the informal economy. Additionally, SMEs should be encouraged to take a more active role in the collective bargaining process through an information campaign that would better explain the advantages and importance of participating in this process.

Policies aimed at increasing the costs of informal economic activities

- *Increasing the efficiency of tax and labour inspections.* More attention should be paid to the exchange of information between key institutions responsible for preventing tax evasion, rather than to the physical presence of labour and tax inspectors at taxpayers' premises. Additionally, inspections should target those sectors that are most exposed to informal economy, and these procedures should be based on clear rules. After such proper accountability mechanisms are in place, the Labour Inspection must be given the ability to enforce these labour regulations. It should have more autonomy in conducting unplanned visits when there is strong suspicion of a labour legislation violation. Additionally, the inspections should address the specific issues of those economic sectors with a high share of informal activity, such as agriculture and construction. This will also reduce the gender and rural/urban discrepancies in the informal economy, as these sectors employ mostly men from rural areas.
- *Increasing the levels of fines for firms practicing informal activities.* The fines for acting informally should be comprised of two key components: (i) the total fiscal revenues that the public budget lost as a result of the tax evasion of the identified firm; and (ii) the penalty for not complying with relevant labour provisions.
- *Strengthening the capacities of the institutions responsible for labour and tax inspections.* These capacities could be bolstered by: (i) freeing these institutions of their non-core activities and increasing their legal competences related to preventing and identifying informal economic practices; (ii) allocating investigation functions to these institutions to reduce entanglement with the judiciary and improve legislative enforcement; and (iii) ensuring that there are legal mechanisms to formalize and enforce cooperation among these institutions, as the current provision calling for voluntary cooperation is not efficient.
- *Implementing an informational campaign against the under-declaration of wages.* This campaign should focus on increasing the awareness of employers and employees about the risks of informal employment and remuneration. It should also encourage employees to verify and monitor their social security contributions by using the electronic personal account system that was set up by the National Commission for Social Insurance.
- *Discouraging the use of cash.* This can be achieved by encouraging the use of electronic payments and enforcing Law No. 144 of 15 May 2012 regarding electronic money and

payments. Moldova should (i) develop a proper infrastructure for using bank cards and other electronic payments, especially in the services sector and in rural areas, where the costs for implementing this infrastructure could be split between firms and banks; (ii) penalize companies that encourage cash payment instead of payment by card (by granting discounts only to items purchased with cash, for example); (iii) organize unplanned inspections of companies' facilities to check whether the card terminals are working properly; (iv) increase the financial understanding of the general population, and increase public awareness about the importance of using electronic payments; (v) encourage whistleblowing among consumers when firms create impediments to paying by card; and (vi) oblige all companies to pay salaries by bank transfers.

Exploring the advantages offered to firms that activate formally

- *Easing the access to financing for companies that work formally.* In order to do this, Moldova must develop its financial sector. This requires (i) easing entry barriers and spurring competition in the financial sector, with greater enforcement of the antitrust legislation by the Competition Council; (ii) improving the supervision of the banking and non-banking financial sectors; (iii) strengthening corporate governance within the financial institutions and enhancing their risk management approaches; (iv) enforcing the rule of law, increasing the efficiency of the judicial system, and easing the process of collateral execution; (v) increasing the transparency regarding the shareholders and final beneficiaries of financial sector assets; and (vi) easing the financial institutions' access to long-term liquidities, especially through the development of the private pension system. Moldova must also solve the information asymmetry problem that currently explains banks' adverse selection against SMEs by developing a functional bureau of credit history.
- *Increasing the level of technological readiness and absorption.* In particular, the national R&D sector should be more transparent and better correlated to the economic necessities of the country. It should be more open to providing private firms with public money for their R&D projects. The level of technological understanding among the population should also be increased. This can be achieved by placing an emphasis on technical specializations in educational institutions. The fiscal, customs and labour legislation should be freed from any impediments to technological transfer and innovation, and firms' investments in new technologies must enjoy preferential fiscal treatment.

Chapter 3. Non-standard forms of employment in the Republic of Moldova: A legal framework assessment

In the last decade, due to the complex combination of globalization with other societal, economic and technological developments, non-standard³⁵ forms of employment (NSFE) have either emerged or have become more frequent in Moldova. Their relevance and impact on the national economy and the labour market has thus become more prominent.

When well-regulated and properly enforced, some non-standard forms of employment can help enterprises adjust quickly to market demands. However, when misused as a means to weaken labour rights in the workplace, NSFE inhibit workers from legitimate and decent working conditions, diminish fair pay and social security coverage, and undermine fair competition in the market.

This chapter surveys the existing non-standard forms of employment in the Republic of Moldova and assesses the extent to which current regulations and policies on non-standard forms of employment enable decent work in the formal and informal sectors and are conducive to an employment-friendly environment in Moldova. Our analysis will rely on the statistical data provided in the previous chapters. A set of conclusions and recommendations are included at the end of the chapter, suggesting ways to extend the labour law protection over NSFE and make compliance cheaper than non-compliance in Moldova.

Throughout the chapter, “employee” refers to a person who performs work and receives a basic remuneration under an employment contract with an employer.

Keeping the Standard Employment Relationship in mind, referring to a full-time, indefinite, continuous, dependent and subordinated relationship between one worker and one employer governed by a permanent employment contract, the following NSFE will be examined in this chapter:

- a. an employment relationship of a determined (or definite) duration,
- b. an employment relationship implying shorter working hours than those generally worked by a full-time worker,
- c. an employment relationship of an intermittent or occasional nature,
- d. an employment relationship involving multiple employers for one employee, and
- e. an employment relationship disguised within a civil or commercial contract.

The chapter will also examine the existing legal framework for domestic work and home work.

35 Standard employment is defined as a full-time, indefinite, continuous or regular, dependent and subordinated relationship between a worker and his or her employer.

3.1 Legal and policy framework regulating employment and the employment relationship

Currently, the labour market in Moldova is governed by a number of laws and policy documents that define national strategic objectives in the area of employment. The most relevant are:

- the Constitution of Moldova;
- the Labour Code of Moldova, which constitutes the general legal framework governing the individual employment contract;
- Law No. 121 of 25 May 2012 on equal opportunities and treatment in employment and professions;
- Law No. 140 of 10 May 2001 on the State Labour Inspectorate;
- Law No. 102 of 13 March 2003 on employment and social protection of jobseekers, which sets out active labour market measures concerning the social protection of job seekers, the prevention of unemployment and how to combat its social effects;
- Law No. 289 of 22 July 2004 on allowances for temporary work incapacity and other social security benefits, which establishes the right to social security benefits in case of sickness, maternity, parental leave or death; and
- the National strategy for the employment policies for 2007-2015, approved by the Governmental Decision No. 605 of 31 May 2007, and the Action Plan to minimize the practice of “envelope” wages³⁶, approved by Governmental Decision No. 477 of 28 June 2011, aiming to reduce undeclared work, stimulate the mobility of the labour force, and encourage the formalization of informal employment.

The Constitution of Moldova (article 43) guarantees the right to work, which encompasses the right to free choice of labour, fair and satisfactory working conditions, protection against unemployment, and labour protection. According to article 47 of the Constitution, the State shall, through economic and social measures, ensure a decent standard of living for citizens without any discrimination whatsoever. These articles provide equal opportunities for all citizens to exercise their right to work.

Referring to the relationship between the right to a decent standard of living and the right to work as stipulated by the Constitution, the Constitutional Court has said the following:

The Country’s Constitution recognizes that the State must ensure that every person has a decent standard of living. By its content, the right to a decent life includes the right of a citizen to living conditions that would ensure him and his family a decent living. It includes, in particular, the right to reasonable conditions of existence and to their continuous improvement. Of course, while decent living is achieved primarily through the work of the citizen and his family, the State in turn should contribute decisively to improving the living conditions so as to ensure a decent standard of living for its citizens. Therefore, the Constitution requires the State to take measures for the economic development of its society and for adequate social protection.³⁷

Article 42 establishes the right to establish and affiliate with trade unions, article 44 prohibits forced labour, and article 45 sets out the right to strike. These constitutional norms enshrine the rights of employees to freely associate in trade unions that defend their interests, to protect their safety and health at work, to a minimum wage, and to paid leave. They emphasize the binding nature of collective agreements, and promote employees’ right to strike for their professional, economic and social interests.

³⁶ The practice of undeclared work, which occurs when a worker receives a higher wage than the one declared by the employer, for the purpose of calculating the social security contribution.

³⁷ Constitutional Court Decision No. 9 of 3 March 1997, OG, 1997, No. 18, article 6.

The Labour Code (LC), adopted in 2003 and incorporating the ILO conventions ratified by Moldova, provides a fundamental regulatory framework for employment relationships. It regulates standard individual employment contracts (full-time with an indefinite duration), fixed-term contracts, part-time work, home work and apprenticeship contracts. All of these will be discussed below. Article 5 of the LC establishes the basic principles regulating labour relations, arising from international law and from the Constitution of Moldova³⁸. According to the LC, these principles must be applied equally to both standard and non-standard forms of employment. However, in many of non-standard contractual relations, the worker has limited access to professional education and training, pension and professional development, and general job security. For non-standard employees outside the contractual employment relationship, these social guarantees are generally lacking.

In the legal system of Moldova, work is only partially governed by the provisions of the labour law. Work can also fall within the legal framework that exceeds the labour law and is governed by other branches of the law. (AthanasIU et al., 2005). Labour law does not attempt to regulate all work relations; it is interested only in those relationships that are based on subordinated, dependent work (Romandas, 2006).

Employment relationships regulated by labour legislation include the following types of work:

- a) Employment relations based on individual labour contracts and subject to the Labour Code.
- b) Labour relations concerning some categories of public servants under the Law No. 158 of 4 July 2008 on the public office and the status of civil servants. In accordance with article 30 of the Law, the labour relations of persons appointed to public office are regulated by the status of civil servants, which is a public law act. Although these relations are not directly governed by the LC, they have a contractual nature because they assume the free contractual will of the parties and involve elements appropriate to an individual contract of employment.
- c) Labour relations of persons elected to public office. According to article 6 of Law No. 199 of 16 July 2010 on the status of persons holding positions of public dignity, these are relations of public authority and are established when a person is elected, validated by the competent authority, or appointed to their position. This type of labour relationship is regulated by the public law (generally the Constitution) and not by the labour law, which is private law.
- d) Labour relations involving co-owners of a unit. With the adoption of Law No. 627-XII on privatization on 4 July 1991, employees were given the opportunity to participate in the privatization of the units in which they perform permanent work. In the privatization process, many of the employees of formerly state-owned enterprises have become co-owners, forming and managing the social capital of their companies. Despite the dual nature of these labour relations, they are not governed by the labour law. The autonomous nature of this relationship, and the fact that an agreement of association and not of employment constitutes the legal source of the relationship, are the main reasons this type of relationship is excluded from the scope of the labour law.

Work performed outside the labour law framework includes the following:

- a) Work performed under a civil legal relationship (such as work performed under a service contract, a lease service contract, or a contract of delegation).
- b) Work performed in various forms of individual activity (such as work performed by an

38 See article 5 of Law No. 154 of 28 March 2003 of the Labour Code, Official Gazette 159-162, 648, 29 July 2003.

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- individual in their own household, or independent work).
- c) Work of legal practitioners. Lawyers are regulated by the Law No. 1260 of 19 July 2002 on the Bar, notaries are regulated under the Law No. 1453 of 08 November 2002 on notaries, bailiffs are regulated under the Law No. 113 of 17 June 2010 on bailiffs, and auditors are regulated by the Law No. 61 on auditing of 16 March 2007.
 - d) Work performed by individuals authorized to conduct entrepreneurial activities. This is regulated under Law No. 93 of 15 July 1998 on entrepreneurial patents.
 - e) Unpaid voluntary work. This is work performed under a volunteering contract, and is regulated by the Volunteering Law No. 121 of 18 June 2010.
 - f) Public work carried out on the basis of legal obligations. This covers community work given as an administrative sanction, which, according to article 37 of the Contravention Code, involves the individual offender conducting the work established by the local public administration, or as the main criminal punishment under article 67 of the Criminal Code and the provisions of the Enforcement Code.

The right to work under the Labour Code is granted through an individual labour or employment contract (ILC). According to article 45 of the LC, an ILC represents the agreement between the employee and employer whereby the employee commits to perform work and to abide by the rulebook of the company, while the employer commits to providing secure working conditions as laid down by the LC, other norms of labour law, or the collective labour agreement, and to pay the employee's wage timely and integrally.

The individual employment contract, as a legal source of the individual labour relationship, is described in articles 11 and 12 of the LC. This states that individual employment contracts, collective labour contracts and collective agreements cannot contain provisions contrary to or below the minimum established by the labour legislation. All conditions of individual employment contracts³⁹, collective labour agreements⁴⁰, collective agreements⁴¹, and other legal acts issued by central and local public administrative authorities⁴² that worsen the situation of employees in comparison to the labour legislation are void and do not produce legal effects. A clause in the individual employment contract which breaches a mandatory provision of the law is legally void.

39 Prepared in accordance with articles 45–65 of the LC.

40 Concluded in accordance with the provisions of articles 25–34 of the LC. The CLA is the legal act of social partnership regulating the legal labour relationships and other social relations within a unit (or enterprise) concluded between employer and employee representatives.

41 Negotiated and signed under the rules of articles 35–39 of the LC. The collective convention is the legal act of social partnership that sets out the social principles regulating labour relationships and social relations at the territorial, branch and national level.

42 Adopted in accordance with Law no. 317 of 2003 on the normative acts of the Government and other authorities of central and local public administration.

3.2 Fixed-term employment

Non-permanent employment is one of the most common forms of non-standard employment in Moldova, and has a wide range of variations determined by certain conditions set out in the labour legislation (such as seasonal employment or employment for less than two months). Non-permanent work is governed by the norms concerning the individual employment contract of a determined duration (FTC), laid down by the Labour Code. The Labour Code states that the FTC shall be concluded in writing; otherwise, it is presumed to be a contract of undetermined duration⁴³. Article 55 in the Labour Code also provides an exhaustive list of cases where a FTC can be concluded. Any contract concluded without proof that one of these cases applies will be considered to be of indefinite duration.

These legal provisions aim to protect employees and to ensure stability and fair treatment in labour relations. They include the principles enshrined in the ILO Termination of Employment Convention, 1982 (No. 158), and its accompanying Recommendation (No. 166), which seek to prevent misuse or abuse which might arise under fixed-term contracts. They also include the principles of the European Union Council Directive 1999/70/EC on the framework agreement on fixed-term work, which prohibit any discrimination between employees hired for an indefinite duration and those employed for a fixed-term. These specify that an employment contract of undetermined duration should remain the rule and fixed-term contracts the exception. Directive 1999/70/EC also requests that Member States establish objective criteria to justify the conclusion, duration and renewal of fixed-term contracts.

Article 55 of the Code lists the persons with whom an individual employment contract may be concluded for a determined duration. They include:

- a) replacement employees, whose individual employment contracts have been suspended (except when they are on strike) or when they are on leave, as provided for in articles 112, 120, 123, 124 126 (annual and sick leaves), 178 (study), 299 and 300 (educational leave);
- b) temporary workers, who work for less than two months or work seasonally, only during a certain period in the year;
- c) employees working outside Moldova;
- d) employees interning or undergoing professional training in another unit;
- e) employees attending day courses at educational institutions;
- f) retired persons, whose retirement is based on their age or seniority (or who obtained the right to a pension because of their age or seniority) and who are not employed for a period of up to two years (which may be extended by the parties under article 54 paragraph (2), article 68 paragraphs (1) and (2));
- g) scientific collaborators from research and development institutions; teaching staff and rectors of higher education institutions; the heads of preschools; and the heads of primary, secondary, artistic, sport, vocational, professional and special institutions, in accordance with the law in force;
- h) employees elected to positions with the central and local authorities, with trade unions, with employers organizations, or with other non-profit organizations and companies;
- i) managers of units, their deputies and their bookkeepers;
- j) unemployed persons who carry out public works, as established by the Government;

⁴³ See paragraph (3) of article 58 of the Labour Code.

- k) creators of art and culture;
- l) employees of religious associations; and
- m) other persons, as provided by the law in force.

According to the LC, those employed under FTCs enjoy the same status as those working under employment contracts of indefinite periods. The employer is obligated to conclude written employment contracts, and if they do not fulfil this obligation, they may be sanctioned with an administrative fine. For fixed-term contracts, a contract not concluded in writing is presumed to be for an indefinite duration. As a result, fixed-term contracts are always in writing.

The Moldovan legal framework does not define a fixed-term ILC as a type of employment contract, but considers it an employment contract whose duration is fixed. The duration of the contract may vary, but it cannot exceed five years. Prolonging a shorter contract must also occur within this timeframe. Without further restrictions, the parties may enter into a new contract after the expiry of five years.

According to the LC, the FTC has some specific characteristics. One of these concerns the probation period. A probation period is usually called for by the employer after entering into an individual employment contract to verify the employee's professional skills. It can be established for a period of up to three months, or six months for employees with official positions (the list of which is approved by employers in consultation with trade unions or employees' representatives). For unskilled workers, probation should be an exception and cannot exceed 15 calendar days. For a FTC, however, the probation period is reduced. Article 61 of the LC establishes that employees, employed under individual employment contracts of limited or fixed duration, may be subject to a probation period not exceeding: (i) 15 calendar days, for an individual employment contract between three and six months; or (ii) 30 calendar days, for an individual employment contract with a duration of more than six months. It is necessary for parties to specify any probation period in their contract. Otherwise, the general conditions of employment will be assumed to apply to the employee.

Article 62 of the LC prohibits applying the probation period to persons employed under an individual labour contract for three months or less. Terminating an individual employment contract of limited duration is also distinct from individual labour contracts of indefinite duration. The Labour Code sets out in article 83 that, when terminating an individual employment contract of limited duration, the employee shall be notified in writing by the employer at least ten working days before the termination. It is worth noting that if, by the expiry date of the individual fixed-term employment contract, neither party has requested its termination and the employment relationship actually continues, the contract is considered to be prolonged for indefinite period. If the contract concerns seasonal employment and also includes a specified period, the work period may be validly extended by tacit agreement until the end of the season⁴⁴.

Individual labour disputes that are not settled amicably by the employee and the employer shall be settled in court. The reinstatement of the employee, with whom an individual contract of employment was concluded for a specified period, is only possible within the timeframe specified in the contract. If at the time of the ruling the timeframe for the contract has expired, and the employee has requested the payment of salary which they did not receive as a result of an illegal deprivation of the opportunity to work, the employee will obtain, as a remedy, the payment of their salary from the date of the illegal dismissal to the contractual deadline⁴⁵.

44 Bulletin of the Supreme Court of Moldova, 2006, No. 6, page 4, Plenary Decision of the Supreme Court of Justice No. 12 of 03 October 2005 On judicial practice of examining disputes arising from the conclusion, modification and termination of the individual labour contract.

45 Ibid.

When negotiating the Labour Code in 2003, and its amendments in 2005, the trade unions insisted on maintaining the exceptional nature of the FTC to ensure employment stability for employees. Although employer's organizations argued for more lenient provisions to increase the flexibility of labour relations, the Code continues to exclusively list the exceptional cases when a fixed-term contract may be concluded.

One should remember that the utmost criterion for a FTC is the temporary nature of the work, which may result from its defined duration or from a specific project or task realization. The national provision discusses concluding fixed-term contracts "for the period of performing a specific work", a concept which is not defined in legislation and which may, in fact, cover work of a permanent nature. This ambiguous provision makes it possible for an employer to circumvent the legal FTC limitations. The law also fails to specify the number of successive FTCs that may be concluded between the same employer and employee, or the total duration of successive FTCs. It is not specified under what conditions a contract may be extended or concluded repeatedly.

Although temporary work for a period of two months or less is a type of fixed-term employment, the law further regulates this type of employment. According to article 275 of the Labour Code, an ***ILC for a period of up to two months*** may be concluded in the cases provided for in article 55 of the LC, and in the manner set out by the Code (articles 45–65 and 276–278 of the LC) and normative acts. The normative acts here refer to the union decree On working conditions of temporary workers and employers (1974), which provides that temporary employees are recognized workers, including employees hired for a period of up to two months and replacement employees for those temporarily absent, for whom the job or position shall be maintained for up to four months. There is no probation period for temporary employees. Temporary employees are entitled to unilaterally terminate their ILC with three days' written notice. The employer can terminate an ILC with a temporary employee if based on the grounds provided by the legislation (article 86 of the LC). The employer shall notify the temporary employee about their termination through written notification three days before termination.

At the expiry of a two-month ILC, a temporary employee shall benefit, in accordance with article 277 of the LC, from an allowance for any unused leave days.

Another form of fixed-term work is seasonal work. According to article 279 of the LC, ***works are considered seasonal*** if, due to weather and other natural conditions, they are carried out within a specific period of the calendar year not exceeding six months. Some regulations of seasonal work are also covered by the Union Decree On the working conditions of workers and employees employed in seasonal works (1974). According to this act, one's working length within their unit shall be summed up and is considered uninterrupted if the worker worked a full season, concluded an ILC for next season and returned to the workplace within the planned deadline. Any inter-seasonal resting period is not taken into account when calculating seniority. The list of seasonal works approved by the Governmental Decision No. 1273 of 2004 contains activities that can qualify as seasonal work. This act also specifies that workers engaged in carrying out more seasonal works, the duration of which is more than six months, as well as those employed for an indefinite period, shall not be considered seasonal employees.

However, the legal practice contains another approach towards seasonal employment. If a contract refers to seasonal employment but also includes a fixed period that may exceed those six months, the working activity may be deemed extended by tacit agreement at the end of the season⁴⁶. At first glance it seems that this is an improper treatment of the legislation in force, but looking at the problem in light of article 55 of the LC, we find that a fixed-term employment contract may be concluded both for seasonal work and for fulfilling other works. Thus, seasonal works could be

46 Ibid.

identified in work within a certain period of time. The norm does not have an exhaustive nature, and contains no clear boundaries to avoid this interpretation. Consequently, the maximum six-month period for seasonal works in article 279 of the LC appears to be more of a recommendation than a requirement in practice. However, the decisions of the Supreme Court on the application of the rules of law and the fair settlement of civil cases have only an explanatory nature, and are not binding for courts in litigation arising from labour relations⁴⁷.

Under article 280 of the LC, the probation period for employees hired for seasonal work may not be more than two calendar weeks. When their FTC is expired, seasonal employees shall be paid compensation for any unused vacation days. The employee can unilaterally terminate their employment contract with at least seven calendar days' notice. The employer is also obliged to notify, in writing, their seasonal employee about their termination with at least seven days' notice.

According to the LC, fixed-term employees enjoy the same social security benefits as permanent employees. These include:

- allowances for temporary work incapacity caused by common illnesses or accidents unrelated to work;
- allowances for illness prevention (quarantine);
- benefits for recovering one's work capacity;
- maternity allowances;
- parental allowances for parents with children three years old or younger;
- allowances for caring for sick children; and
- allowances at death.

The extent of these social guarantees is established by Law 289 of 2004 on the allowances for temporary working incapacity and other insurance benefits. Article 6 of the Law provides that insured persons who work under individual employment contracts of limited duration, including those engaged in seasonal work, have the right to social security benefits if their contribution period is at least 12 months, fulfilled during the 24 preceding months. This is much shorter than the contribution period for other employees, who must complete three years of contributions. Insured women are entitled to maternity allowances regardless of their contribution length. Similarly, death benefits are provided to insured persons regardless of the length of their contribution period. The Governmental Regulation on the conditions for establishing, calculating and paying temporary disability allowances, No. 108 of 2005⁴⁸, establishes that for persons employed under individual employment contracts of limited duration or service contracts, the right to sick leave is granted until the individual labour contract expires, and ceases on the date of contract termination. This also applies if a unit is liquidated, but does not apply to maternity allowances or disability allowances.

In order to ensure the uniform application of the LC to individual employment contracts, model standard individual employment contracts and model fixed-term contracts were approved by the National Collective Convention of 25 February 2005 and the National Collective Convention of 09 July 2004, which establish the working time and resting time of employees in accordance with the provisions of the LC. There are also sectorial collective conventions in the fields of science,

⁴⁷ See article 17 of the Code of Civil Procedure of the Republic of Moldova, no. 225 of 30 May 2003.

⁴⁸ See page 5 of the Governmental Decision No 108 of 3 February 2005 on approving the Regulation on conditions for establishing, calculation and payment of temporary working disability allowances, *Official Gazette* 24-25/162, 11 February 2005.

education, health, telecommunications, energy, light industry and agriculture. Concerning non-standard forms of employment, these documents generally reflect the provisions of the labour legislation and do not contain any additional guarantees and rights, with some exceptions. For collective employment contracts in the sphere of education, individual employment contracts for a specified period are concluded only when the employment relationship cannot be established for an indefinite period. In other cases, these documents give preferential status to employees on contracts of undetermined duration compared with those on fixed-term contracts. For instance, for non-teaching staff, those with FTCs “will be the first to be terminated” (meaning seasonal or temporary workers). Dismissal of the teaching staff by the employer is usually done at the end of the school year, except for those employed for a fixed period.

Although fixed-term work provides flexible possibilities for employment and provides wider access to the labour market for unemployed people, this type of employment creates insecurity for the employee. In Moldova, employers often use the individual fixed-term employment contract as a trial period for the employee. In periods of increased activity in a company, FTCs are concluded with employees who should hold key positions in the company, with the aim of verifying if the people correspond well to their positions. Employers, trying to avoid the disadvantages of permanent contracts, also resort to fixed-term contracts to more flexibly hire and fire employees. That is why fixed-term contracts are advantageous, in general, for the employer: they automatically terminate by law, without the application of complex dismissal procedures as for indefinite ILCs. FTCs do not require valid reasoning, prior notification, or the consent of the trade union, and severance payments are not due for FTCs.

For employees, the individual fixed-term employment contract is disadvantageous because it provides poor job security, limited access to vocational training (since employers typically do not invest in temporary employees), limited prospects for advancement, and limited protection against an unjustified dismissal.

As it has been shown above, the national labour legislation does not fully incorporate the substance of the Framework Agreement on fixed-term work concluded by the social partners at the European level, enforced by European Union Council Directive 1999/70/EC. This can ultimately lead to abuse from employers, and does not encourage employers to sign employment contracts of indefinite duration.

Moldova must introduce a limitation on the number of successive fixed-term contracts that may be concluded between the same parties, with a clear regulation of the conditions under which a fixed-term contract can be concluded immediately after the previous one.

The current labour legislation should also be streamlined and revisited so that it provides clearly-defined and objective criteria for the conclusion of a FTC, which fully take into account the temporary nature of fixed-term employment. It should specify the criterion for concluding fixed-term contracts “for the period of performing a certain (specific) work”, because at the moment this can cover any type of work. Although the labour legislation provides for a limited list of instances that allow for fixed-term employment, fixed-term employment contracts, in practice, may be concluded for any reason. The norm set forth in article 279 of the LC, which sets out a special term of six months for seasonal work compared with the general one of five years, creates additional confusion, since seasonal work can currently overlap with work of a determined duration. The labour legislation does not address the frequently-occurring situation where a person is temporarily employed during the suspension period of another employee. This usually occurs in the public administration sector, when civil servants employed for a specified period receive compensation or allowances for dismissal at the end of the employment period. If the

termination of the employment of the substituted employee coincides with the termination of the substitute employee, an uncertainty arises: should the original employee receive the allowance only, or should they both receive it? Unfortunately there are no clear regulations on this topic, so the problem must be solved through judicial recourse.

3.3 Work of employees for individual employers (domestic workers)

Another type of non-standard employment is the work of employees for individuals as employers (domestic workers). The labour legislation grants any individual the right to conclude an ILC in writing with an employee (usually called a domestic worker) to fulfil a job not prohibited by legislation in force (such as babysitter, driver, gardener or cleaner), where it is necessary to include all of the provisions of an employment contract. Although article 283 of the LC sets out that these contracts may be concluded both for indefinite and fixed periods, fixed-term contracts are primarily used in practice. Special attention should be given to an important regulation concerning the working and resting hours of domestic workers, as set out by the article 285. This provides that the individual, in their agreement with the domestic worker, may establish any working and resting regime, conditioned by the nature of employment relationship, allowing them to make better use of their working time. The LC provisions do not clearly specify what working time arrangements apply to domestic workers.

3.4 Temporary agency work

One new type of employment arrangement in the European labour market that is still not provided for in Moldova's labour legislation is the temporary agency work contract. This type of contractual arrangement does not fall under the domestic legal framework. The temporary employment contract falls under the European Union Council Directive 1991/383/EEC on accomplishing the measures aimed at promoting improvements in the labour, safety and health of employees who have fixed-term or temporary employment relationships (Litec, 2002), and under the Directive 2008/104/EC on employment through an temporary employment agent. A temporary employment relationship is established between a temporary work agency – the employer – and the worker, who is assigned to work temporarily under their supervision and direction.

As such, the relationship is a “triangular” one, implying rights and obligations for three parties.

Although Moldova has ratified the ILO Private Employment Agencies Convention, 1997 (No. 181), its national legislation has not assimilated the concept of the “temporary employment agent”. However, temporary work seems to have some similarities with the “delegation” or “deployment”⁴⁹ of private employment agencies, regulated by Law No. 180 of 10 July 2008 on labour migration and Law No. 102 of 13 March 2003 on the employment and social protection of job seekers. According to article 10¹ of Law No. 180 of 10 July 2008, the private employment agency operates under national law to license certain types of activities, in accordance with the provisions of this law and international norms regulating the activity of private agencies.

The employment agency may only undertake the selection and placement of workers in the country or abroad by providing a labour exchange. Law No. 180 of 10 July 2008 practically provides for the same opportunities for agencies that undertake employment activity abroad for Moldovan citizens. Under article 21 of that law, the agency can contribute to the conclusion of individual employment contracts or conclude employment contracts with citizens seeking employment abroad by an employer's proxy. We find that the national legislation has not adjusted to the provisions of Convention No. 181, which confers to private employment agencies the right to recruit workers and make them available to third parties, which may be individual or legal

⁴⁹ See article 71 of the Labour Code, adopted by Law No. 154 of 28.March 2003.

personalities, and sets out the tasks to be performed by them. Thus, the absence of temporary work regulations is an important impediment to private agents attempting to provide temporary employment services. However, there is already a practice in some companies (mostly with IT profiles) to acquire “temporary staff”. This occurs with both short-term (staff leasing) and long-term (outsourcing) contracts, and can also provide the necessary employees from the existing staff (out-staffing).

Under this scheme, the “user company” delegates to the “employer company” part of its obligations towards its employees, and the employees of the employer company are legally taken by it, or the employer company resorts to delegating its employees. These companies, in order to practice or veil their outsourcing services, illegally change the employee’s job. An employee’s job may be temporarily changed by the employer because of a business interest or by deploying them to another job in accordance with articles 70 and 71 of the LC. Repositioning because of a business interest means delegating the employee, according to the employer’s order and for a certain period, to perform work duties outside their permanent job. Changes to the employee’s job because of a business interest may be ordered for a period not exceeding 60 calendar days. Under article 70 of the LC, the deployment may be ordered only with the written consent of the employee for up to one year and is carried out under an individual labour contract for a fixed period. If necessary, the deployment period may be extended, by mutual agreement, for an additional year. An employee may also change the specifics of the work, but only with the written consent of the employee. As with deployment because of a business interest, the employee maintains his or her position, their average wage, and other rights under the collective and individual labour contracts.

Current labour legislation in Moldova does not regulate temporary agency work. This legal gap must be addressed considering the commitments undertaken by Moldova on this issue, including the ratification of the Association Agreement between Moldova, the European Union and the European Atomic Energy Community and its Member States (Association Agreement), which envisages bringing the national legal framework in compliance with EU standards, including employment relations. The agreement refers to European Union Council Directive 1991/383/EEC, to be implemented within three years from the entry into force⁵⁰. With the transposition of Directive 1991/383/EEC into national legislation, it is important to take into account the provisions of Directive 2008/104/EC as well, which lay down certain restrictions on the use of temporary agency work in order to prevent and deter abuses.

3.5 Part-time work

In Moldova’s labour legislation, the part-time employment contract is not identified as a distinct type of employment contract, but a type of standard individual employment contract that provides for a fraction of the normal working time. A part-time employee is an employee whose normal working hours, calculated per day or average per week, are lower than the number of normal working hours of a full-time employee.⁵¹⁵² There is no minimum limit established by law.

The legal regulation of part-time work arrangements in Moldova is paid relatively less attention. The main aspects are addressed in article 97 of the LC. In accordance with paragraph (1) of that article, the employee and the employer can agree to establish a partial working day or partial working week. At the written request of a pregnant woman, an employee who has children under the age of fourteen

50 The Association Agenda between Moldova and the European Union establishes a set of jointly agreed priorities for the period 2014–2016, in order to prepare for the implementation of the Association Agreement, including the Deep and Comprehensive Free Trade Agreement.

51 According to article 98 paragraph (1) of the Labour Code, the distribution of working time within the week is usually uniform and constitutes 8 hours per day during 5 days with two resting days.

52 According to article 95 paragraph (2) of the LC, the normal duration of working hours of employees in the unit cannot exceed 40 hours per week.

or disabled children (including children under their guardianship or trusteeship), or an employee taking care of a sick family member (according to a medical certificate), the employer is obliged to establish a partial working day or partial working week for them. This results in part-time work agreements that are, in principle, created through the parties' agreement and not by the will of one party. However, upon the written request of those three categories of persons, the employer is obliged to allow for the requested part-time working regime. The working time arrangements in these cases are established by an additional signed agreement annexed to the ILC, which becomes an integral part of it in accordance with article 68 of the LC. In paragraph (2) of article 97 of the LC, it is stipulated that part-time wages (resulting from partial working days, partial working weeks, or part-time week or day regimes) are allocated proportionally to the time worked (for employees whose work is remunerated by an hourly or day rate), depending on the volume of the workload accomplished (for employees paid based on a labour agreement). In other words, an employee's wage upon transitioning to part-time work decreases because its calculation is proportional to the time worked and the amount of work accomplished (which cannot be maintained at the full time levels).

Article 97 of the LC establishes that part-time work does not limit an employee's rights in calculating seniority, or their contributions for working experience, except in cases provided by the legislation in force. Therefore, the transition of an employee to part-time conditions in principle does not damage their core labour rights (with proportional remuneration). There is one exception concerning the calculation of the length of service: that is, in accordance with article 6 paragraph (2) of Law No. 156 of 1998 on state social insurance pensions, if the annual contribution paid is less than the annual contribution calculated from the country's minimum wage established by law (currently 1,000 MDL per month for a work program of 169 hours), the contribution for a working period is calculated proportionally to the amount paid.

An employee employed under a part-time contract shall enjoy the same rights as a full-time employee, and is less vulnerable compared to other non-standard employees. Freedom of association in unions, collective bargaining, rights to labour safety and health and other social guarantees will be fully applied to part-time workers. Disadvantages could include the salary, social security benefits, allowances for paid leave, and allowances upon termination of the employment relationship, which are determined proportionally with the rights recognized for full-time workers.

A problem that reduces an employee's rights is that employers are not required to transfer their employee from a part-time to full-time job when the circumstances that initially called for part-time employment no longer exist, or to increase the employee's working program if the opportunity arises. Currently this is only possible when initially stipulated in the labour contract negotiated between the employer and employee, or if there was a collective labour agreement with this specification. Removing barriers that limit transitions from part-time to full-time employment, in line with the ILO Part-time Work Recommendation, 1994 (No. 182), and the ILO Workers with Family Responsibilities Recommendation, 1981 (No. 165). Adopting measures which ease the transition to full-time employment could enhance individual welfare, prevent part-time employment from becoming a long-term trap, and help reduce the negative effects on earnings (Fagan et al., 2013, p. 39).

3.6 Home work

Although Moldova is not a party to the ILO Home Work Convention, 1996 (No. 177), and the ratification of the Convention has not yet been discussed in the country, the national legislation contains provisions regulating home work (articles 290–292 of the LC).

According to article 290 of the LC, home work employees are those who have signed a labour

contract offering services at home by using materials, tools and mechanisms made available by the employer or purchased with their own money. The thing that makes the home work contract unique is the place of employment, which is the employee's home. As opposed to the national legislation regulations, Convention No. 177 provides that the employment place must not only be the home of the employee, but any other place chosen by the employee. The regulation allowing the employee to only offer services at their home is more restrictive. Given that the national legislation regulates the provision of home work only at the employee's home, Moldova could consider changing the Labour Code to be in line with this convention.

According to the paragraph (2) of article 290 of the Code, the home worker will be compensated if they use their own tools and mechanisms. The payment of such compensation, as well as the compensation of other expenses related to home work, is undertaken by the employer according to the employment contract⁵³. The provision in paragraph (3) of article 290 has special organizational and legal significance. According to this provision, the method and terms for ensuring the home worker with raw materials and semi-finished products, the payment for the final products, the refund for the value of the materials, and taking over the final products are set out in the employment contract.

Some aspects regarding home work are contained in the Regulation on home workers' working conditions (1981), which is applied in Moldova. According to article 392, paragraph (2) of the LC, taking into account the provisions of article 391, paragraph (3) of the LC, the normative acts in force which regulate the labour relations shall be applied only if they do not contravene the Labour Code. The Regulation states that the activity of home workers must be directed, usually, towards the production of commercial products or services. The production tasks may be achieved with the participation of the home worker's family members. The employer may also hire the home worker for making other types of products, if this is possible and economically acceptable under the home conditions.

The preferential right to sign a home work employment contract is granted to women who have children under 15 years old; people with disabilities and retired people; people who have reached the retirement age but do not receive retirement pensions; people with limited labour abilities who are recommended to work at home; people who are taking care of a disabled person or a sick family member for a long period of time; people engaged in seasonal production who are between seasons; people who study full time; and people who, because of objective reasons, cannot be involved directly in the production process in a given locality (such as localities with a surplus of labour). Article 291 of the LC stipulates that home works must be carried out under conditions compliant with occupational safety and health. The basic rules on occupational safety and health are contained in article 225 of the LC.

Article 293 of the LC states that the termination of a home work employment contract should be based on the general principles provided for in the LC. According to article 81, paragraph (1) of the LC, the employment contract may discontinue in circumstances which do not depend on the wish of the two parties (article 85 of the LC), or on the employer's initiative (article 86 of the LC). However, not all reasons for discontinuing the employment contract provided for can be applied without exception to home workers. According to the provisions of article 82 of the LC, the following reasons may not be applied to discontinuing the employment contract with a home worker: expiration of an employment contract with a limited period of time (because there is no employment contract with a limited period of time for the home worker); the end of the season

53 Such conditions are introduced in the employment contract, taking into account article 49, paragraph (1), letter (j), paragraph (2), and the provisions of article 51, paragraph (1), letter (c) of the LC regarding the payment of compensation and inclusion of other specific clauses in the contract which do not contravene the legislation in force, including the compensation of expenses related to offering services at home.

(since there is no home worker employment contract for seasonal activities); or when the head of a State institution reaches the age of 65⁵⁴, including municipal institutions and institutions with a majority of state financing (to which the home workers do not refer).

Home work jobs are frequently “invisible” to labour inspection, the regulatory framework and labour statistics. The Convention requires that an inspection system be in place to ensure compliance with the laws and regulations applicable to home work. In Moldova, both labour inspection and trade unions face challenges when reaching out to these workers. The Ministry of Labour does not collect data or register home worker contracts. There is little awareness of the regulatory framework in this respect, and little is known about the number of home workers in the country. However, the labour force survey asks whether the primary location of work is the home, and could provide further insight into this issue.

3.7 Self-employment and self-employment activity

As mentioned previously, the labour law only covers the subordinated type of employment relationship and does not apply to self-employment (in one’s own household), independent or freelance activity. Although national law does not include the notion of independent or self-employed activity, the definition provided by the ILO in the “International Classification by professional status” describes an independent activity as an activity whose remuneration is directly dependent on the benefits derived from provided goods or services. Given this, the National Bureau of Statistics defines a self-employed person as one conducting activities in their own unit in an individual business without hiring any permanent employee, with or without help from unpaid family members. This status encompasses independent entrepreneurs (itinerant sellers, mediators, patent holders, private taxi drivers), freelancers (strolling musicians, artists, lawyers, notaries), casual day labourers, and individual farmers. Self-employed persons may have temporary employees.

The category of self-employed (independent) workers varies widely depending on their role in the labour market and the nature of their work. The category of self-employed workers should be differentiated from those who are economically dependent in order to better understand the evolution of self-employment, which, as a result of major social and economic changes, exceeds the traditionally recognized forms of self-employment. In this context, self-employed, independent or own-account workers should be differentiated from economically dependent or bogus self-employed persons (whose earnings totally depend on one client). An independent worker is one who determines when and in what case the work must be performed. This category includes people who practice a profession, such as lawyers, notaries, bailiffs, auditors and artists. Their activity related to the labour market is usually governed by special laws, such as Law No. 1260 of 19 July 2002 on lawyers, Law No. 1453 of 08 November 2002 on notaries, Law No. 113 of 17 June 2010 on bailiffs, and Law No. 61 of 16 March 2007 on auditors. At the same time, their work can be also regulated by the labour law or the Labour Code when they do not contradict the special regulations.

When a worker is economically independent, they assume an entrepreneurial risk. While the work in an employment relationship is regulated and protected by the labour legislation, the independent worker is completely exposed to the economic risks of the market. Independent workers can also include individual entrepreneurs and individuals authorized to conduct business activities⁵⁵.

The activities of self-employed and economically independent persons fall under the provisions

54 See article 82 of the Labour Code, which provides grounds for termination of individual labour contracts in circumstances beyond the control of the parties.

55 Law No. 93 of 15 July 1998 on entrepreneurial patents.

of the tax system, the public system of social insurance and the mandatory health insurance system. Therefore, these people benefit from guarantees provided by the social system. However, considering that the rate of social contribution is fixed (at 5,748 MDL per year) and covers just a guaranteed minimum of individual insurance⁵⁶, these persons benefit only from certain social security benefits such as old-age minimum pensions and death benefits. At the same time, they can benefit as uninsured persons from the single childbirth allowance or the monthly childcare allowances for children under 1.5 years.

The disguised employment relationship is another aspect of the phenomenon of informal employment that has recently grown in Moldova. In this situation, both parties resort to other types of contracts rather than the individual employment contract to conceal the employment relationship and avoid the obligations arising from it (such as paying social security contributions). Frequently, the employment relationship is disguised under various civil and commercial contracts, most commonly under a service contract concluded directly with individual providers.

Both the enterprise contract and the service contract are regulated by chapter XI of the Civil Code. According to article 931 of the Code, the service contract is a contract through which the entrepreneur or the service supplier is free to choose how to execute the works or supply services. There is no subordination relationship between the entrepreneur or supplier and the beneficiary. Similarly, for the enterprise contract, article 946 of the Code states that a party (the entrepreneur) to the contract obliges to execute at their own risk a certain activity for the other party (the client), and the latter obliges to receive the work and pay the agreed price.

There may be certain difficulties in identifying which contracts regulate the professional activity of a person, the employment contract or some legal and civil contracts. For instance, article 45 of the LC allows for the individual employment contract to be distinguished from civil law contracts using labour (such as enterprise, service, or mandate contracts), since the individual employment contract regulates the labour process and the civil law contract regulates the final result. According to the individual employment contract, the labour should be executed by the employee personally, but according to the civil law contract, the work may be entrusted by the executor to other people.

Parties are tempted to confuse these agreements because a more relaxed fiscal regime is applied to service contracts and other civil law contracts compared to individual employment contracts.

For example, under an individual employment contract, the contributions are distributed as follows:

The employee's contributions:

- retirement fund, 6 per cent;
- health insurance, 4 per cent;
- income tax, 7 per cent up to 27,852 MDL, and 18 per cent starting from 27,852 MDL;

The employer's contributions:

- social insurance fund, 23 per cent; and
- health insurance, 4 per cent.

The employers and the employees do not pay these contributions if, for example, they sign a service contract. But a person supplying a service based on a civil contract does not benefit from the protections of the Labour Code. For example, a civil contract may be terminated following a simple notification, by observing a warning notification, and no reason needs to be given and no

⁵⁶ The Law on the state social insurance budget for the year 2014, no. 329 of 23 December 2013, *Official Gazette* 17-23/50, 24 January 2014.

preliminary procedure is required, unlike when an individual employment contract is terminated. This is another reason for employers to prefer these types of contracts over the individual employment contract.

An increasing number of workers have resorted involuntarily to non-standard forms of employment in both the formal and informal sectors. For example, fixed or part-time work is frequently used to share jobs. This is a consequence of the scarcity of full-time jobs and represents an alternative to unemployment.

3.8 Determination of the existence of an employment relation

According to the ILO Employment Recommendation, 2006 (No. 198), the determination of the existence of an employment relation must be guided, first of all, by the facts related to the execution of the work, and to the remuneration of the worker, without taking into account how the relation is defined in the contract. Moldova must also take into account the possibility of defining specific indicators of the existence of an employment relationship through its laws and regulations. These indicators may include:

- a) situations where the labour is achieved according to instructions and control of a third party; where the participation of the worker is implied in the organization of the activity of the enterprise; where the labour is done to the benefit of a third party; where it is carried out personally by the worker; where it is done during the hours and at a place defined by the employer; where it has a determined duration and a certain continuity; where it needs the availability of the worker; or where it implies the transmission of tools, materials and the equipment by the employer; and
- b) instances where the payment is done periodically for remunerating the work; situations where the remuneration is unique or the main source of income; instances of remuneration in kind, such as foodstuffs, housing or transportation; instances where the right to weekly rest and the annual leave are recognized; situations where the employer pays the expenses for business trips; or situations which imply a lack of financial risk for the worker.

The existence and terms of an employment relationship must be determined by independent institutions, such as a court of law or an industrial tribunal. Under articles 351 and 352 of the Labour Code, the labour jurisdictional bodies in Moldova are the judicial courts, which rule over labour issues in first cases and in cases of appeal.

When applying the principle of the supremacy of the facts in national jurisprudence, article 2, paragraph (3) of the Labour Code states that if the court determines that, through a civil contract, employment relations exist between the employee and the employer, provisions of the labour legislation shall be applied to these relations. This norm facilitates the employees' task to prove the existence of legal labour relations (especially the existence of the individual employment contract), since a legal employment relationship may be recognized simply because services are provided under the contract.

In order to ensure the unitary application of the labour law concerning the conclusion, modification and termination of individual employment contracts, the Plenum of the Supreme Court has provided the following advice for situations where labour relations are disguised as civil relations.⁵⁷

⁵⁷ The decision of the Plenum of the RM Supreme Court Decision of 03 October 2005, No. 12, On the judicial practice of examining disputes arising from the conclusion, modification and termination of individual employment contract, SCJ, *SCJ RM Bulletin* 6/4, 2006.

- The courts are to distinguish labour relations from civil relations, which can have as a legal basis only the individual employment contract, referred to in article 45 of the LC.
- If the contract bears a different name, but its contractual clauses (like salary payment, observance of work discipline, and ensuring working conditions) imply definitive elements of an individual employment contract, it shall be deemed as lawfully concluded with all of the legal consequences it produces.
- It is necessary to distinguish between the individual employment contract and an order of employment. An order of employment is a way to legalize or legally confirm a person's employment (article 65, paragraph (1) of the LC). It is not necessary for the order to contain clauses that have already been indicated in the individual employment contract, or to indicate additional conditions that were not included in the employment contract. The contract, and not the order, will be the object of reference for labour disputes.
- On behalf of the employer, the individual employment contract shall be signed by the individual authorized to conduct entrepreneurial activity. In the case of legal persons, the contract shall be signed by the head of the unit or by the person authorized by law to manage the employment of employees in that unit.
- If work was actually performed by an employee not entitled with this right, and the person in charge of hiring does not agree with this decision, the court cannot compel the employer to conclude the employment contract.
- For work performed, an appropriate fee shall be established.

Obviously, these suggestive criteria may be useful in elucidating the nature of the employment contract compared to civil or other contracts, only when a party to the legal relationship judicially challenges the transaction. Usually this party is the one who performs the work. This is currently the only way to examine a civil contract which may be disguising an employment relationship, since the limited functional control competences of Labour Inspection, the authority charged with monitoring compliance with the labour legislation, are insufficient to ascertain or challenge this violation.

3.9 Undeclared work and the national policies to fight it

There are two predominant situations of undeclared work in Moldova, which can occur in both the formal and informal sectors.

- Employees do work without an employment contract, whether they are aware of it or not. This may be a trial period, an occasional work, or an activity with a limited or unlimited duration.
- Employees have an employment contract, but it either mentions a salary smaller than the real one (often the national minimum wage) and the difference is paid unofficially and is undeclared (the “envelope salary”), or the salary mentioned in the contract includes services provided by the employer that are not taken into account for pension rights (such as meal tickets).

From the worker's point of view, undeclared workers cannot benefit from labour legislation protection, particularly relating to wages, social and health insurance, OSH, and vocational training. From the point of view of the employer who abides by the labour and tax laws, the practice of undeclared work is a distortion factor of fair competition in the market.

The alternative offered by the informal labour market is a vital source of income and social security for the poor population. But the extent of informal practices unfortunately contributes to lowering

the population's living standards, reducing the real wage compared to the cost of living, expanding the need for people to have additional income sources, transforming the structure of the economy, and deepening the impoverishment and the manifestation of external instability in the country.

In the Law No. 477 of 28 June 2001, the Government approved the **Action Plan on minimizing the practices of “envelope” salaries and “black labour”**. The plan provides a list of measures that aim to amend the legislation, diminishing informal employment and undeclared work. The most important objective achieved by this document was the introduction of the notion of “undeclared work” into the national labour legislation. Thus, the Labour Code has been complemented with article 7¹, which expressly forbids undeclared labour, defined as any labour offered by an individual for and under the authority of an employer, without the observance of the provisions of the present Code related to the signing of an individual employment contract. In order to ensure the observance of this provision, the Contravention Code has been complemented with a new article 55¹, providing for administrative liability for undeclared work. The sanction for individuals is from 250 up to 350 conventional units, and for people with managerial positions, from 350 up to 500 conventional units (one conventional unit = 20 MDL). These sanctions have reached the maximum allowed limit set by the Contravention Code. Thus, with these amendments to the legal framework, informal employment is no longer tacitly tolerated, and qualifies as an action that violates the law and that should be punished.

Although this conceptual change of attitude is an important component in fighting informal employment, attaining new measures remains difficult because of the following reasons. The State Labour Inspection, as the authority ensuring the observance of the labour legislation, faces limitations in identifying and fighting undeclared work. With the adoption of the Law No. 131 of 2012 on state control, amending the Law No. 140 of 10 May 2001 on labour inspection, the functional supervision and control tasks of the State Labour Inspectorate were significantly reduced. With new procedures now required to initiate and conduct controls, the monitoring and operational capacity of this authority became ineffective. According to the Law on the State Labour Inspection (Law No. 140 of 10 May 2001) and the Law on state control of business activity (Law No. 131 of 8 June 2012), it can carry out planned controls no more than once a year, and only after an employer has been given five days advance notice of the visit. Under these conditions, the chances of discovering unauthorized workers have been greatly reduced. Unannounced controls also face legal restrictions that hinder their effectiveness.

This issue was analysed by an ILO Committee that examined the failure of the Republic of Moldova to observe the ILO Labour Inspection Convention, 1947 (No. 81). Considering how important it is to fully empower labour inspectors to make visits without notice to guarantee effective supervision, the Committee found that the restrictions on unannounced inspections contained in sections 18 and 19 of the Law on state control are incompatible with the requirements in Articles 12(1)(a) and (b) of the Convention with respect to undertaking inspections without notice given to the employer. The Committee also found that the particular limitations on carrying out unscheduled inspections contained in section 19 of the Law on state control constitute an impediment to the inspections and appear to be incompatible with the principles contained in Article 16 of the Convention. The Committee therefore suggested that the Government discuss these matters with the social partners at the national level, with a view to bringing the national legal framework into conformity with the Convention. It also encouraged the Government to consider availing itself of ILO technical assistance when drafting any new versions of the law⁵⁸.

Improving the State's record-keeping of labour relations, labour activity and working time is

58 The Report of the Committee set up to examine the representation alleging non-observance by the Republic of Moldova of the Labour Inspection Convention, 1947 (No. 81), submitted under article 24 of the ILO Constitution by the National Confederation of Trade Unions of Moldova (CNSM).

another objective of the Action Plan, which proposes to introduce a general registry of employees. The register will be managed by the State Labour Inspectorate and will contain the following information:

- the names of all employees;
- their employment date;
- their position or occupation, according to the Classification of the Positions;
- the type of individual employment contract used; and
- the date and reason for discontinuing the individual employment contract.

The Action Plan also suggests changes to the Labour Code and to the Law No. 436-XVI of 28 December 2006 on local public administration to empower the public authorities (State Labour Inspectorate, mayoralty, and territorial employment agencies) to keep records and register individual employment contracts for small private sector enterprises with a staff of up to 20 people, as well as to maintain and make entries in the work books.

Another objective is to improve wage declaration. The organization of wage salary payments can be improved by extending the application of some effective forms of wage payment within non-wage systems, annually increasing the minimum guaranteed quantum of the wage in the real sector (according to the annual increase of consumption prices and labour productivity rates at the national level), negotiating and establishing sectoral collective conventions, popularizing wage payments through bank cards, and revising the system for establishing and reviewing the minimum guaranteed wage in the real sector.

Finally, the Action Plan provides for other strategic objectives to be fulfilled by 2017. These include reducing the tax burden by improving the taxation system for individuals; developing a mechanism for differentiating social insurance contribution tariffs depending on one's labour safety and health; increasing employer responsibility in protecting an employee's rights; enhancing labour controls to detect evasion and counteract the phenomenon of "black labour"; and promoting the legal education of employees.

3.10 Conclusions

The fundamental principles of equal opportunity in one's occupation and profession, fair access to justice, freedom of association, the right to strike, and the right to social assistance are enshrined in the Constitution of Moldova. It guarantees the right of every worker, irrespective of their form of employment, to decent working conditions and social protection. The Labour Code regulates the conditions and protection of both standard and non-standard forms of employment.

The standard employment contract remains the rule, and it is preferred for some of the reasons below.

- Differences continue to manifest between men and women in non-standard employment, despite the legal protection against discrimination based on sex and the policies and measures to promote gender equality in employment relationships. Women enter into non-standard employment contracts more frequently than men. They often resort to non-standard work to reconcile their professional and family responsibilities, which are perceived as the woman's duty only. As a result, they benefit from lower social security guarantees, have lower wages, and have fewer opportunities to participate in educational programs (basic education, lifelong learning or training). They also often cannot contribute substantially to the pension fund, subjecting them to a greater risk of not having enough income upon retirement.

- Often, workers who perform work under non-standard contracts (especially home workers) have limited opportunities for organizing, joining trade unions or participating in collective bargaining.
- There are fewer social security safeguards and labour rights for persons working under non-standard contracts than those employed under standard contracts. Self-employed or independent workers only reap some social benefits (a minimum pension for their age limit), while informal workers are generally deprived of them. People with the status of insured employees (based on ILCs) have greater benefits for maternity leave and child-rearing than other types of employed persons.
- The health care system provides health care equally to payers of compulsory insurance and to those with unemployed status (registered with the National Employment Agency) and other persons (pregnant women, mothers with four or more children) by law⁵⁹. Although the health care system is flexible in terms of the medical service supply, providing assistance to all categories of people is less feasible in practice. Those who are not employed (without official unemployed status) and those who are engaged in informal work often cannot benefit from these services.
- There are limited prospects for advancement and limited protection against dismissal for non-standard employees. For these reasons, employers sometimes conclude permanent contracts only with the key employees in their company, ensuring their involvement in regular professional training and internal promotion systems. Workers with peripheral positions are employed under employment contracts of fixed durations, so that their hiring and dismissal can be managed in a more flexible way.

There is also a risk that non-standard employment relationships create a source of insecurity and precariousness for vulnerable categories of the economically active population. Temporary jobs are mostly filled by young people, people with low education and skills, and people with little or no specializations. They are often for low-skilled positions in agriculture or in small firms. Temporarily employed persons are vulnerable to underpaid work (as there is tendency for temporary jobs to be paid less than permanent ones), precarious and unsafe working conditions, and poor access to a range of additional benefits because of the principle of contribution (limiting them from unemployment insurance, pensions, health insurance, paid holidays and sick leave). Temporary employment, often informal or on the border between formal and informal, decreases individual revenue and discourages workers from entering into full employment structures, thus increasing their social insecurity and exclusion. However, the diversity of employment contracts, and the extent to which they are actually used by the parties, indicate the flexibility of labour relations. The general trend of the national labour legislation is to increase the diversity of contracts that serve as the basis for subordinated employment.

Existing statistical data on NSFE, which only captures fixed-term employment in the formal and informal sectors, indicates a significant share of temporary employment in the informal sector, or 40 per cent, as compared to 3.6 per cent in the formal one. Since the national labour legislation regulates most of NSFE except for temporary agency work, one can conclude that the available various types of employment contracts have not thus far incentivized persons to formalize employment in Moldova.

59 See article 4 of the Law on compulsory health insurance no. 1585 of 27 February 1998, *Official Gazette* 38-39/280, 30 April 1998.

3.11 Recommendations

- Bearing in mind that social protection systems play an important role in addressing the risks of flexible labour markets, the social protection system must be revitalized to adapt to new risks and become more comprehensive.
- The legislative framework should be amended to address unregulated situations and to adapt the national legal framework to provisions of international standards. Namely, two changes should be made:
 - Article 97 of the LC should be amended to reflect the ILO Part-Time Work Recommendation, 1994 (No. 182). This requires that the employer, in justified cases, grant the employee's request to be transferred from full-time to part-time work, and subsequently to return to full-time work.
 - The Labour Code should be supplemented with provisions on temporary agency work. The national legislation has not adjusted to the provisions of Convention No. 181, which allows private employment agencies to recruit workers to make them available to a third party (which may be an individual or legal personality), and to set the tasks to be performed by them.
- It is necessary to promote legal education for employees. Although the labour legislation provides for the possibility of establishing individual working programs for employees with part-time or flexible schedules, this right is not yet widely offered and is rarely encouraged by employers. Few families know of their existing rights, in particular those in article 97 of the Labour Code, which gives pregnant women or employees with children under 14 years the right to work part time. Employers are generally reluctant to embrace this form of work, which is why few employees can enjoy part-time work or flexible work schedules. Collective bargaining can play an important role in promoting decent working conditions for workers in these forms of employment.
- The legal and institutional framework for labour inspection needs to be reformed. Although the national legislation contains provisions to identify and combat cases of undeclared work, the actual controlling power of the State Inspection of Labour is limited, which causes inefficiency and limits the operational and monitoring capacity of this authority. The Government should continue to discuss these matters with the social partners at the national level, aiming to bring the national legal framework into conformity with the Convention. The Government could also consider availing itself of ILO technical assistance to this end.
- Like many countries in the European Union, the Government could consider attaching criminal liability to employers with undeclared workers, as well as administrative liability depending on the degree of social harm caused. This could make sense for Moldova, considering that the Contravention Code provides a ceiling on administrative fines and prevents their further increase for informal work.
- Carrying out joint inspections by several competent bodies will increase their efficiency and operational monitoring capacity to combat undeclared work.
- Regulating the temporary employment relations of seasonal or day workers and simplifying the registration procedures for individual labour contracts with employees who perform casual work, such as domestic work or agricultural work, may encourage the formalization

of informal employment. This would ensure their access to social protection and bring them under the coverage of the law.

- A new tax policy approach is necessary. This should provide incentives for small- and medium-sized enterprises, such as tax exemptions at the beginning of their activity, the modification of the threshold for taxable income, and tax incentives for enterprises established and managed by young people or those dealing with education. For employees, the Government should raise the annual personal exemptions and establish a linear, proportional personal income tax for individuals.
- Campaigns can contribute to combating undeclared work and promoting the formalization of the informal economy. This can be done by raising awareness of the rights and obligations of employees and employers under the existing legal framework. People should be aware of the risks of working without a contract or receiving “envelope wages”, and of the benefits of formalization. Actions may include:
 - publishing press releases, notes or thematic articles regularly in local newspapers;
 - broadcasting informative programs on local TV stations;
 - disseminating informative materials on the benefits of formalization and existing labour rights;
 - strengthening trade unions’ capacity on issues of labour law and how to reach workers in the informal economy;
 - starting awareness-raising campaigns to encourage the payment of contributions, taxes and the use of electronic payments; and
 - making all relevant information for workers and employers in urban and rural areas available on a dedicated webpage for the National Commission on Consultations and Collective Bargaining (NCCCB).
- Finally, the Government should encourage the negotiation of sectoral collective agreements in agriculture and construction. These should include measures to promote formalization and to ensure labour protection for workers in non-standard forms of employment.

Chapter 4. Extension of social security to the informal economy in the Republic of Moldova

4.1. Challenges and responses to extending social security coverage to the informal economy

4.1.1 Scope and definition

The purpose of this chapter is to analyse the effects of the informal economy on various aspects of social security, and discuss what measures can be taken to extend the coverage of social security for workers in the informal economy.

As affirmed by fundamental international documents such as the Universal Declaration of Human Rights (1948) and the International Covenant on Economic Social and Cultural Rights (1966), as well as regional instruments like the European Social Charter (1961, revised 1996), every member of a 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 areas of critical importance in the ILO’s Decent Work agenda. In this regard, the ILO Social Protection Floors Recommendation, 2012 (No. 202) calls for the ILO Member States to build comprehensive social security systems and to extend social security coverage by establishing and maintaining national social protection floors, ensuring that all members of society enjoy at least a basic level of social security throughout their lives.

Most European countries already have comprehensive social security systems. The existing systems typically operate in the forms of (contributory) social insurance systems and tax-financed (non-contributory) social assistance systems, both of which constitute a main pillar of the European social model. Although the existing social security systems in European countries have achieved a reasonably high personal coverage, gaps still exist, notably among workers in the informal economy, migrant workers, and farmers in rural areas. Extending social security coverage for informally employed workers is an important step for transitioning from the informal to the formal economy.

The agricultural sector has one of the highest occurrences of informal employment in South Eastern Europe. In Moldova, 63.4 per cent of workers in the agricultural sector work informally. In Bosnia and Herzegovina, informal employment is also quite common among people working in the agricultural sector. Informal workers and supporting family members often work on their own land or are hired by a bigger landowner. The stability of their income is influenced by environmental and other natural conditions. Agricultural work is often more hazardous than other works as well. These vulnerabilities make it more important that adequate social protection is provided for this group.

In South Eastern Europe, informal work is traditionally performed by diverse groups of domestic workers, many of whom are women. Generally, this group works under an informal contract (an oral contract based on custom) to provide household services or to support the family work, mostly in agriculture. Although food and accommodation are provided so that the group is protected from absolute poverty, in many cases there is no regular, if any, remuneration or social security coverage. The closed and limited working environment in the rural setting is a barrier against inspection and control.

4.1.2 Effects of informal and undeclared work on social security systems

Following the principle that social security is a basic human right, there are a number of advantages in extending social security. In particular, extending social security coverage to informally employed workers and their families will improve their well-being by protecting them against various social risks. It also helps improve the productivity and employability of the informally employed workers, which in turn can facilitate their transition into the formal economy. By covering all groups in a society, it enhances social inclusion and cohesion.

The major forms of non-coverage and non-compliance are broadly classified into four cases. The first case is when an employer (often in a small- or micro-enterprise) or a self-employed worker (like a farmer) fails to register as a contributor. The second case is when an employer under-reports their number of employees (especially part-time or casual workers). The third case is when an employer or a worker under-declares their wage levels. The fourth is when the employer fails to pay contributions or wages.

Clearly, if a worker in the informal economy fails to comply with the social security law (or other fundamental labour legislation), then the worker and their family members are unprotected against substantial social risks. However, it should be noted that most countries in Central and Eastern Europe provide health insurance coverage for unemployed, retired, and disabled persons and their dependent family members. Therefore, some workers in the informal economy (such as family workers) are at least covered by health insurance. This, however, is not the case with contributory cash benefits aiming for income security.

From the point of view of social security, undeclared work implies fraud and evasion of tax and social security contributions. This practice refers to a situation in formal employment in which workers and employers declare a lower-than-actual income in order to maximize their current disposable income or profit. A typical case of income under-declaration occurs when a worker and their employer pay only the minimum contribution level stipulated by the law. This secures at least a certain minimum level of benefits if the worker completes their required contribution period. The problems related to the under-declaration of income are sometimes more serious and more difficult to tackle compared with the case of non-coverage.

The under-declaration of income threatens the sustainability of social security systems and the adequacy of social security benefits. This results in social security systems that face significant leakage of funds, causing an imbalance between their revenues and their expenditures. Considering the recent reforms in Central and Eastern Europe to tighten the link between contributions and benefits, a lower amount of contributions will result in lower levels of benefits (in particular for cash benefits such as pensions), thereby exposing the workers and their families to a higher poverty risk. This could eventually require States to subsidize the shortfall of their social security systems, and to spend more on social assistance and other social protection programmes. Moreover, the under-declaration of income seriously undermines the credibility of the social security systems. If such a practice persists and spreads widely, the public willingness to pay contributions will deteriorate, and in turn will result in fostering the adverse practice.

4.1.3 Barriers in extending social security to the informal economy

Historically, social security was established to serve wage and salary workers who had an explicit employment contract in formal enterprises. Therefore, if one simply applies this concept without taking into account the different characteristics of the informal economy, the extension of the coverage to workers in the informal economy may face various challenges in terms of registration, compliance, contribution collection, and record-keeping.

The weak contributory capacity, due to the low and irregular income pattern of the informal economy, is a major obstacle in ensuring secure resources. As most workers in the informal economy receive irregular income, it is difficult to establish a reliable monthly contribution base. Delays and irregularities are also frequently found between the actual work being done and payment being received. Frequent changes are also made to the informal workers' activities, contributing to the variable nature of their income. In the absence of employer participation, the total contributions are not affordable by most workers in the informal economy. This is referred to as the double contribution problem.

The design of the benefit system is also not responsive to the needs and resource constraints of workers in the informal economy. They need to reflect the characteristics of the informal work and of the workers' specific family circumstances. For instance, it would be difficult for workers in the informal economy to meet the qualifying conditions for pensions, which usually require 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) in rural areas makes it difficult for informal workers to join these schemes.

On the other side, the social security institutions, tax authorities and labour inspectorates do not have the capacity to effectively enforce compliance and efficiently collect contributions. Unless the employers voluntarily comply with social security contribution payments on behalf of their employees (which is rare), it is difficult to efficiently collect contributions within the existing administrative infrastructure. Complex administrative procedures also represent a major bottleneck for small- and micro-enterprises in particular. The extensive number of documents required for registering employees and paying regular contributions are not easily available, and painstaking efforts are required to obtain them.

The under-declaration of income can be ascribed to the potential pay-off for both employers and employees in avoiding social security contributions as compared to its costs (including a loss of benefits, high penalties, and administrative costs). However, it is possible that those engaging in undeclared work are not acting rationally for various reasons.⁶⁰ 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 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 and must accept undeclared work.

Moreover, some workers in the informal economy exhibit distrust in social security systems and government institutions in general. This lack of confidence may have serious negative impacts on the proper functioning of social security systems and a detrimental influence on future membership. These perceptions may lead to attempts at fraud (such as claiming benefits without sufficient contributions) or to an apathetic view that the family, community, or eventually the State, rather than the social security system, will provide support in the event of difficulties.

4.1.4 Measures to extend social security coverage to the informal economy

Tackling informal employment and undeclared work requires coordinated and concerted actions by all stakeholders involved, notably the labour inspectorate, the tax authority and the social partners. Within the sphere of social security, a variety of measures are implemented to extend coverage to the informal economy. This section summarizes common measures that are appropriate in the context of Central and Eastern Europe.

60 The results of a survey of EU countries also suggests 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 2014(a).

(1) Improving compliance and contribution collection

Concerning undeclared work, the main issue is how to improve the compliance and collection of social security contributions. The solution generally consists of a combination of measures promoting self-compliance through removing disincentives and providing appropriate incentives, and measures strengthening enforcement through inspections, controls and sanctions.

To encourage workers and employers to declare their full income, they should be convinced that it is worth it to make additional contributions. In theory, this may be difficult for health insurance, and it has already been incorporated in the cash benefits that increase with one's period and salary. In the context of the lower income countries in Central Eastern Europe, in which the range between the minimum and maximum benefits is relatively narrow, the possibility of benefit increase from an increase in contributions is rather limited.

To reduce the administrative burden, efforts should be made to improve customer service. One-stop shops that offer all services in one place are a recommendable option. At the same time, administrative procedures should be made simple and transparent while meeting essential requirements.

These incentive measures should be complemented by enforcement through sanctions and judicial recourse. The effectiveness of this approach depends on the capacity of the control authority and on the threat posed by the level of fines levied.

Information and communication technology can also create a number of potential advantages in the efficient administration of contribution collection and compliance. Incorrect contributions and payments can be detected at an early stage, data can be exchanged between institutions, and improvements can be made to the interface and in the communication between the population and social security institutions.

For the sectors where evasion is endemic, one can consider using "notional wages" as a basis for contribution calculation. The notional wages can be established according to the current position of the individual worker and the average wage in their specific industrial sector or at the national level.

(2) Extending coverage for workers in the informal economy

In order to facilitate the transition to formality, the strategy for extending personal coverage needs to be more flexible and progressive, taking into account the characteristics of those in the informal economy and their families.

Concerning the unregistered workers in formal employment, such as part-time, seasonal, and casual workers, the aforementioned enforcement approach can be applied. Informally employed workers without any form of employer-employee relation, typically the self-employed and own-account farmers, require a more innovative approach to be covered under the social security scheme.

In the absence of a regular fixed income, a proxy measure can be used as a basis for the contribution calculation base. The measure should represent a notional income, which can be established as the minimum or average wage at the national, sectoral or regional level. The payment method should allow for greater flexibility by taking into account the irregularities of income patterns or of force majeure (such as natural disaster). Sometimes, the major hindering factor for joining social

security systems is one's lack of financial resources in cash. In this case, subsidies targeting low-income earners could be considered.

Although the completion of a certain contribution period is a precondition for cash benefits, requiring a long qualifying period will make it practically impossible for informally employed workers to obtain the benefits. The eligibility conditions should reflect this. The requirement of an uninterrupted contribution period should definitely be avoided, considering the frequent changes in the employment status of the informally employed workers.

Social security institutions should adopt their services to the particular target groups. The staff needs to be trained with the required knowledge and skill to deal with the informal economy. In a country where many workers live far away from the physical location of the social security offices (like farmers in rural or remote areas), greater efforts should be made to improve their access and enhance customer service. In addition to one-stop shops, other local networks (such as postal services, local commercial banks, community centres, and cooperatives) should be used to reach potential members. Longer opening hours and less bureaucracy are positive changes that could help sway potential members. Communication tools, such as a telephone helpline, the internet or mobile devices, are also effective for reaching potential members.

A more involved option to provide minimum income security is to introduce non-contributory universal benefits, with or without a means test. One idea is to introduce social pensions that provide a flat-rate benefit for all elderly persons aged 65 years or more. Although this option could rapidly achieve universal coverage, creating and sustaining a sufficient fiscal space would be the main issue to be addressed.

(3) Building public confidence in social security

Many of the conventional measures presented above are based on incentives and enforcement. At a more fundamental level, however, the commitment of the actors to the scheme is of utmost importance. Unless there is confidence in the integrity of the social security systems, it is extremely difficult to build a climate of support for change.⁶¹ Therefore, the aforementioned measures should be supported by a “social security culture” encouraging trust in the social security systems. Clearly, such a culture cannot be built overnight. The continuous cooperative efforts of all stakeholders are essential. For this purpose, awareness-raising and education are essential to developing a better understanding of the value of social security benefits and fostering positive attitudes towards full participation in social security systems.

4.2. Policies for extending social security to the informal economy in the Republic of Moldova

Developing an effective strategy for extending social security coverage to the informal economy needs to be based on a better understanding of the target groups and an assessment of their social security needs and existing services. However, the nature and characteristics of the informal economy vary widely in European countries. In order to collect information at the national level, the ILO conducted a technical mission in the Republic of Moldova in 2014.

This section presents the results of the analysis of the social security coverage and of the compliance and contribution collection during the above-mentioned ILO mission. The analysis will focus on

⁶¹ An analysis based on the 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 dissatisfaction with public services and social security support in return for taxes. See EC 2014(a).

health insurance and the pension system. Concerning compliance and contribution collection, it should be noted that several countries in Central and Eastern Europe, including the Republic of Moldova, have recently implemented a measure to unify contribution and tax collection by transferring the contribution collection function to the tax authority.⁶² By implementing this policy, these countries have made significant investments in information and communication technology. Our analysis will also assess the effectiveness of the unified collection scheme, and the recent use of information and communication technology.

4.2.1 Problem analysis

As mentioned in Chapter 1, according to the National Bureau of Statistics, a total of 362,800 persons had an informal job as their main job in 2013, which represented 30.9 per cent of the total employed population in Moldova. By sector, informality is particularly high in the agricultural sector (68.7 per cent). Informal employment is also high among older persons who need to earn additional income due to the generally low level of pensions. Some employers pay the minimum wage for part-time work, although their employees actually work full time.

Article 7¹ (2) of the Labour Code 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 the signing of individual labour agreements.”

Despite the legal prohibition, the under-declaration of income is common, especially in the private sector. The estimated 800,000 formally employed persons include 200,000 public sector workers and 600,000 private sector workers. An analysis based on 2010 data reveals that the average official salary of a private sector worker is only one-half of the average salary of public sector workers.

(1) Health insurance

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

As Table 1 presents, the health insurance system covers 2.5 million persons, representing 82 per cent of the population in Moldova (excluding those groups covered by other systems, such as the army).

Contribution payments are mandatory for employees, self-employed persons (own-account workers) and farmers. The health insurance contribution rate is 8 per cent, shared equally between employers and employees. The self-employed pay both parts of the contribution rate.

Farmers are mandatorily insured in Moldova. The health insurance system offers an incentive option for farmers. If a farmer pays their annual contribution in the first quarter, then the amount of their contribution is reduced by half. About three-quarters of farmers take advantage of this option.

In addition, there are several categories of insured persons whose costs are covered by the State. These include pensioners, children, mothers of children up to three years of age, unemployed persons, persons with disabilities, and students.

The non-covered population typically consists of temporarily returning migrants and vulnerable groups such as Roma. As a result of the recent amendment, returning migrants should pay contributions based on the length of their stay in Moldova. However, every citizen is entitled to

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

emergency health care and primary consultations for free.

(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. This covers old-age, disability and survivors' pensions, employment injury benefits, sickness benefits, maternity benefits and unemployment insurance benefits.

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

As mentioned in Chapter 1, it is estimated that between 30-40 per cent of the total wage bill is undeclared, either through informal employment or by under-reporting.⁶³ Only public sector workers report their actual wages for tax and social security contributions. In analysing the records of social security contribution payments, one can find private enterprises reporting that they pay the minimum wage to all employees, from senior managers to junior staff. There is a proposal to define different minimum contributory bases according to a worker's skills and qualifications.

Several fraud cases 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. Currently, the pension calculations take into account one's whole career average salary since 1999 (while it was previously the average of the highest five consecutive years), and maternity benefits are based on the average salary of the past 12 months⁶⁴ (while previously it was the average of the previous six months).

The total contribution rate for the social insurance system is 29 per cent. Employers pay 23 per cent and employees pay 6 per cent. The contributions cover 90 per cent of the system's expenditure, but the deficit of 800 million MDL is covered by the State budget. Some benefits (such as childbirth benefits, support for extra school curriculum activities, and war veterans' benefits) have been transferred to the State budget.

Since 2008, farmers are insured voluntarily. It is estimated that few are participating. With an annual flat rate contribution requirement of 1,400 MDL, farmers are entitled to certain pensions and funeral benefits.

The minimum pension is currently 800 MDL for employees and 749 MDL for farmers. In 2013, the average pension was 1,050 MDL, which was below the subsistence minimum level of 1,300 MDL. Currently, the minimum wage is 1,000 MDL in the public sector and 1,650 MDL in the private sector.

(3) Contribution collection

The State Tax Service is responsible for collecting tax and social security contributions, and for transferring the contributions to the National Office of Social Insurance (CNAS) and the National Social Health Agency (CNAM). In addition, the State Tax Service is responsible for conducting inspections and fraud controls. The State Tax Service has 1,800 inspectors, 400 of whom directly communicate with employers, with a focus on high-risk groups. Their emphasis is currently on

63 This estimate should be treated with caution, as there are a large number of reporting errors in the Household Budget Survey.

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

prevention rather than on enforcement. Because of its relative success, the State revenue increased by 32 per cent while the economy recorded only 2.5 per cent growth in 2013.

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

(4) 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 informational campaign. According to the trade unions, the main reasons for undeclared work are high taxes, high social security contributions, and the weak bargaining power of workers due to the scarcity of employment. The current penalties are also too low. At the same time, there should be more incentives for compliance. Trade unions find it difficult to organize 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 have problems.

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

4.2.2 Conclusions and recommendations

From our analysis of the Republic of Moldova, the following observations can be made:

All of the tripartite constituents in Moldova recognize that the informal economy is one of the most serious problems in labour market governance, making it a major obstacle to creating a comprehensive social security system for all. Currently, however, informal employment – especially undeclared work – is a common practice and accepted as a necessary vice. The under-declaration of income far exceeds the capacity of the control authorities. This makes it difficult for the relevant authorities to evenly apply sanctions across the country. As a result, most violations end up in lengthy court processes. Moreover, the penalty levels in Moldova are relatively low in comparison with its neighbouring countries. It is recommended that the control authorities deal with violations more decisively, thus increasing public awareness of the risks and penalties involved in attempting to defraud the social security systems.

Concerning social security, the extent of personal coverage differs by benefit branch. Moldova has nearly attained universal health insurance coverage, protecting more than 80 per cent of the total population. In Moldova, the State plays a crucial role in subsidizing the population with little to no contributory capacities. Health insurance is thus considered a national priority among the social security benefits. The full achievement of universal health insurance coverage is feasible. Moldova should pursue this goal based on further detailed analyses of their currently uninsured population.

On the other hand, the social insurance system providing benefits for income security (including old-age, disability and survivors' pensions, sickness benefits, maternity benefits, and unemployment benefits) covers fewer people. Unlike health insurance, the rights related to these benefits are acquired by paying contributions, and their levels depend on the period and the wage from which contributions are levied. Consequently, their coverage is limited to the population with contributory capacity, consisting essentially of employees in the formal economy.

Agricultural workers, particularly farmers in rural areas, represent a typical group not adequately covered by social security in Moldova. Due to limited enforcement, the participation of farmers *de facto* depends on their voluntary compliance. In the Republika Srpska in Bosnia and Herzegovina, the payment of health insurance contributions is linked to other special benefits, such as discounted chemical materials. Subject to an impact assessment, this measure could be scaled-up and replicated in countries like Moldova.

The under-declaration of income, typically through the misuse of the minimum wage as a contributory base, negatively affects the financing of social security systems. If the contribution base represents only a portion of the actual income, then the nominal contribution rates turn out to be relatively high.⁶⁵ Such high contribution rates not only act as a higher barrier for participation by the informally employed population, but also result in the unfair sharing of the tax burden between the public and private sector workers within the formally employed population. A high tax wedge will undermine the competitiveness of the country and also obstruct foreign investment.

The under-declaration of income also influences the financing and the levels of social security benefits. Although the health care system is more or less financed by the current resources, an overwhelming portion of the revenue consists of employee contributions. Thus, despite the State's participation in the health care financing, employees are cross-subsidizing the rest of the population. In view of the rising health care costs of demographic ageing, the current health care financing mechanisms may reach an impasse in the future.

The Moldovan pension system has been suffering financial deficits, mainly due to the policy granting pensions for the massive numbers of redundant workers in the 1990s. In order to restore the financial sustainability of the pension systems, Moldova has enacted a series of reform measures. More emphasis has been placed on the contributory principle, and the entitlement and generosity of the benefits have been tightened to a large extent. These conditions give rise to a serious concern about the adequacy of income security. The declining level of benefits and the gap in the coverage of the contributory social insurance systems will result in an increasing number of persons without adequate income protection. Although Moldova has a social assistance system for the poor, its scope and levels are subject to fiscal constraints that are expected to be severe under the current austerity measures.

In these situations, the scope of further incentive measures is rather limited. The long-term trends of demographic ageing further narrow the range of possible policy options. Therefore, any measures to counter the informal economy and undeclared work should focus on strengthening the enforcement of the control authorities, including the labour inspectorate and the tax authority. As noted earlier, there is much room for improvement. For this purpose, capacity-building and more strategic interventions are necessary. There is a related need for a large public awareness campaign against the informal economy.

Moldova has already implemented a unified collection system for social security contributions and taxes by the tax authority. To improve the effectiveness of the collection system, the tax authority and the social security institutions must collaborate to successfully implement this policy. In particular, a closer collaboration is required in the areas of inspections, controls and the exchange of individual members' records. The new scheme also requires tax collectors to have a wide range of knowledge. To make up for their lack of special knowledge on social security legislation, the tax authority can involve the social security institutions by jointly conducting inspections and contribution collection with them.

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65 The total social security contribution rate is 41.5 per cent in the Federation of Bosnia and Herzegovina, 33 per cent in the Republika Srpska, and 36 per cent in the Republic of Moldova.

The informal economy, particularly undeclared work, is a deep-rooted problem. The recent slowdown in the transition from the informal to formal economy in Moldova proves the high resilience of the informal economy. Policies aimed at transitioning to formality and reducing undeclared work thus require a long-term commitment and the continuous efforts of all stakeholders. Above all, there should be a strong political will to change the current situation.

To effectively combat the informal economy, a national strategy should be developed for achieving comprehensive social security. Such a strategy should address two objectives. First, the national strategy should aim to progressively extend the coverage of social security to the currently uncovered population in the informal economy. Second, the national strategy should address the issue of undeclared work by improving the compliance and contribution collection of the social security systems. In view of the existing coverage gaps, the needs of the target groups, gender issues, resource constraints and implementation capacities, the strategy should formulate and prioritize their course of action, and delineate an implementation plan for the short- and long-term.

A national strategy for comprehensive social security will largely contribute to the goal of universal social security coverage in line with ILO Social Protection Floors Recommendation, 2012 (No. 202) and play an important role in transitioning Moldova from the informal to formal economy, reducing the prevalence of undeclared work. The ILO is ready to provide further assistance in line with the recommendations made in this chapter.

Table 9. Number of insured persons with health insurance, 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 aged under 18 in education	613,943
Pensioners	441,495
Unemployed	12,171
Persons with disabilities	149,438
Persons who take care of a person with 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	2,515,713

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