

How can the reform of the State Labour Inspectorate help combat undeclared work?

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Informal employment and envelope wages are still part of the economic reality of the Republic of Moldova. This is manifested by the fact that almost every 4th employed person works informally. Societal perceptions of envelope wages point to around 30 percent of the labour remuneration fund, and as a result the revenue lost to the public budget exceeds 7 percent of GDP. From a self-interest point of view, it suits both employees (desire for higher income, people's distrust of the social contract, perceptions regarding the quality of public services) and companies (permanence of cash flows, perceptions regarding high compliance costs, low costs of non-compliance). The low costs of non-compliance are also due to the fact that the State Labour Inspectorate (SLI) has no real leverage to fight informal work. This institution may not carry out unannounced checks and may not impose any penalty, which is also in contradiction with the international conventions of the World Labour Organization to which the Republic of Moldova is a party. Thus, the analysis addresses institutional vulnerabilities in countering undeclared and under-declared work and the provisions of the ongoing reform of the State Labour Inspectorate. At the same time, recommendations for the successful and impactful implementation of the given reform are presented.

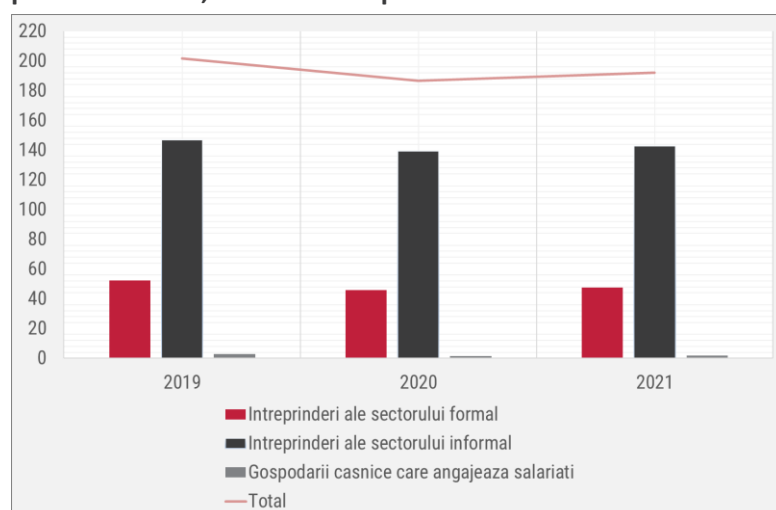
The magnitude of the problem of undeclared work in the Republic of Moldova

The informal (grey) economy and employment continues to be an important component of the Moldovan economy. According to NBS data, in 2021 the number of people in informal employment was 192,000, which represents about 22.8% of the employed population². By economic sector, the largest share of the informally employed population is found in agriculture (61.2% of total informal employment) and construction (22.1% of total informal employment), followed by trade and HoReCa (together forming 6.6% of total informal employment). By type of employer, the largest part of the informally employed population is found in informal sector enterprises defined as unregistered sole proprietorships (without legal entity status), amounting to 142.9 thousand persons. Not to be neglected is also the number of people working informally in formal sector enterprises, with officially registered economic units – 47.7 thousand people.

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² All persons aged 15 and over who carried out an economic or social activity producing goods or services for at least one hour during the reference period (one week) with the purpose of obtaining income in the form of wages, payment in kind or other benefits.

Figure 1. Population in informal employment by type of production unit, thousands of persons



Source: NBS data

Undeclared work is a breach of the social contract with a harmful impact on the population, businesses and the Government. In order to better understand the harmful effects of the informal economy, it is sufficient to point out the statistical criteria³ by which people are included in the informal sector, namely: i) no social security contributions are paid for these employees, ii) they do not receive paid annual leave, iii) they do not receive paid sick leave in case of illness. Based on these characteristics, we can also list the main negative consequences associated with a high level of informal economy, namely: i) loss of significant revenues to the budget, ii) lack of social protection and insurance for employees (pension rights, maternity leave, medical services, compensation in case of work accidents, fully paid annual leave) or iii) development of unfair competition between businesses.

However, the phenomenon of undeclared work extends far and wide even throughout the informal economy, and this manifests itself in not declaring the total amount of wages paid to employees, also known as 'envelope wages'. Data from the study 'The Phenomenon of the Informal Economy and Employment in the Context of the COVID-19 Pandemic'⁴ reveals that according to businesses' perceptions, about a third of companies practice 'envelope wages' and on average about 30% of wages remain undeclared.

As a result, according to the estimates of the same study, between 2015 and 2020 the tax losses generated by the grey economy increased from MDL 8.9 billion to MDL 15 billion annually. Relative to GDP, these losses have been on an upward trend, increasing from 6.1% in 2015 to 7.3% in 2020. At the same time, the ratio of tax losses to tax revenues varied around 25%.

Main causes of undeclared and under-declared work

Based on the assessments of several studies and researches carried out over time, from the perspective of employers, the high level of informal employment in the Republic of Moldova can be explained and structured in terms of the following factors:

- Significant presence of cash in the economy and the propensity of some businesses to sell products and provide services without calculating and paying VAT;

³ <https://statistica.gov.md/public/files/Metadate/AFM.pdf>

⁴ <https://www.expert-grup.org/ro/biblioteca/item/2247-fenomenul-economiei-si-ocuparii-informale-in-contextul-pandemiei-covid-19&category=7>

- Perceptions of companies, especially SMEs, regarding high compliance costs (high level of taxation and bookkeeping);
- Low costs of non-compliance. Penalties applicable only in case of not complying with the requirements of the State Labour Inspectorate, plus a weak control mechanism. Undeclared work is difficult to detect, especially in the context of the limited institutional capacities of the authorised institution (State Labour Inspectorate – SLI);
- High share of the agricultural sector in the economy;
- Existence of tools to circumvent the formal regulatory framework, such as patents in trade;
- Legal limitations on the maximum number of working hours an employee can work.

The phenomenon of informal employment is also stimulated by a number of factors coming from the employees themselves, such as: i) desire to have a higher income, ii) negative perception of the quality of services and benefits that come with being part of the public social and health insurance system, iii) willingness to engage in very low productivity activities just to avoid falling below the poverty line (especially in the agricultural sector), and iv) low fiscal morality, considering that the public's reaction to the phenomenon of undeclared work is generally anaemic.

Institutional vulnerabilities in countering undeclared and under-declared work

As can be gleaned from the above, one of the reasons of informal work is the reduced costs of non-compliance coupled with the limited powers of the enforcement institution, as well as limited institutional capacity. According to the existing legal framework (until December 2022), SLI may not carry out unannounced checks concerning undeclared work. In addition, SLI may not apply directly penalties for undeclared and under-declared work offences. Offences are examined by courts. When finding undeclared work, the SLI may instruct the employer, by way of a recommendation, only to pay social security contributions in the future, not to pay the previously unpaid contributions. These conditions reduce the cost of compliance for employers.

In the absence of clear powers to combat undeclared work, the number of cases of undeclared work detected by the SLI has declined in recent years. While between 2010 and 2015, the SLI detected an average of 756 cases per year, since 2016 the number of cases has dropped to 119 per year. Out of 80 cases detected in 2021, the lowest number detected in the last 12 years, the court applied penalties to 23 cases, an insignificant number in relation to the magnitude of this phenomenon in the Republic of Moldova⁵.

The vulnerabilities and the need to reform the State Labour Inspectorate are also analysed in the study conducted in 2022 under the auspices of the International Labour Organization (ILO)⁶. Thus, the main issues and challenges associated with SLI activity are related to:

- the national legal framework for labour inspection – limited possibilities to carry out unannounced inspections, as well as a complicated and multi-layered system of applying penalties originating from the existing legal acts;
- planning and reporting within the SLI – the overall system of national planning of inspection activities seems to be very strict and inflexible for the use of modern inspection methods applied by the SLI (e.g. targeted inspection campaigns);

⁵ <https://ism.gov.md/ro/content/raport-de-activitate>

⁶ ILO, Analysis of legislation, organizational structures and operational procedures of the State Labour Inspectorate of the Republic of Moldova, 2022

- the system of penalties – impossibility to apply appropriate fines for violations;
- SLI's internal work organisation and technical capabilities – SLI does not use modern inspection methods, e.g. inspection campaigns, carried out on certain days, weeks, months, which would target specific industries or manage specific risk factors at the workplace;
- recruitment of labour inspectors and the SLI training system – uneven distribution, with 90% of labour inspectors employed in sub-regions in 2020 having legal education and experience;
- SLI awareness-raising activities and image – SLI does not use modern communication methods sufficiently, and there is no culture of prevention.

Goal of the ongoing reform of the State Labour Inspectorate

With this in mind, the Ministry of Labour and Social Protection and the relevant parliamentary committee have initiated a comprehensive and systemic reform to combat undeclared work by modernising and increasing the efficiency of the State Labour Inspectorate (SLI). The institutional reform strategy has three basic aims:

1. enabling inspectors to carry out unannounced checks to identify undeclared work and to impose penalties.
2. better risk analysis when planning inspections – the frequency of inspections and the resources used will be proportionate to the level of risk, i.e. honest employers who do not practice undeclared or under-declared work will not be subject to inspections;
3. Reorganisation of the SLI with improved governance, including new internal integrity policies with zero tolerance for abuse and corruption – all with the objective of increasing internal transparency and the Inspectorate's powers to prevent and sanction illegal labour practices.

The legislative amendments aimed at combating undeclared work by empowering the SLI to carry out unannounced checks and apply penalties were voted in final reading by Parliament at the end of December 2022. They provide for⁷:

- **the possibility for the SLI to establish through indirect methods and sources that wages or other payments have been paid without being reflected in the accounting records.** The indicators established in the law that will serve as benchmarks for the estimation are: 1) the average wage in a company for employees in similar work, not including top management wages; 2) the average wage by sector for employees in similar work or the wage specified in the applicable industry-wide collective agreement and/or collective labour agreement, whichever is higher; 3) information obtained from data exchange with public authorities; 4) other information determined by the Government.
- **delegation to the Inspectorate of certain tasks relating to the control of the correctness of the calculation and timely transfer of compulsory state social insurance contributions to the SSIB** – in the event of finding that the employer uses undeclared work or pays wages or other payments without reflecting them in the accounting records, the State Labour Inspectorate shall refer the matter to the State Tax Service within 10 days of the date of finding the facts mentioned, for voluntary or forced compliance measures. If no other information is available for estimating the duration of the violations, it is assumed a duration of at least 6 months for the violations reported by the State Labour Inspectorate.
- **giving the SLI the authority to establish and examine offences of the employer's use of undeclared or under-declared work**, resulting in the application of the appropriate penalties by the staff with management and control functions.

⁷ <https://www.parlament.md/ProcesulLegislativ/Proiectedeactelegislative/tabid/61/LegislativId/6287/language/en-US/Default.aspx>

- **supplementing the grounds for carrying out unannounced checks on a person based on a risk assessment with an additional one**, which requires the possession of information/indications, supported by evidence, of the use of undeclared or under-declared work.

In addition to unannounced checks and penalties, the Government has improved the risk criteria to be used when identifying companies for inspection. This will ensure much better targeting of the risk areas for undeclared and under-declared work, while protecting the companies that do not practice undeclared work from abusive or arbitrary inspections. Thus, the amendments made by the Government⁸ in November 2022 specifically provide for the identification of area-specific risk criteria following a clear rationale, namely:

- the lower the average salary per establishment compared to the average salary per industry, the greater the risk of prejudicing wage entitlements or the likelihood of undeclared payment of a part of the salary,
- the shorter the period since the last control, the higher the likelihood of compliance with the regulations in the areas of control of the Inspectorate.
- the higher the share of employees earning equal to or less than the minimum wage, the greater the likelihood of undeclared work.
- the greater the difference between the ratio of the amount of revenue recorded in the financial accounting data to the number of employees in the establishment compared to the same indicator in the industry, the greater the extent of undeclared work.

The assessment of specific risk factors in the area of control⁹ will allow more accurate identification of establishments using undeclared work or paying wages in envelopes. This will increase the objectivity of decisions on checks and the efficiency of resource allocation for carrying out state labour control.

For the overall successful implementation of the reform to combat undeclared work, it remains crucial to implement the institutional modernisation efforts in order to increase the productivity, transparency and efficiency of the SLI and to reflect the institution's work priorities in its organisational structure. The most important adjustments to the regulatory framework made to support this priority is the October 2022¹⁰ amendment to GD No 788/2013 on the Organisation and Operation of the State Labour Inspectorate¹¹. The main changes made concern the reduction of the number of staff in the institution and the creation of new subdivisions, based on institutional priorities and after consulting the practice of other European countries.

The reduction by 20 inspectors at the SLI subdivisions from 78 to 58 (other 26 positions are in the SLI head office) is dictated by the possibility of substantial efficiency gains and the opportunity for better remuneration of inspectors. This is also supported by statistical data. Thus, in 2021, a labour inspector in Moldova carried out an average of 3 checks per month, which is one third of the average for 12 EU countries (10 checks) or half of the average for Romania (6.6 checks) for the same period. There is hence room for optimising the number of inspectors with maintaining or increasing the current number of

⁸ on the amendment of Annex No 1 to Government Decision No 894/2018 approving the Methodology on State Control of Entrepreneurship Activity based on risk analysis in the areas of control of the State Labour Inspectorate, https://www.legis.md/cautare/getResults?doc_id=134137&lang=ro

⁹ https://www.legis.md/cautare/getResults?doc_id=134204&lang=ro#

¹⁰ https://www.legis.md/cautare/getResults?doc_id=133812&lang=ro

¹¹ https://www.legis.md/cautare/getResults?doc_id=133904&lang=ro#

checks. This will also result from the increased motivation of inspectors, as the savings from the 20 positions have been allocated to salary increases for operational positions in the inspectorate.

At the same time, the organisational structure of the SLI was reorganised for a better organisation of work and a more efficient internal monitoring and control system. For this, the functions of some subdivisions have been adjusted, but most importantly, 3 new subdivisions have been created, namely: i) the Consultancy Division, which will enable labour inspectors to pay more attention to inspection activities¹², and will professionalize and standardize SLI's consultancy work, ii) the Undeclared Work, Occupational Safety and Health and Labour Relations Inspection Support Division, which will provide methodological assistance to territorial inspections, develop and modify inspection procedures and ensure a common understanding of the labour inspection process in all regional inspections. This will increase the effectiveness of thematic checks and the capacity of inspectors to combat undeclared work, a subject to which no institutional resources were dedicated in the previous organisational structure, iii) the Monitoring and Internal Control Service, which will supervise and control the implementation of all internal procedures, investigate the complaints on the quality of inspectors' work and provide suggestions to the SLI Director on the measures to be taken, as well as analyse whether the territorial inspectorates are using institutional resources effectively.

Another key issue for regaining the institutional integrity of the SLI is the introduction of incompatibilities for the labour inspector. Thus, the law passed by the Parliament at the end of December 2022¹³ introduced incompatibilities for labour inspectors who are founders or instructors in private protection and prevention services, as provided for by the Law on Occupational Health and Safety, as well as the obligation to declare conflict of interest if persons close to them, as defined in Article 2 of the Law on Declaration of Assets and Interests, are founders of private protection and prevention services, as provided for by Law No 186/2008. Given that the phenomenon in question has become quite widespread, the express introduction of these incompatibilities in the law, which are in the spirit of the European regulations, will increase confidence in SLI, increase efficiency and substantially reduce selective approaches to companies.

The institutional modernisation of the SLI is aimed at reducing undeclared work more effectively. Thus, as shown in the Regulatory Impact Analysis¹⁴, the authorities aim to achieve the following objectives by 2024: i) Increase the productivity of labour inspectors from 3 checks per month to 7 checks per month per inspector, ii) Increase the share of time spent by the inspector on checks from 30% to 60%, iii) Double the detection rate of undeclared work by improving the methodological support provided to labour inspectors, iv) Increase satisfaction of citizens and legal entities with the advice provided by the SLI due to a uniform approach by a specialized subdivision, v) Increase public confidence in the institution, expressed by reducing by 10% among households and by 5% among business people the perceived corruptibility of inspectors.

The reform of the State Labour Inspectorate, along with other means to combat undeclared work, is a necessary part of Moldova's alignment with the international commitments to which it is party. For example, in recent years our country has been advised on several occasions of the need to comply with the provisions of the Labour Inspection (Industry and Commerce) Convention, 1947 (commonly referred

¹² In 2021, labour inspectors spent only a third of their time conducting inspections, while other activities such as advising individuals and businesses and examining claims from individuals took up more than 50% of inspectors' time.

¹³ <https://www.parlament.md/ProcesulLegislativ/Proiectedeactelegislative/tabid/61/LegislativId/6287/language/en-US/Default.aspx>

¹⁴ <https://particip.gov.md/ro/document/stages/se-publica-spre-avizare-si-consultare-publica-proiectul-de-hotarare-cu-privire-la-modificarea-hotararii-guvernului-nr7882013-cu-privire-la-organizarea-si-functionarea-inspectoratului-de-stat-al-muncii/9673>

to as ILO Convention No 81)¹⁵. The Convention stipulates, among others, that labour inspectors with proper credentials shall be able to carry out unannounced inspections or that they are prohibited from having any direct or indirect interest in the undertakings under their supervision – rules to which the national regulatory framework has also been aligned following the latest amendments described above. The subject is also important in terms of European integration aspirations. More specifically, the regulations approved by the authorities are in line with the recommendations of the European Parliament resolution of 14 January 2014 on effective labour inspections as a strategy to improve working conditions in Europe¹⁶.

Recommendations and steps to follow

The year 2022 brought substantial improvements in aligning the regulatory framework and paving the way for a genuine reform of SLI. The year 2023 is no less important as it should be the year in which the reform becomes operational. Moreover, the right of the SLI to carry out unannounced checks will enter into force as of 1 March 2023 and the possibility to apply sanctions as of 1 July 2023. By doing so, the legislator gives additional time to make the necessary institutional adjustments. In this regard, the recommendations for the Government, as well as the development partners that may support some of the recommendations, are as follows:

1. **Strengthen the human resources development policies**, which is to be achieved in two ways: i) regular staff training for the most successful transposition of all regulatory and institutional changes and enhancing the professionalism of the SLI team, ii) promotion and strengthening of the recruitment process of SLI staff. Given the reorganisation process, the emergence of new positions and responsibilities, the institution will inevitably also need to attract new professionals to help modernise SLI.
2. **Change the inspection methods to implement a modern approach to labour inspection, with changes being made rapidly according to the needs of the labour market** by: i) using modern inspection methods when planning inspections, e.g. inspection campaigns carried out on certain days, weeks, months, targeting the inspection of specific industries or the management of specific risk factors in the workplace (such as work at height or the use of chemicals). i) awareness-raising activities to attract the attention of the media.
3. **Improve the IT infrastructure and digitalise the institution** to generate accurate data, keep better track of activities and generate more qualitative reports. In the future, examine the possibility of introducing a CRM or similar system to have traceability in the inspection system carried out by SLI.
4. **Automate the administration of the database on the assignment of risk criteria for companies.** Digitalisation and integration into the government interoperability platform (M-Cloud) of the information system for assigning risk criteria to companies.
5. **Examine the possibility of using GPS systems and/or video cameras during inspections.** This will be beneficial for the protection of labour inspectors, for reducing the risk of corruption and providing evidence of identified violations, which are essential in the case of undeclared work and unsafe working conditions.
6. **Establish as the key performance indicator for the Inspectorate the number of people who have moved into declared work as a result of the work of the institution.** The ultimate goal of the reform is the formalisation of the economy and putting an end to undeclared work. In other words, a key benchmark for all SLI activity should be how many jobs have been formalised as a result of the actions carried out.

¹⁵ https://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:C081

¹⁶ https://www.europarl.europa.eu/doceo/document/TA-7-2014-0012_RO.html

7. **Adapt the SLI activities to reduce the disproportion between the higher number of businesses located in Chişinău in relation to the distribution of SLI subdivisions and the number of inspectors.** Given that the average number of companies per inspector is significantly higher in Chişinău compared to the other SLI subdivisions, certain adjustments in the activity are necessary, such as: i) examination of part of the petitions originating from Chişinău by subdivisions from other regions or equipping the SLI subdivisions in the vicinity of the capital with modern means of transport so that their inspectors can also carry out inspections in the Chişinău municipality.
8. **In addition to the SLI-related activities, the authorities should also move forward with incentives to combat undeclared and under-declared work, such as providing government financial incentives to promote legal work.** In this context, we recommend further promotion of the draft law to approve the Automated Wage Increase Subsidy Mechanism¹⁷. The bill proposes to introduce a tax credit measure for private economic operators if they increase their employees' wage income by at least 50% compared to the income calculated in the previous financial year. Thus, if an economic operator increases the employee's salary by at least 50% compared to the salary paid in the previous financial year, the employer is reimbursed for a maximum period of 2 years, from the state budget, the employer's contribution to the social security fund related to the salary increase. The employee, in turn, is exempted from the contribution to the compulsory health insurance fund for the salary increase.
9. **Last but not least, initiatives to attract employees from informally operating economic units should also be a priority.** Given that more than 60 percent of these jobs are in agriculture, this area should be addressed as a priority. In this regard, the idea of establishing a voucher system to cover the payment of salary taxes and to simplify as much as possible the declaration of day labourers by farmers, an option previously presented in research¹⁸ and promoted by the MLSP at the Conference 'Moldova brings undeclared work to light: solutions to encourage the transition to legal work'¹⁹, must be promoted and implemented in practice. It also remains topical to streamline the petition/whistleblowing system to bring undeclared work to light, as well as related awareness-raising campaigns.

¹⁷ <https://particip.gov.md/ro/document/stages/ministerul-muncii-si-protectiei-sociale-publica-spre-consultare-si-avizare-publica-proiectul-de-hotarare-pentru-aprobarea-proiectului-de-lege-pentru-aprobarea-mecanismului-de-subventionare-a-cresterii-salariale/9747>

¹⁸ https://moldova.fes.de/fileadmin/user_upload/2021/Publications/Legea_zilierilor.pdf

¹⁹ <https://www.expert-grup.org/ro/activitate/evenimente/item/2413-conferinta-C8%9Ba-E2%80%9Emoldova-trece-pe-alb-solu%C8%9Bii-pentru-%C3%AEncurajarea-tranzi%C8%9Biei-spre-munca-legal%C4%83&category=3>