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The phenomenon of informal economy and employment in the context of Covid-19 pandemic

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ABBREVIATIONS

LFS	Labour Force Survey
ILB	International Labour Bureau
NBM	National Bank of Moldova
NBS	National Bureau of Statistics
HoReCa	Hotels, Restaurants and Cafes
ILO	International Labour Organization
SME	Small and medium enterprises
MIMIC	Multiple Indicator Multiple Cause Model
OECD	Organization for Economic Cooperation and Development
UN	United Nations
GDP	Gross Domestic Product
UNDP	United Nations Development Program
SEC	European System of Accounts
ICT	Informational and communication technologies
VAT	Value Added Tax
GVA	Gross Value Added
EU	European Union

Introduction

Informal or unobserved economy or consists of economic activities that are not officially registered, which can be done on purpose in order to extract certain benefits (hidden production and/or tax evasion) or can be result of structural peculiarities of the Moldovan economy (e.g. production of households for own consumption).

Informal economic activities and informal employment represent an important part of Moldovan economy. Due to its complexity, this phenomenon deserves more thorough analysis and understanding. Informal economy may be both, a cause and an effect of the major problems faced by the economy. On one hand, it may devour public finance at the central and local levels, including the pensions' and health system; it may undermine fair competition, as the companies which do not pay taxes may be more competitive from price perspective as compared to those companies, which are obedient; it may contribute to corruption, as it is associated, most of the times, with cash-based transactions, which are difficult to be traced; and it also can be a trap for companies working in informal sector due to difficulties/impossibility to get foreign financing for development, hence being subject to undermined sustainability. On the other hand, it may result from breaking up the social contract, because of the negative perception by population and companies about the quality of public goods and services (e.g.: infrastructure, public service, pension system, healthcare system, etc.); it may also result from deficient tax regulations (not necessary high taxes), inefficient administration and corruption, which fuels companies' propensity to enter/remain in the informal sector; it may result from low level of legal and economic literacy among employees who accept informal jobs (for instance, salaries in envelopes) or the result of weak negotiation power of employees as related to that of the employer.

The informal economy problem becomes even more complex if taking into account the fact that not all informal economic activities are illegal, some of them representing subsistence farming activities, which are widely spread, considering the big share of rural population and limited economic opportunities in rural areas. Hence, to a certain extent, the increased share of Moldovan economy informality is the result of a series of objective structural peculiarities of the country.

Hence, the phenomenon of informal economy should be analyzed, understood and tackled properly through adequate political measures, which would take into consideration the above-mentioned complexities. Moreover, this problem becomes even more acute during the "corona-crisis" because of increasing financial constraints and higher vulnerability of companies and individuals practicing informal activities. An increased propensity is frequently noted towards tax evasion and fiscal optimization in order to cope with financial constraints in the context of crisis. Furthermore, the employees who work informally are widely exposed to the crisis because of missing social and legal security, which leads to two basic problems: (i) higher probability to be dismissed, because it is easier for the employer to resort to such practices; and (ii) in case of those left without a place

of work, it is very difficult to get unemployment allowances, emergency loans or any other form of cash benefits due to non-reporting the previously obtained revenues.

Taking into consideration the above-mentioned context, this study was carried out to describe informal economic activities and informal employment in the Republic of Moldova, dynamics registered over the last years, especially in the context of Covid-19 pandemic, as well as the population and business perception regarding this phenomenon. These analyses were used to formulate policy recommendation for the Government to address efficiently this problem, considering the complexities it implies.

Executive Summary

DYNAMICS OF INFORMAL ECONOMY

Informal economy accounts for almost one quarter of the entire economy of the Republic of Moldova, being divided in more or less equal parts among households' production for their own consumption, hidden production in the formal sector (as a result of tax evasion) and unregistered economic activities. Over the last years, it has registered a slow growth, especially at the expense of construction sector, which has advanced against the background of public investments in infrastructure (especially in roads), as well as the private ones, in particular after the tax reform implemented in 2018 and "Prima Casa" program. Nevertheless, agriculture is the sector with the highest share in the informal economy, but this share got actually compressed over the last years. Although statistical data are not available for 2020, different survey results reveal that the extent of informal economy did not increase, with certain signals even indicating on its decrease. However, this dynamic should be rather a concern than advantage, because the cause of this reduction refers to decrease, discontinuation or even closure of many enterprises from sectors with an increased share of informal economy (agriculture, HoReCa, trade, transport), in the context of the pandemic crisis, as well as that of severe drought of 2020.

Unlike informal economy, informal employment experienced a negative dynamic over the last years, when the number of informally employed population has decreased alongside the number of formally employed population. In the context of the crisis from 2020, this trend got more intensified (the number of informally employed population decreased twice as fast as formally employed population), hence confirming the vulnerability of this sector. The same goes for informal economy, with informal employment dynamics confirming that business and population use these practices, most of the times, out of necessity rather than opportunity, being impacted by multiple vulnerabilities (e.g.: financial difficulties, income instability, bankruptcy and poverty risk, etc.). This conclusion

is also supported by the survey results and focus group discussions, hence suggesting the state policies in this respect should rather focus on incentives (e.g.: supporting entrepreneurs who work formally), than constraints, to encourage population and business to migrate and remain in the formal sector.

One of the main causes of tax evasion prevalence (informal economy in formal sector) refers to the fact that informal labor productivity in the formal sector is higher than the formal labour productivity in the formal sector. Hence, the activity of enterprises in the formal sector, which partially or fully hide their revenues is more profitable, hence creating essential motivation for companies to resort to such practices. Therefore, besides incentives for supporting the formalization of economy, measures are also necessary to disincentivize the informal activities, first of all by making more effective the controls of the State Tax Service and State Labor Inspectorate so as to increase the likelihood of detecting informal practices.

BUSINESS PERCEPTION

According to the business perception, about one third of the companies are practicing salaries "in envelope", and an average of 30% of salaries remain undeclared. The most pronounced perception regarding the "salaries in envelope" practices is registered in HoReCa sector (accommodation and public food activities), where 44% of respondents consider that these practices are widely spread or present almost in every company, and other 30% consider that such practices are spread to a certain extent. This sector is followed by Professional, scientific and technical activities with 40% of respondents considering that "salaries in envelope" are widely spread or present almost in every company, Agriculture – with 38% and other areas – with 39%.

The perception regarding tax evasion is a little bit weaker as compared to that of "salaries in envelope". Hence, about one fifth of companies consider that tax evasion is widely spread, and companies practicing such activities hide about one fourth of their revenues. The biggest share of respondents (about one quarter) considering that tax evasion is widely spread or present almost in every company in agriculture, professional activities (mainly operating on patent basis), transport and other areas (e.g. services).

According to respondents' statements, the pandemic crisis did not lead to increased tax evasion or informal employment. On the contrary, about half of respondents consider that the share of revenues which was not reported in 2020 by companies from their industries decreased as a result of the pandemic induced by COVID-19. At the same time, about one third of respondents (31%) mentioned that the share of salaries paid "in envelope" in companies from their industry remained the same in 2020, as a result of the pandemic induced by COVID-19, and one quarter stated that this share has decreased. This perception correlates with the developments reflected by statistical indicators, according to which, the share of informal employment decreased in the context of the

pandemics, as informal jobs and companies operating informally, in general, were the most unstable and, thus, many of them got closed during the crisis because of financial constraints.

The survey results suggest that tax compliance among companies should be fostered through incentive and institutional measures rather than compulsion. Hence, constraint measures are generally perceived as rather tough: likelihood of identification and size of high fines, with majority of companies advocating for tax decrease as a measure to foster tax compliance. At the same time, the likelihood of identifying "salaries in envelope", non-reporting the real number of seasonal workers and unofficial payments to facilitate award of contracts (corruption) is perceived as rather low. Hence, for these cases, it is necessary to develop the institutional capacities of the State Labor Inspectorate to streamline its activity of such practices' identification.

POPULATION PERCEPTION

Population perception regarding informal employment spread correlates with that expressed by the businesses. Informal activities are accepted by population because of economic and social constraints, and not due to opportunistic considerations. Most of the times, informal activities represent the only employment alternatives for the population, especially in rural area, with small incomes and low level of education. In most of the cases, people had no other place of work before getting involved in such activities, and the main motivation refers to obtaining a certain source of income, although incomes in the informal sector are rather small and unstable (occasional). Besides, the transition from informal sector towards the formal sector is rather difficult, the majority of people remaining without jobs when informal activities come to an end. Hence, population engaged in informal activities is exposed to a number of major vulnerabilities, which became more acute during the pandemic. This relates mainly to the low level and unstable nature of incomes, as well as insufficient employment alternatives and formal employment possibilities. Therefore, public policies should treat this category of population as a vulnerable one and not as offenders, with a focus on active policies to foster formal employment and not those to punish informal employment. Also, as medium- to long-term perspectives, the policies should support the skills' elevation of the Moldovan human capital, taking into account that the unskilled workforce is the most vulnerable to informal employment.

Population propensity for informal activities is determined by deficiencies of the social contract between the population and the state. The persons consuming fewer public services and using less the social and health insurance system, and who do not plan to benefit from them in the near future are the most reticent to pay taxes (this refers especially to young people). At the same time, a higher level of fiscal morality is noted among those who benefit from such services or those who plan to do it in the near future (this refers mainly to older population, pensioners, beneficiaries of maternal/paternal leaves). The deficiencies related to the social contract functioning get aggravated by the level of population perception regarding the way in which the state manages collected taxes: the

population with a rather negative perception tends to register a lower level of fiscal morality.

The low level of financial education and low awareness of tax importance among the population are important factors fueling tax evasion. The persons engaged in informal activities or having low fiscal morality level are also the persons who do not know the differences between the net salary and gross salary and what taxes are paid in case of salaries, and are also indifferent towards receiving or not the cash receipts from sellers. Hence there is a correlation between the level of financial/ fiscal education and the level of tolerance for tax evasion, on one hand, and the level of engaging in informal activities, on the other hand.

BUDGETARY LOSSES BECAUSE OF INFORMAL ECONOMY

The tax losses generated during 2015 – 2020 by unobserved economy grew from 8,9 billion MDL up to 15 billion MDL annually. The respective losses registered an ascending trend when related to the Gross Domestic Product (with certain episodes of moderate decrease in 2016-2017 and more pronounced increase in 2018 and 2020), growing from 6.1% in 2015 up to 7.3% in 2020. A similar dynamic was registered by the share of the Gross Added Value generated by informal economy in the total Gross Added Value per economy, from 18.8% in 2015 to 20.3% in 2020. At the same time, the ratio between the tax losses and tax revenues varied around the level of 25%.

POLICY RECOMMENDATIONS

The immediate measures for mitigating the problem of unobserved informal economy should refer to its 2 basic components: (i) informal activities from the formal sector, which mainly includes informal employment ("salaries in envelope" and workers without contracts, especially the day workers and seasonal workers) and tax evasion; and (ii) that part of informal sector which generates revenues which are not reported intentionally, so as to avoid paying taxes, which mainly includes the unregistered entrepreneurship activity and entrepreneurial patent-based activity. The state policies should cover a set of measures, which would motivate the population and business to give up informal activities, on one hand, and create an environment in which practicing informal activities is risky, costly and even impossible, on the other hand. In parallel, the state should provide all possible information support to encourage formalization of economic activities. The main measures in this respect may be grouped in 5 basic objectives, which would solve the preconditions and fundamental causes of informal economy: (i) discouraging cash-based transactions; (ii) mitigating compliance costs; (iii) increasing the costs of failure to comply; (iv) increasing population fiscal morality; and (v) enhancing employees' negotiation power in relation to employers.

Informal economy – definitions and concepts

National economy covers two basic components: (1) official component, in which the economic processes (production, trade and consumption) are observed, registered and may be measured with high accuracy, and (2) unofficial component, in which economic processes are "unobservable", are not registered and hardly may be quantified.

Substantial efforts were undertaken to detect informal economy at international level. The Republic of Moldova takes into account these trends, and the statistical authority of the country has taken over international methodologies to estimate informal economy. Hence, the National Bureau of Statistics from the Republic of Moldova (NBS) develops national accounts in line with the methodology of the UN System of National Accounts, version 2008 (SNA-UN-2008), compatible with the methodology of the European System of Accounts, version 2010 (SNA, UN-2008/ESA-2010)[1]. For complexity and accuracy reasons, the national accounts get adjusted with the unobserved economy elements, and estimates are produced in line with the SNA methodology, UN-2008/ESA-2010 and OECD recommendations[2].

The level of informal economy in the Republic of Moldova is also reflected in labor force statistics. The Labor Force Survey (LFS) carried out by the NBS is the main source of information regarding the situations and the trends on the labor market[3]. This survey is carried out in line with international recommendations in force in the area of labor statistics, adopted by the International Labor Office (ILO). With certain exceptions, the LFS methodology complies with the EU Framework Regulation for Labor Force Survey in EU countries. The survey covers in a comprehensive way, aspects related to informal employment as well.

There are two approaches to quantify informal economy – the direct and indirect methods. The direct method is based on use of questionnaires, which should be well-developed and representative[4]. The estimates' accuracy depends essentially on the quality of questionnaires. The Republic of Moldova actually uses direct methods for determining the level of informality. For instance, the Labor Force Survey is carried out on a sample of households and implies interviewing households' members who are aged 15 years old and over. The indirect approach implies the measurement of informal economy based on statistical estimates or running econometric models. The following may be mentioned among the indirect methods: quantification of informal economy by analyzing

[1] https://statbank.statistica.md/PxWeb/Resources/PX/Databases/40%20Statistica%20economica/13%20CNT/SCN2008/CNT010/Resurse/Conturi_nationale.pdf

[2] Ibidem

[3] https://statistica.gov.md/public/files/Metadate/AFM.pdf

[4] Budianschi D., Lupușor A., Fala A., Morcotîlo I., Fiscal discrepancy – an invisible reality, „Expert-Grup", Chisinau 2014, p.12., available on: https://expert-grup.org/ro/biblioteca/item/download/1282_3f38a03e63105f8154a2036547d3e436

the volume of money in circulation (usually monetary aggregate M0 is used) or by reviewing electricity use, or measuring unobserved economy based on some more complex models, such as MIMIC (Multiple Indicator Multiple Cause Model), which implies taking into consideration a number of influence factors. One of the main drawbacks of the indirect methods is the fact that these are built based on assumptions, reflecting the reality only to a certain extent, which may lead to underestimation or overestimation of unobserved economy.

According to the NBS methodology, the unobserved economy includes the following components:

- Informal sector covers the totality of production units involved in production of goods and services meant for the market, which are not registered or have a number of employees under the established threshold. Institutionally, these economic units cover informal enterprises on their own account and those of informal employers. The main characteristic of these enterprises is the fact that they operate at a low level of organization, frequently without a clear division between the production factors. At the same time, the economic activities from the informal sector are perfectly legal and in the majority of cases do not have the intention to avoid tax contributions. Nevertheless, there is a certain overlap with hidden economy, because a part of the economic units does not get registered deliberately, so as not to get into the attention of the record-keeping bodies and not to pay taxes or social insurance contributions.
- The hidden production in the formal sector (hidden economy) covers the totality of productive and legal activities, intentionally underestimated and hidden by economic units and not registered by the relevant public bodies. The main reasons for distorting fiscal and economic information refer to minimizing the quantum of taxes and social contributions, noncompliance with certain normative standards (minimum salary, number of worked hours, etc.), as well as failure to observe certain administrative procedures (not filling in statistical, fiscal questionnaires, etc.).
- The households' production for self-consumption covers the totality of goods and services produced and consumed by the households themselves – agricultural production, agricultural products' processing, construction of individual houses, rent-service and services of the personnel employed in these households. It is recommended to calculate this component of unobserved economy especially in cases when it represents a significant share of the total volume of products and services provided at the country level. Although, according to the Decision adopted by the 15th International Conference of Labor Statisticians, production for self-consumption is not part of unobserved economy, in countries with a significant share of this component, a part of products and services initially meant for self-consumption, may be meant to be sold on the market, hence leading to a certain overlap with informal sector.

- Illegal production represents the totality of production and distribution activities, which contravene the legislation in force (illegal goods and services, such as drugs and prostitution), but also production of legal goods and services by unauthorized economic units (production of alcoholic beverages without license, poaching, etc.), as well as those which to not meet certain standards or are counterfeit (goods with falsified brand, counterfeit video disks, etc.)[5].

NBS does not calculate illegal production, because it is rather difficult to carry out such an exercise. There are few countries at the international level, which have integrated the estimation of illegal production in their national accounts[6]. Hence, informal economy which may be estimated through national accounts covers only three components: informal sector, households' production for self-consumption and hidden activity in the formal sector. At the same time, referring to the labor force statistics, it is necessary to clarify that before 2018, NBS was reporting informal employment according to 4 components: population employed informally in formal sector, population employed in informal sector, households employing employees and households producing for their own consumption. Since 2019, NBS has been presenting data for population employed informally in the formal sector, population employed in informal sector and households employing employees, while the households producing for their own consumption have been attributed to inactive population. This fact produces certain confusion. Hence, it results that a part of the GDP, and namely households' production used for self-consumption, is created by inactive population, which actually is not engaged on the labor market. All in all, the quality of NBS statistics on informal economy and employment complies with international classifications and can be considered as reliable.

Analysis of informal economy from the perspective of national accounts

From the very start, a series of methodological challenges should be mentioned when analyzing the phenomenon of informal economy. Since 2015 important methodological changes occurred, such as the adjustment of the methodology for calculating the GDP or implementation of a new Classifier of Economic Activities (CAEM REV-2). These methodological changes influenced the data series. Hence, it is rather difficult to build chronological series, which would be sufficiently long to reflect the dynamics in the informal sector by economic activities. This is possible for the period after 2015, when the economic activities started to be reported according to the new classifier. At

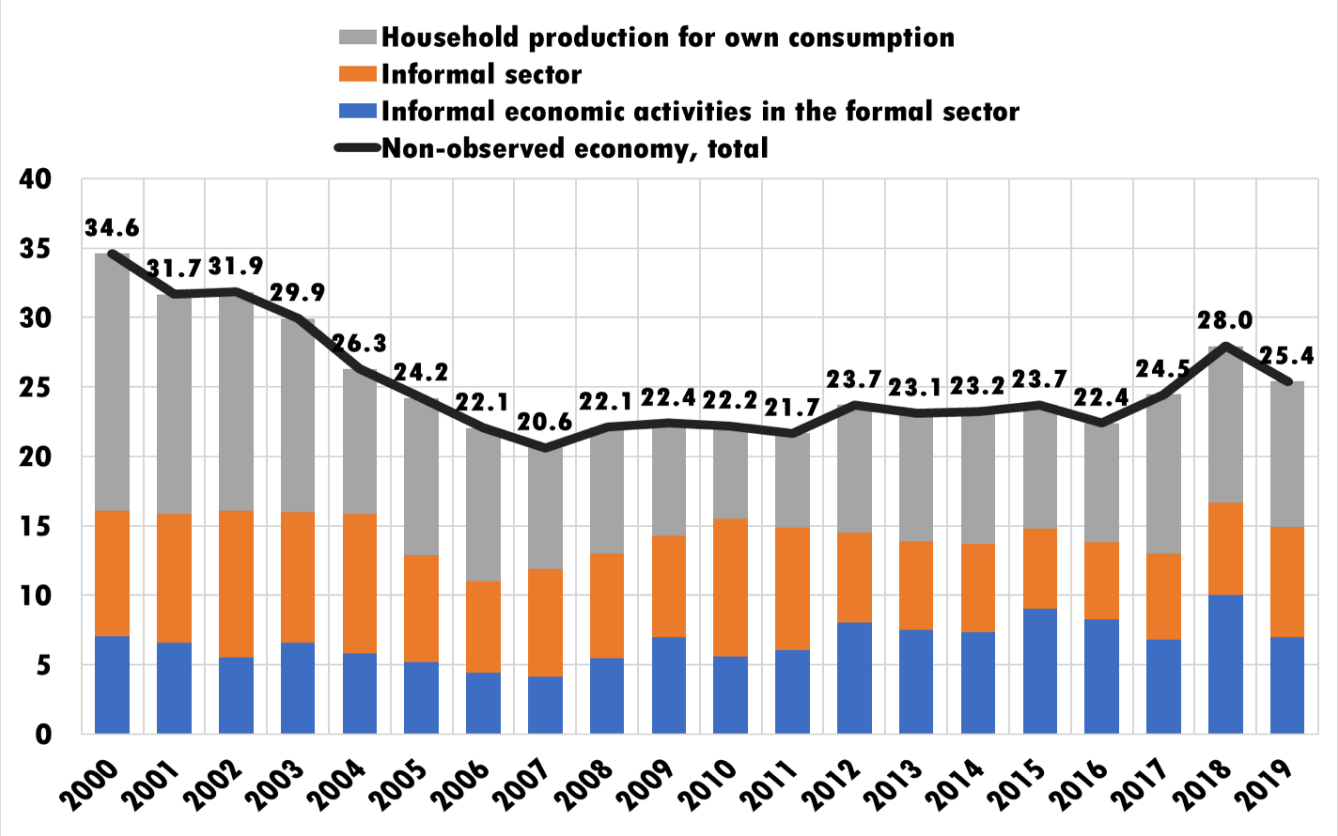
[5] National Bureau of Statistics, "Measuring the elements of unobserved economy in the Republic of Moldova", 2003: https://statistica.gov.md/public/files/publicatii_electronice/Conturi_nationale/Econ_neobs_ro.pdf

[6] Popa A., Lupușor A., Roșca I., Hirose K., Hettes M., Informal Economy in the Republic of Moldova: A comprehensive analysis, p. 9, available on http://www.cnpm.md/public/files/Economia_informala_26_03_2015.pdf

the same time, it is not clear how the methodological changes impacted the data on the share of informal economy in the GDP. In spite of this lack of clarity, the study used the aggregated data on share of informal economy in the GDP for 2000-2019, and the information reflecting the structure of informal economy refers to the time interval between 2015 and 2019.

After the decrease registered in 2000, informal economy got extended over almost a decade. In spite of this evolution, the level from the beginning of 2000 was not achieved. Informal economy experienced rapid shrinking until the economic crisis from 2009. If at the beginning of 2000, the unobserved economy accounted for 1/3 of the GDP, already by 2007, this indicator decreased down to somewhat over 1/5 of the GDP. After the crisis in 2009 until the one from 2014/2015, the share of informal economy increased slowly and grew from 22 to 24%. A more accelerated growth of informal economy was registered after 2016, reaching in 2018 a share of over 28% in the GDP. The very last data, for 2019, show that informal economy got compressed as compared to the level of 2018 and accounted for ¼ of the GDP. The biggest part of unobserved economy is represented by households' production for their own consumption, with informal sector competing with the hidden production in the formal sector for the second place (figure 1). Although data for 2020 are not available, the survey results and other proxy-indicators, presented below, suggest that the level of informal economy during 2020 did not increase.

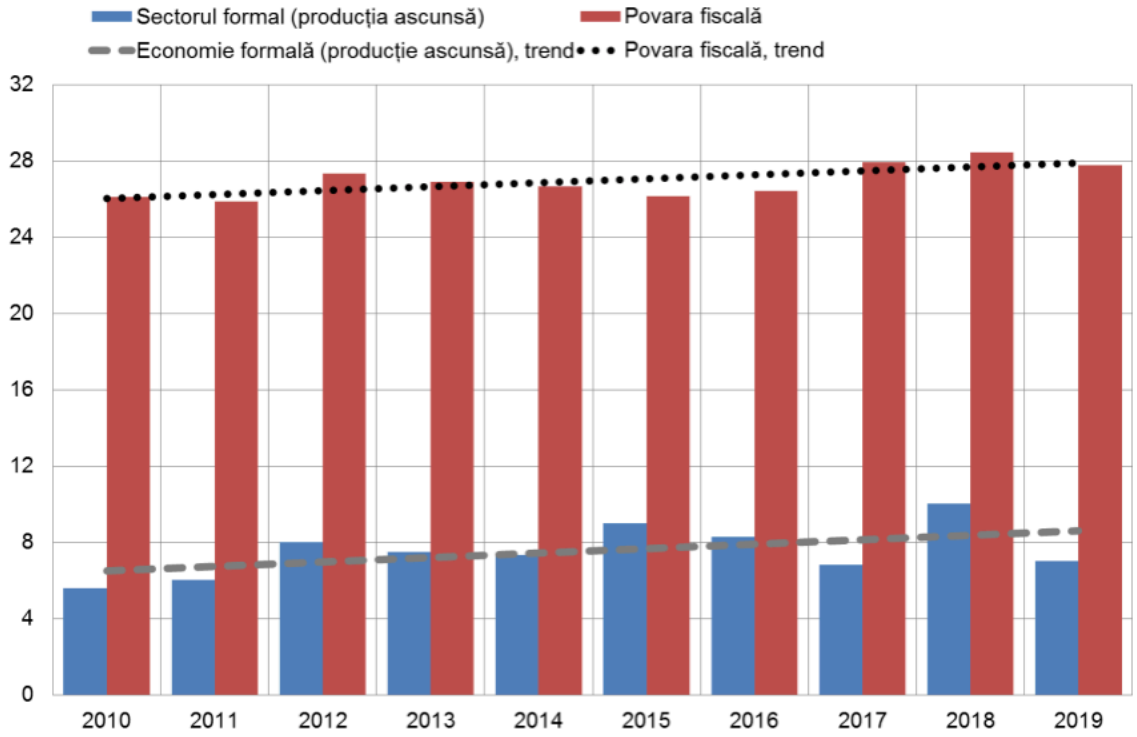
Figure 1. Share of unobserved economy components in GDP, %



Source: NBS, authors' calculations

The growth of informal economy after 2009 was due to the rapid expansion of hidden production in the formal sector. If in 2010, this component was less than 6% of GDP, in 2018 it reached 10% of GDP. This development is also explained by increased tax burden, expressed as a ratio between the proceeds from all taxes and GDP, which grew between 2010 and 2018 from 26.1 to 28.5% (Figure 2). The fiscal reform from 2018, envisaging a decrease of the share of state social insurance contribution paid by the employer, as well as a switch to a single tax rate for individuals' incomes, has contributed to a certain decrease of the tax burden (by 0.7 p.p.) and contributed to the compression of hidden production in the formal sector. It was mainly observed in the retail trade and industrial sectors. Still, the changes are rather marginal and it is still not clear if it marked a structural break and a sustainable downward trend or a one-off and temporary decline (to this date, NBS did not provide updated estimated for 2020-2021).

Figure 2. Hidden production in the formal sector and tax burden, % of GDP



Source: NBS, authors' calculations

Note: the tax burden was calculated as a ratio between the proceeds from all taxes and GDP

After 2010 and 2011, when the share of households' production for their own consumption in the GDP was smaller than 7%, a period with relatively stable development has followed. Between 2012 and 2016, the share of households' production for their own consumption varied around 9%. An increase of this component of unobserved economy occurred after 2017. Shares over 11% were registered in 2017 and 2018. In 2019, the share of households' production for their own consumption in GDP decreased and accounted for 10.5%. The increase from 2017 and 2018 may be associated with the increased employment in this sector of Moldovan citizens returning from abroad. Between 2014 and 2017, the number of Moldovan citizens working abroad decreased by almost 7%. This drop was determined by worsening economic conditions in the Russian Federation, which was one

of the main destinations of Moldovan emigrants. A relatively stable development was registered for informal sector of unobserved economy in GDP between 2012 and 2018, when it fluctuated slightly around the value of 6%.

Agriculture is one of the main activities in informal economy, although its share in the informal economy slightly decreased over time. Hence, the share of unobserved component of agriculture in GDP decreased from 7% to 6% in 2019 as compared to 2015. At the same time, over 40% of the added value from the unobserved component of agriculture is represented by households' production for their own consumption. The unobserved component of other economic activities registers a big share in GDP (6.4% in 2015 and 7.9% in 2019), as it includes activities of private households as employers of domestic personnel and activities of private households producing non-agricultural services and goods meant for their own consumption. It is worth paying attention to the almost three-fold increase in the GDP of the share of unobserved component in construction: from 1.2% in 2015 to 4.6% in 2019 (Table 1). This rapid growth was determined by the rise of this sector during the respective period, especially after the State has increased significantly public investments in infrastructure, the most representative example in this respect being the implementation of "Good Roads" Project. At the same time, on the background of the tax reform of 2018, a certain boosting of private investments was registered. As a consequence, the share of construction sector in GDP grew from 7.2% in 2015 to 8.6% in 2019. Nevertheless, this increase occurred based on informal sector's expansion. Hence, between 2015 and 2019 the share of construction in GDP increased by 1.4 p.p., while the share of unobserved component associated to the construction branch in the GDP increased by 3.4 p.p. This progression was mainly due to increased share of informal sector in added value from the unobserved component from construction from 14.9% in 2015 to 42.5% in 2019. A decrease of the unobserved components was noted for other economic activities between 2015 and 2019.

Table 1. Share of unobserved economy activities in GDP, %

ECONOMIC ACTIVITIES (ACCORDING TO CAEM REV-2)	2015	2019
Agriculture, forestry and fishing	7	6
Industry + Water distribution, sanitation, waste management	3.2	2
Construction	1.2	4.6
Trade	4.7	3.9
Transport and storage	1.0	0.8
Accommodation and public food activities	0.3	0.2
Other activities	6.4	7.9
Total	23.7	25.4

Source: NBS, authors' calculations

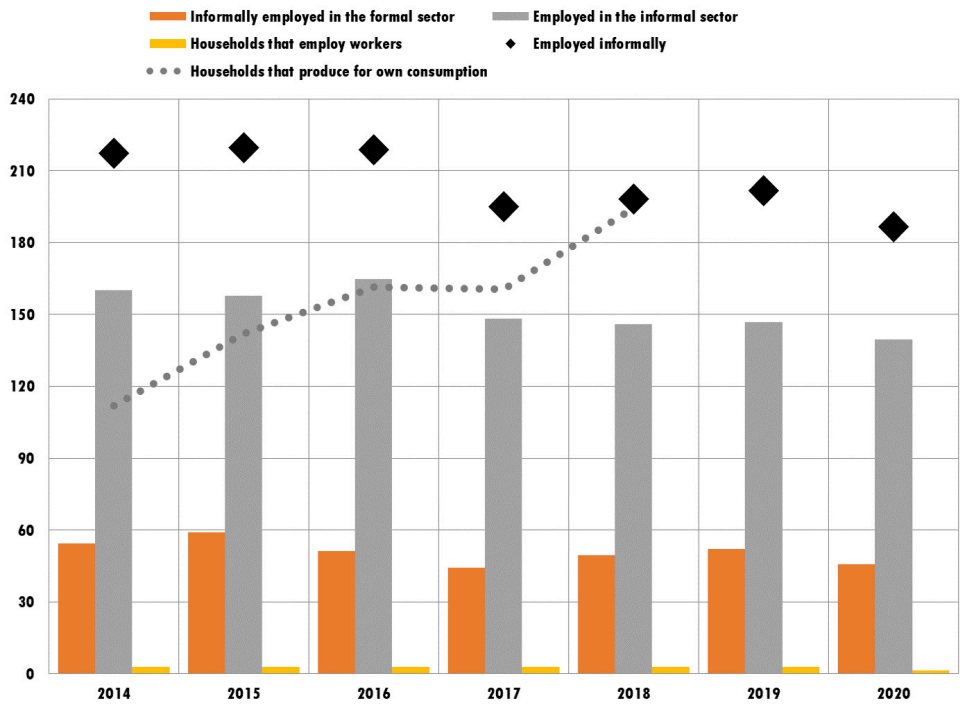
Analysis of unobserved economy from the perspective of labor force statistics

The dynamics of unobserved economy may be analyzed also based on labor force indicators. The analysis of informal employment, just like the examination of unobserved economy, was affected by methodological changes. After 2015 some important changes occurred: (1) statistical indicators got readjusted to the census results from 2014, (2) in calculating the statistical indicators a switch occurred from stable population to population with usual residence, and (3) the households producing for their own consumption got excluded from estimating the number of employed population. These constraints have led to a reduction in labor market analysis to the post-2014 period, when the employment level started to be estimated depending on the population with usual residence (number of persons who lived over the last 12 months mainly on the territory of the Republic of Moldova regardless of their temporary absences). The informally employed population includes: (i) own account workers working in informal sector enterprises; (ii) employers who work in informal sector enterprises; (iii) members of informal production cooperatives; (iv) contributing family workers, employed in formal or informal sector enterprises; (v) employees in formal or informal sector enterprises, or in households, and meet at least one of the criteria: a) the employer does not pay social contributions for them; b) do not benefit from paid annual leave; and c) in case of illness, do not benefit from paid sick leave[7]. At the same time, household members producing for their self-consumption were not included in the informally employed population and got treated as a separate category.

There is a clear decreasing trend for informally employed population (Figure 3). Between 2015 and 2020, informal employment decreased by 14.1%, from 217.4 to 186.7 thousand persons. The decrease is registered for all components of informal employment. As well, during the same period of time, the number of population working in the informal sector shrank by about 13%, from 160,2 to 139,5 thousand persons. Informal employment in formal sector dropped by 15.8%, thus decreasing from 54.4 to 45.8 thousand persons. The number of households employing employees almost halved from 2.8 to 1.4 thousand persons. Nevertheless, between 2015 and 2018, the number of households producing for their own consumption has increased by 73.9%, going up from 111.8 to 194.4 thousand persons.

[7] https://statistica.gov.md/public/files/Metadate/en/AFM_en.pdf

Figure 3. Informally employed population, thousand persons

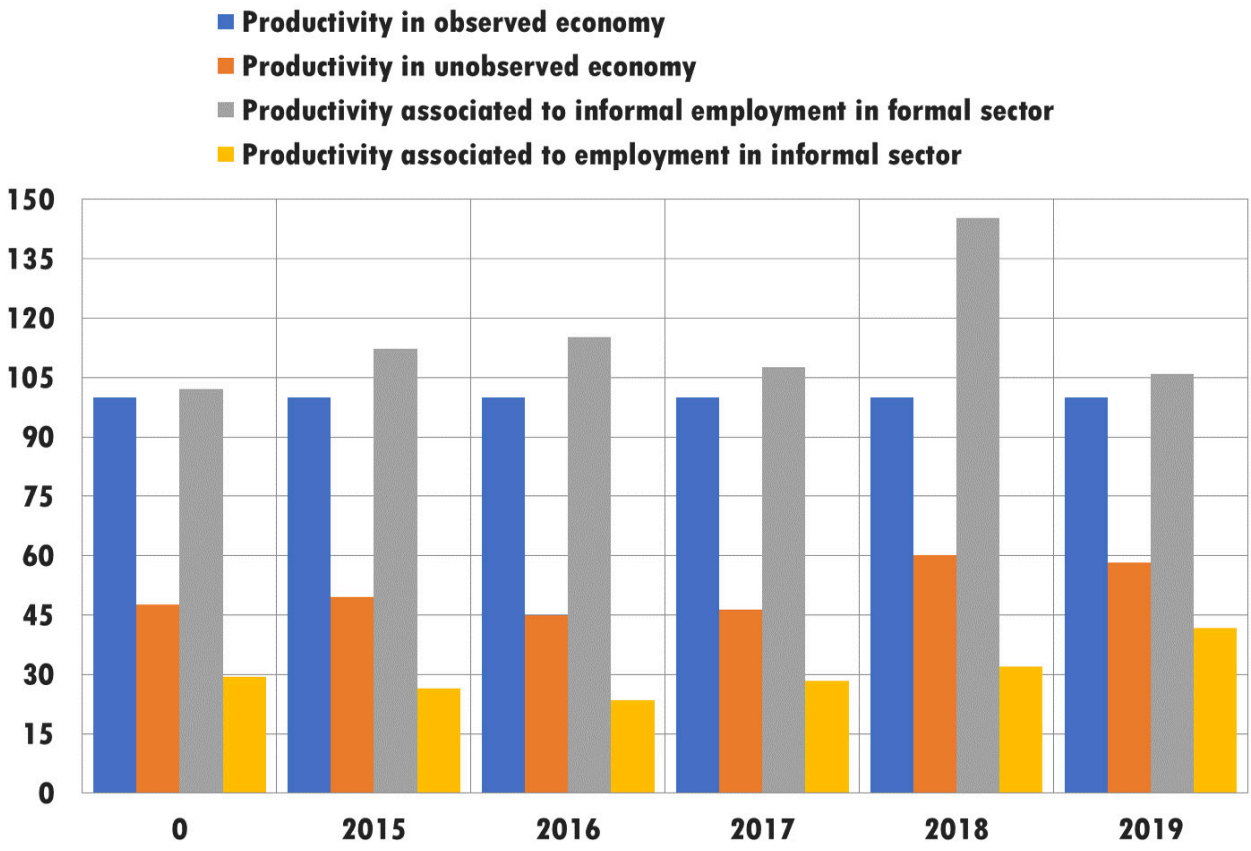


Source: NBS, authors' calculations

The decrease between 2015 and 2018 of informal employment was determined, most probably, by "migration" of persons towards the households producing for their own consumption. Alongside informal employment, a decrease was registered between 2015 and 2018 for formal employment (-8.6%), but also an increase for the number of households producing for their own consumption. At the same time, the increase registered for the number of households producing for their own consumption was supported by the decrease registered in the number of emigrants (a drop by 7% between 2014 and 2017), caused by the economic downturn in Russia. This dynamics was also induced by demographic factors, as the number of working age population decreased, during the same period of time, by 7.8%, primarily because of emigration. In 2019, a revival was noted for the labor market, and the share of employed population increased by 9.9%. Nevertheless, formal employment increased more rapidly as compared to informal employment. Hence, the number of formally employed persons increased by 12.5%, the number of informally employed persons in formal sector increased by 5.7%, and employment in informal sector increased slowly, only by 0.6%. The crisis from 2020 was felt on the labor market by decreased formal and informal employment.

In general, labor productivity in the formal economy is higher compared to the informal one (Figure 4). This is mainly explained by the lower competitiveness of informal activities, as well as by the fact that the informality is concentrated in sectors with traditionally low labour productivity, such as agricultural activities. However, a more detailed analysis reveals a series of worrisome trends related to the productivity of formal jobs. Thus, the productivity registered at informal jobs in the formal sector is higher compared to other forms of employment. As a result, employers from formal sector have the motivation to maintain informal employment in their production units in order to extract benefits and distort the competition (e.g. maximization of net wages and, as a result, increased capacity to attract easier skilled workers who can generate higher productivity).

Figure 4. Labor productivity specific to components of unobserved economy as compared to labor productivity in unobserved economy, %



Source: NBS, authors' calculations

Except for construction sector, all other economic activities registered between 2014 and 2020 a decrease of informal employment (Table 2). At the same time, the number of informally employed persons in constructions increased by one forth. This increase was caused by the extension of the construction sector in 2017-2019, in the context of rapid increase of public investments in infrastructure (it implies that the growth of the sector did not turn into better working conditions, but rather aggravated the problem of informal employment). These changes got also reflected in the structure of informal employment by economic activities. Over 60% of informally employed population is in agriculture. The share of informal employment in agriculture out of total informal employment remained the same between 2014 and 2020. Due to the rapid increase of informal employment in constructions, the share of informally employed population in this economic activity increased solidly by 6.5 p.p. in 2020 as compared to 2014. As a consequence, in 2020, about 1/5 of the informally employed population was employed in constructions. Trade is the third economic activity according to the number of informal employees. The share of informally employed population in trade decreased from 11.5 to 6.5%. The share of informally employed persons for other economic activities has also decreased, registering values which are equal to or under 5%.

Table 2. Structure of informal employment by economic activities

Economic activities	Number of employed persons, th		Modification (2020/2014), %	Employment structure, %		Difference (2020 -2014), p. p.
	2014	2020		2014	2020	
Agriculture, forestry and fishery	134.5	115.5	-14.13	61.87	61.86	-0.01
Construction	31.5	39.2	24.44	14.49	21	6.51
Wholesale and retail trade, Accommodation and public food	25	12.1	-51.6	11.5	6.48	-5.02
Industry	7.4	5.2	-29.73	3.4	2.79	-0.61
Transport and storage, Information and communication	6.5	5.2	-20	2.99	2.73	-0.26
Public administration, Education, Health and Social Assistance	0.5	0	-100	0.23	0	-0.23
Other activities	12.0	9.6	-20	5.52	5.14	-0.38
Total	217.4	186.8	-14.13	100	100	X

Source: NBS, authors' calculations

Men are more exposed to informal employment than women (Table 3). The number of informally employed men between 2014 and 2020 varied around 120 thousand persons. The number of women during the same period of time has decreased significantly by one forth, from 89.1 to 64.4 thousand persons. These developments have determined also a change in the ratio between informally employed men and women. If before 2019, about 60% of informally employed persons were men and about 40% were women, already in 2020 this ratio accounted for 2/3 (men) and 1/3 (women). Informal employment is much more spread in rural area. By 2020, slightly over 80% of informally employed population was in rural area (154,1 thousand persons) and less than 20% in urban area (32,6 thousand persons). Nevertheless, the decrease of informally employed population is more pronounced in urban than rural areas. Hence, informal employment decrease between 2014 and 2020 by 10% in rural areas and by 30% in cities.

Table 3. Informally employed population, disaggregated by sex and area of residence, th persons

YEAR	Sex		Area of residence	
	Men	Women	Rural	Urban
2014	128.4	115.5	61.87	61.86
2015	127.7	39.2	14.49	21
2016	126.1	12.1	11.5	6.48
2017	113.5	5.2	3.4	2.79
2018	113.5	5.2	2.99	2.73
2019	124.9	0	0.23	0
2020	122.2	9.6	5.52	5.14

Source: NBS, authors' calculations

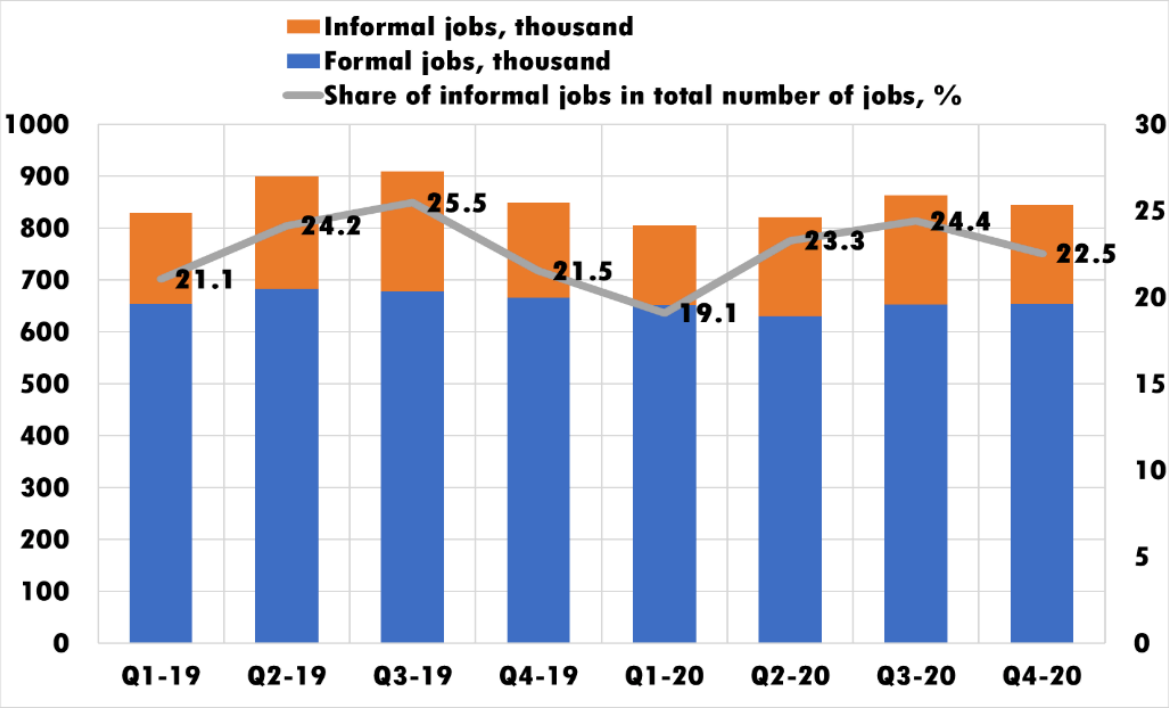
Impact of 2020 recession on informal employment

2020 was marked in the Republic of Moldova by two overlapping negative shocks, leading to the worst economic recession from the last 20 years. COVID-19 determined a global recession, which affected the foreign economic relations of the country. The economy was subject to an additional shock due to the restrictions imposed on a number of social-economic activities – as a measure to alleviate COVID-19 spread. A severe drought has accompanied this situation, which has led to a decrease of agricultural production by 27.1%. As a consequence, the Republic of Moldova was faced with one of the biggest recessions from the last 20 years, and the GDP contracted by 7%.

The labor market got compressed, but the reaction to economic recession was rather moderate. Employed population decreased by 4.4%, and inactive population increased by 2.2%. At the same time, no major decrease was registered for the number of emigrants from the Republic of Moldova. Although there are no data on migration, the development of migration processes may be deduced from remittances' dynamics. The volume of remittances decreased over the first 9 months of 2020 only by 2.4% as compared to the similar period of the previous year.

The informality level of workplaces has slightly decreased during 2020, which is rather a concern than a positive evolution. In 2020, the share of informal jobs out of total number of workplaces has increased from 19.1% in Q1 to 22.5% in Q4, but on average, it remained in 2020 under the level registered in 2019 (22.4% as compared to 23.1%). The biggest part of this drop is due to the decreasing number of self-employed people (-10.1 th persons), which accounts for more than half of all informal jobs (57% in 2020). This could be the result of two major shocks that influenced the labor market in 2020: (i) the drought, which undermined the labor demand in agriculture – the sector in which two thirds of jobs are informal (66% in 2020) and almost a half of jobs are represented by self-employed people (43% in 2020); and (ii) the crisis which undermined the labor demand in the entire economy, especially transport and HoReCa services, as well as retail sale, which represent rather big shares in informal jobs, as well as the fact that informal workers are traditionally the most vulnerable to staff layoffs. Hence, this decrease of informal labor force employment should be prudently considered, as it was rather on the account of the increase of inactive and unemployed population, than the transition from informal to formal workplaces.

Figure 5. Dynamics of formal and informal places of work



Source: National Bureau of Statistics

Hence, the recession had determined a greater compression of informal employment in relation to the decrease of formally employed population. In 2020, the formally employed population decreased by 3.4%, while the number of informally employed persons decreased by 7.5%. The components of informal employment witnessed the following developments: the number of informally employed persons in formal sector decreased by 5%, while the employment in informal sector got compressed by 12.3%. This dynamic is explained by two main factors. First, the severe draught that hit the agricultural sector determined the overall decline in informal jobs, which are highly concentrated in this sector. Second, it is related to the traditionally higher vulnerability to negative shocks and crisis of the informal sector compared to the formal one. As a result, it was much more difficult for enterprises from informal sector to maintain the activity than for those working in the formal sector[8]. For example, under the crisis conditions, the companies from the formal sector could contract bank loans or even benefited from support measures based on the "Law No. 60 of 23-04-2020 on establishing a number of measures to support entrepreneurship activities", such as subsidizing the interest payments for the loans taken by entrepreneurs or the VAT refund program, while the informal enterprises cannot use these possibilities[9].

The economic crisis has impacted more informally employed women than men. The decrease of formal employment among men was smaller than the employment decrease among women, but this gap was not significant. The number of men employed in formal sector decreased by 3.2%,

[8] Lupușor A., Fala A., Pîntea D., Sava T., Madan S., Economy and Public Finance in 2021. Risks, forecasts, recommendations of economic policies to relaunch the economy / MEGA, Edition No. 22, Chisinau, 2021, p. 22, available on: https://www.expert-grup.org/media/k2/attachments/MEGA_22_RO_compressed.pdf

[9] Ibidem, p. 22

while that of women decreased by 3.7%. The situation is different in case of informal employment. The number of informal jobs held by women decreased was several times faster compared to men (16.3% for women, compared to 2.1% for men). This disproportionate effect was determined by the fact that educational institutions suspended their activity[10]. As a result, some of the parents had to resign or to reduce their work program, so as to supervise the children left home and it was mainly women who assumed themselves this task[11]. This evolution may be explained by the following factors: (1) men's incomes are bigger than those of women and usually the household member with a lower remuneration gives up the job, and (2) in the Republic of Moldova families, women traditionally assume themselves the role of taking care of children.

The crisis hit primarily youth and older people employed informally. The number of informal jobs decreased by 24.1% for the age category of 15-24 years and – by 13.2% for the age category of 25-34 years. Also, this decline was visible (-36.3%) in the case of 65+ years age category. It was caused by the fact that youth and elderly are, usually, in the first line when the employed decides to cut personnel costs, because of lower productivity that is traditionally registered for these age categories.

In general, in case of the majority of economic activities, the decrease of informal employment was higher than the decrease of formal employment. Exceptions from the respective trend were registered in case of agriculture and construction (Table 4). The drop of formal employment in agriculture accounted for 7.5%, while informal employment decreased only by 1.8%. In construction, formal employment decreased by 4.1%, and informal employment decreased only by 0.5%. These developments may be explained by the fact that population employed in agriculture and constructions, especially the informal workers, remained in these sectors because the opportunities to get employed in other sectors or to emigrate abroad to find a job were limited during the crisis period[12]. At the same time, informal employment was most affected during 2020 in 2 sectors: industry (-27.8%) and trade (-36.7%).

Table 4. Employment change by economic activities in 2020 as compared to 2019, %

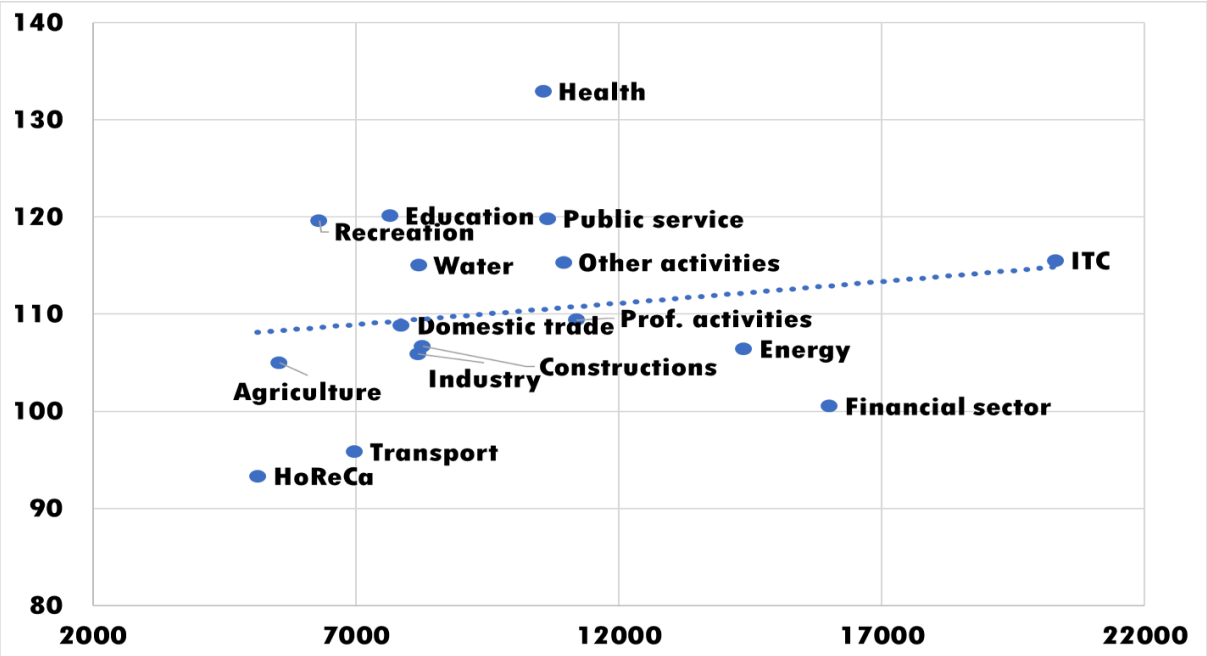
Economic activities	Formal employment	Informal employment
Agriculture, forestry, fishing	-7.5	-1.79
Industry	-3.73	-27.78
Construction	-4.07	-0.51
Wholesale and retail trade, Accommodation and public food	-5.81	-36.65
Transport and storage, Information and communications	3.3	-5.56
Public administration, Education, Health and social assistance	-2.03	
Other activities	-3.47	-25
Total economic activities	-3.44	-7.48

Source: NBS, authors' calculations

[10] Ibidem, p. 22
[11] Ibidem, p. 22
[12] Ibidem, p. 22

A counterintuitive effect of informal employment decrease is the increase of average salary level. The monthly average salary increased in 2020 by 10.2% as compared to 2019, in nominal terms (considering the annual inflation of 0.39% by the end of 2020, there is almost no difference between the salaries' increase in nominal and real terms). But this positive evolution conceals a series of major problems. First of all, the salaries' increase was due to closing of poorly paid places of work in industry and with a high level of informal employment, mainly in domestic trade and HoReCa, where the number of employed workers decreased by 9.4% in 2020 as compared to 2019. Secondly, the average value is disguising actually the strong salary inequalities between the increase of salaries that occurred in the sectors with relatively big salaries (for instance, ITC), while the increase in the sectors with small salaries was smaller or even negative. Figure 6 clearly shows the positive correlation between the level of average salaries among sectors and salary increase, confirming the increase of salary inequalities. The most affected salaries seem to be transport, HoReCa and agriculture, where the salaries are the most decreased and which registered at the same time the lowest level of increase in 2020 as compared to 2019. In case of agriculture, the dynamics is of particular concern, as it represents about one quarter of the total number of jobs, where salaries are among the smallest as compared to other sectors (the average salary in agriculture accounts for about 2/3 of the average salary in the real sector). The sector suffered a double blow: the severe draught in 2020, which undermined the agricultural production, overlapping with the pandemic repercussions. HoReCa is also faced with major problems, as the salaries from this sector are among the smallest in the economy (about 60% of the average salary in the real sector). In both cases, such a low level of salaries, among other factors related to productivity and competitiveness, is explained by the big share of informal payments ("salaries in envelope"), which distort the official statistics on de facto wage income of workers.

Figure 6. Correlation between the level and the growth rate of average salaries, depending on sector



Source: NBS, authors' calculations

The scale of the problem according to business and population perceptions

BUSINESS PERCEPTION

About one third (33%) of interviewed companies consider that unofficial salary payments are widely spread or almost in every company, the shares being similar for enterprises of different sizes (figure 7). At the same time, about one fifth of companies participating in the survey consider that tax evasion is widely spread or almost in every company, the respective share being even higher among big companies (figure 8).

Figure 7: The extent to which unofficial salary payments are spread in Moldova, „Q20. In your opinion, to what extent are the unofficial salary payments (in the envelope) spread in the Republic of Moldova? (one possible answer)", %

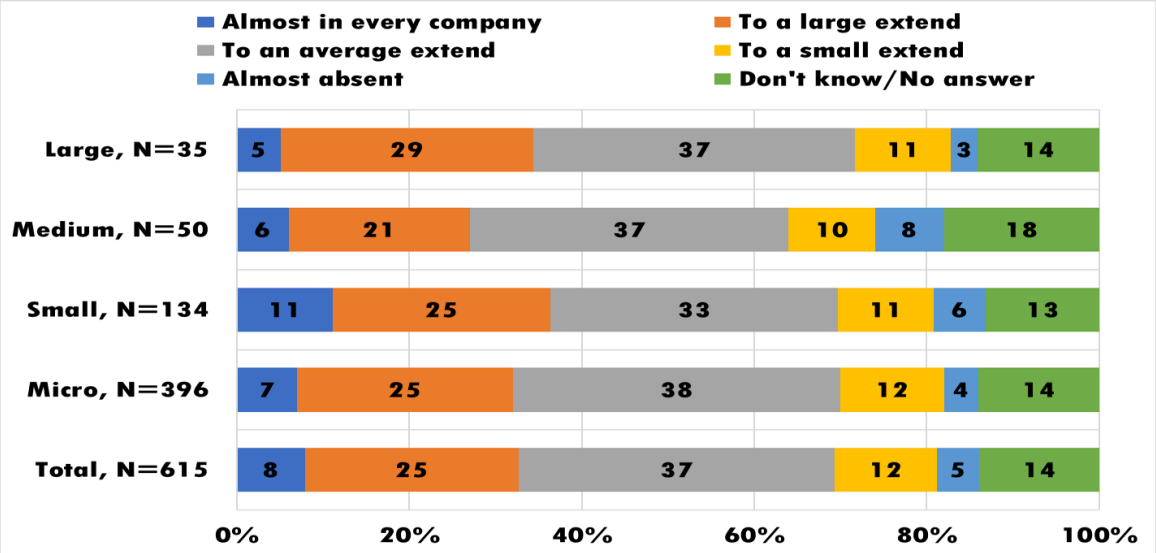
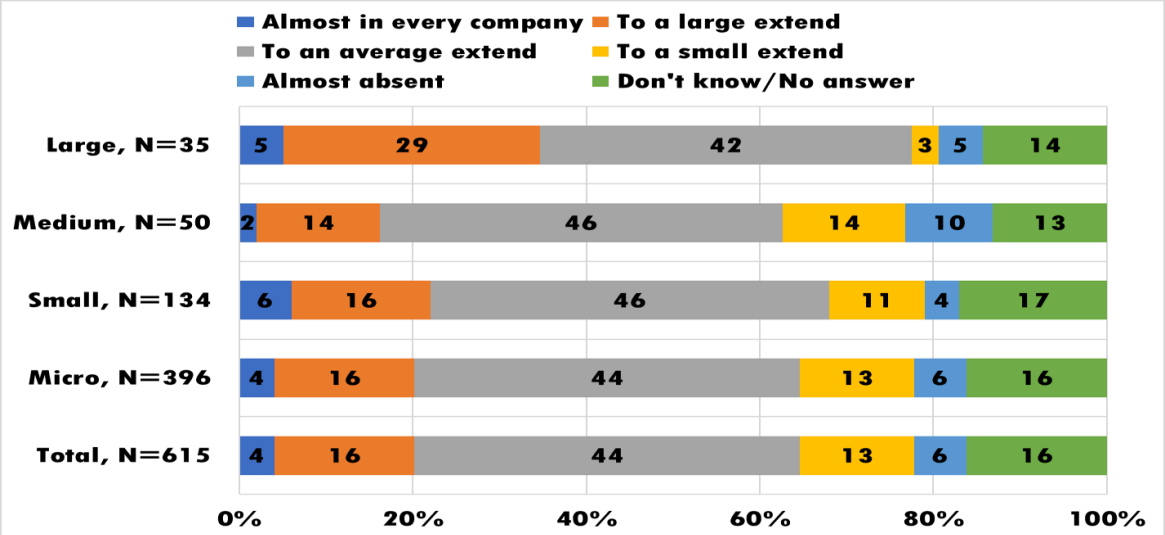


Figure 8: The extent to which tax evasion is spread in Moldova, „Q21. In your opinion, to what extent is tax evasion spread in the Republic of Moldova? (one possible answer)", %



According to respondents' perceptions, on average, about one fourth of companies' activity is not reported (figure 9), which is correlated, to a certain extent, with the estimates of the National Bureau of Statistics regarding the share of unobserved economy in GDP. The respective share does not differ a lot between companies of different sizes, hence revealing the robustness of this estimation. The share of salaries in the envelope is a little bit higher (29%) and again with no significant differences among companies depending in their size (figure 10).

Figure 9: Opinion about the share of tax evasion in companies from the respondents' industries in 2020, „Q24. In your opinion, what is the share of the total revenues NOT reported by companies from your industry in 2020?", %

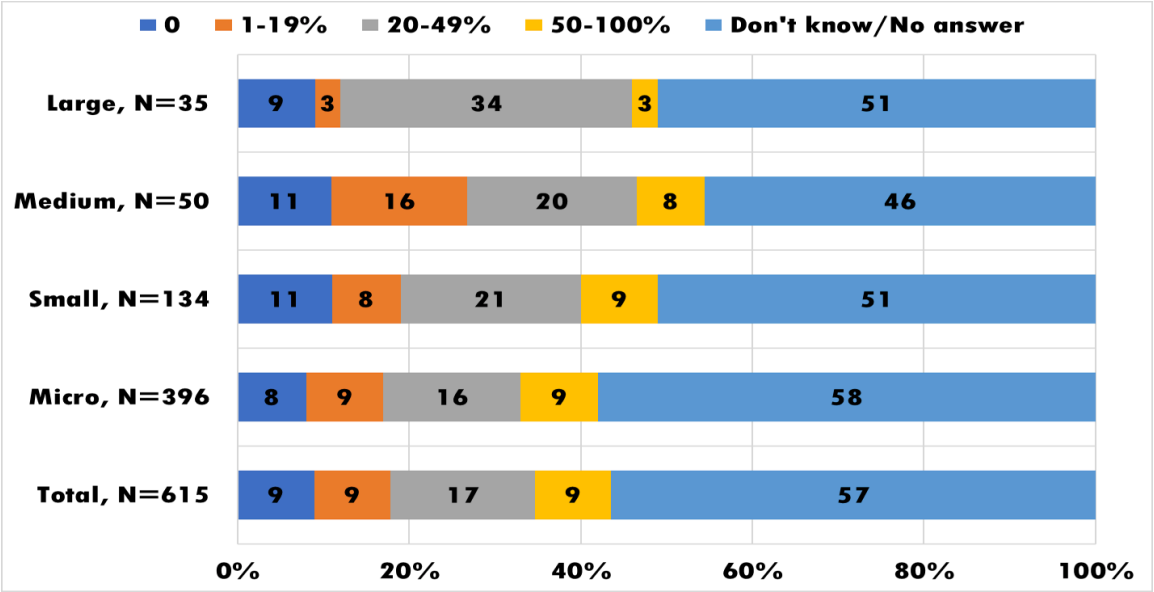
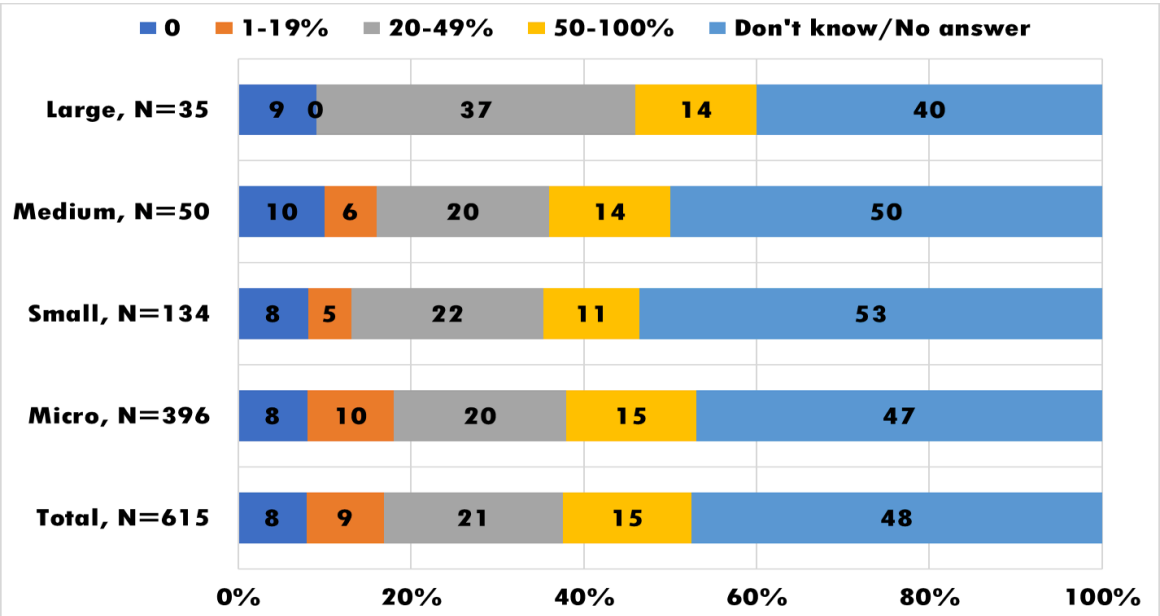


Figure 10: Opinion about the share of salaries paid "in the envelope" in the companies from the respondents' industries in 2020, „Q25. In your opinion, what is the share of the total salaries of employees from the companies in your industry that is paid "in the envelope" (or without paying all the necessary taxes), in 2020?", %



The most pronounced perception at sectors' level regarding the "salaries in envelope" practice is found in HoReCa (accommodation and public catering activities), where 44% of respondents consider that these practices are widely spread or almost in every company, and other 30% consider that such practices are spread to some extent. The respective sector is followed by Professional, scientific and technical activities with 40% of respondents considering that "salaries in envelope" are widely spread or almost in every company, agriculture – with 38% and other areas – with 39% (figure 11). The perception regarding the spread of "salaries in envelope" correlates with that regarding tax evasion. Hence, the biggest share of respondents (about a quarter) considering that tax evasion is widely spread or almost in every company is found in agriculture, professional activities (that mainly operated on patent basis), transport and other areas (figure 12).

Figure 11. Opinion about the spread of "salaries in envelope" in companies "Q20. In your opinion, to what extent the unofficial salary payment (in envelope) is spread in the Republic of Moldova? (one possible answer)"

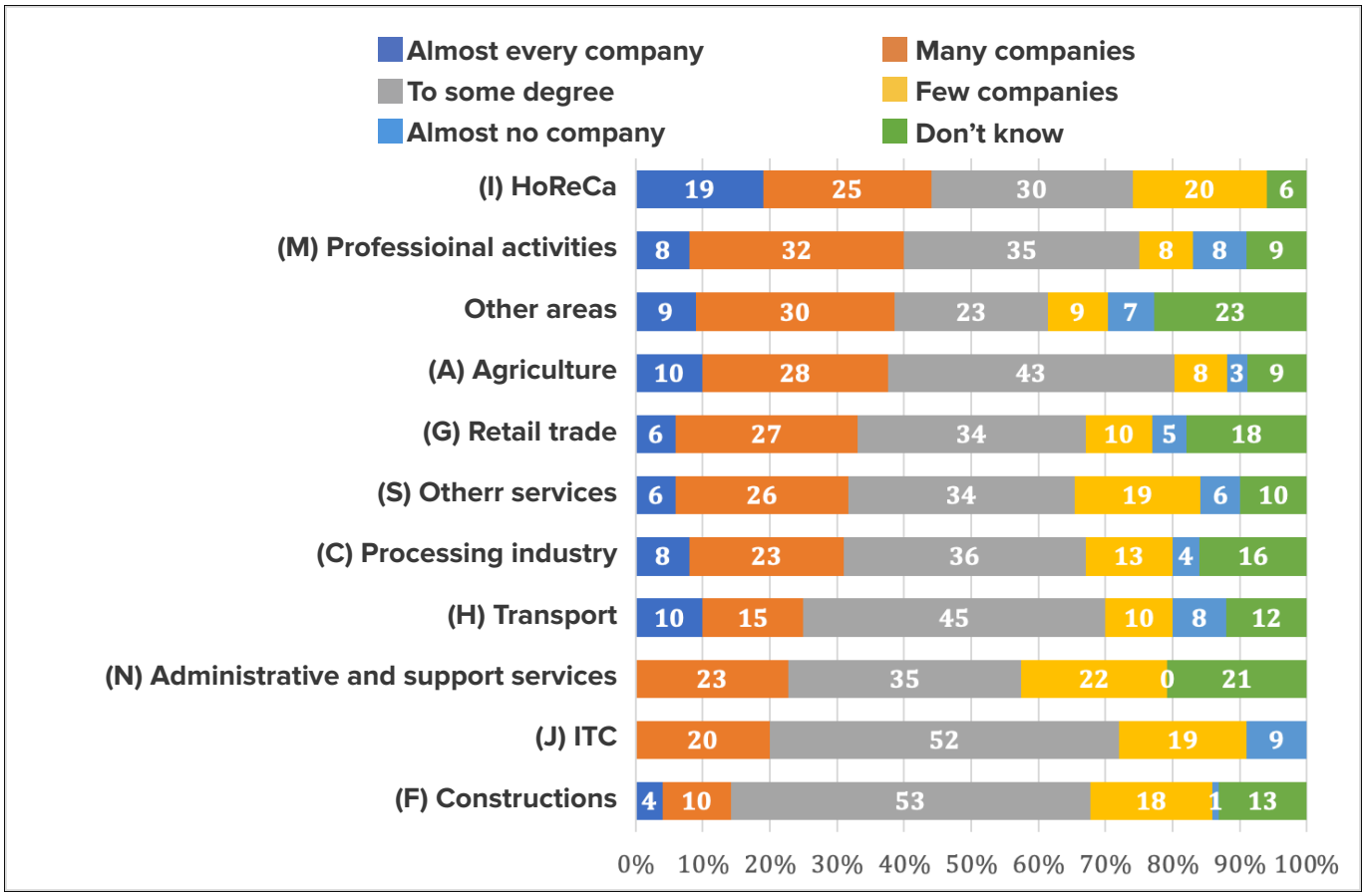
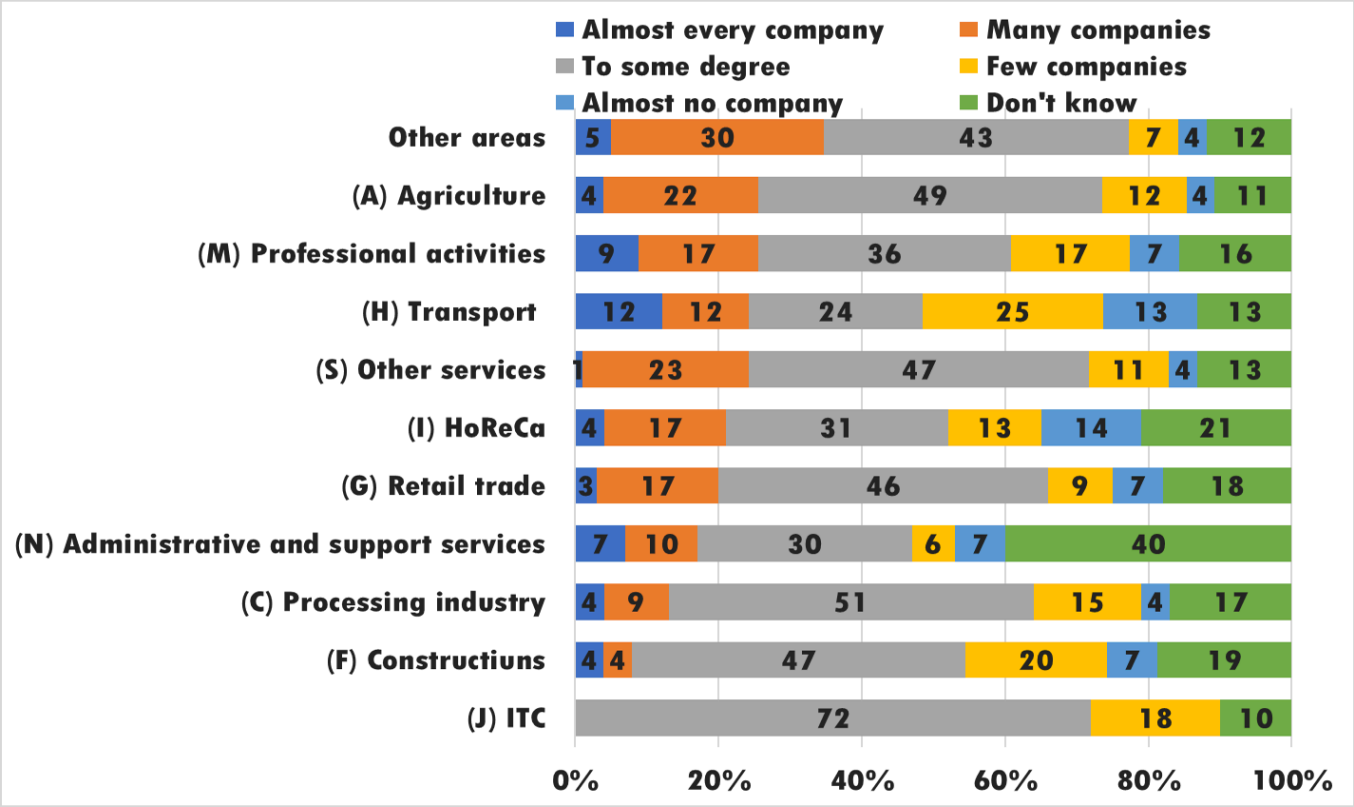


Figure 12. Opinion about the spread of tax evasion in companies „Q20. In your opinion, to what extent the unofficial salary payment (in envelope) is spread in the Republic of Moldova? (one possible answer)"



The respective findings are supported by focus group participants. Hence, the respondents mentioned that categories of employees who more frequently can get unofficial salaries or "salaries in envelope" are the following:

- Seasonal workers (they are mainly employed in agriculture, HoReCa and construction sectors).
- Employees with low vocational training (low skilled) – it is considered that such employees do not know about the rights and benefits of an official salary;
- Employees from such areas as: constructions, goods' transportation services, advertising distribution, installation and assembling services;
- Persons who work at agro-food markets.

According to the respondents' statements, the pandemic crisis did not lead to increased tax evasion or informal employment. To the contrary. About half of respondents consider that the share of revenues that was not reported in 2020 by companies from their industries has decreased as a result of the pandemic provoked by COVID-19 (figure 13). At the same time, about one third of respondents (31%) thinks that the share or salaries paid "in envelopes" in the companies from their industry remained the same in 2020, as a result of the pandemic provoked by COVID-19, and one quarter think that this share has decreased (figure 14). This perception correlates with the developments registered for statistical indicators, according to which the share of informal employment decreased in the context of the pandemics, as the informal jobs were the most unstable and, respectively, many of them got closed in crisis conditions due to enterprises' financial constraints.

Figure 13: Opinion about changes in the share of revenues which was not reported by companies from respondents' industries, as a result of COVID-19, „Q26. In your opinion, as a result of COVID-19, the share of the total revenues of the companies from your industry, which was NOT reported in 2020 has ... ? (one possible answer)", %

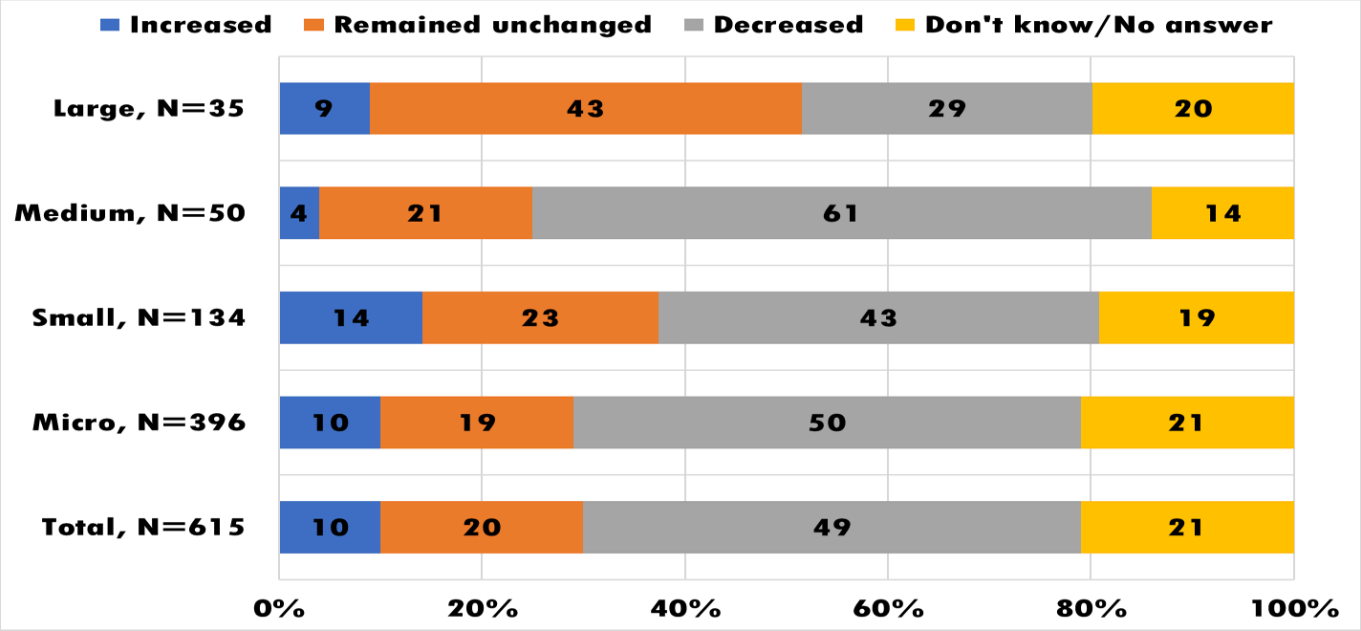
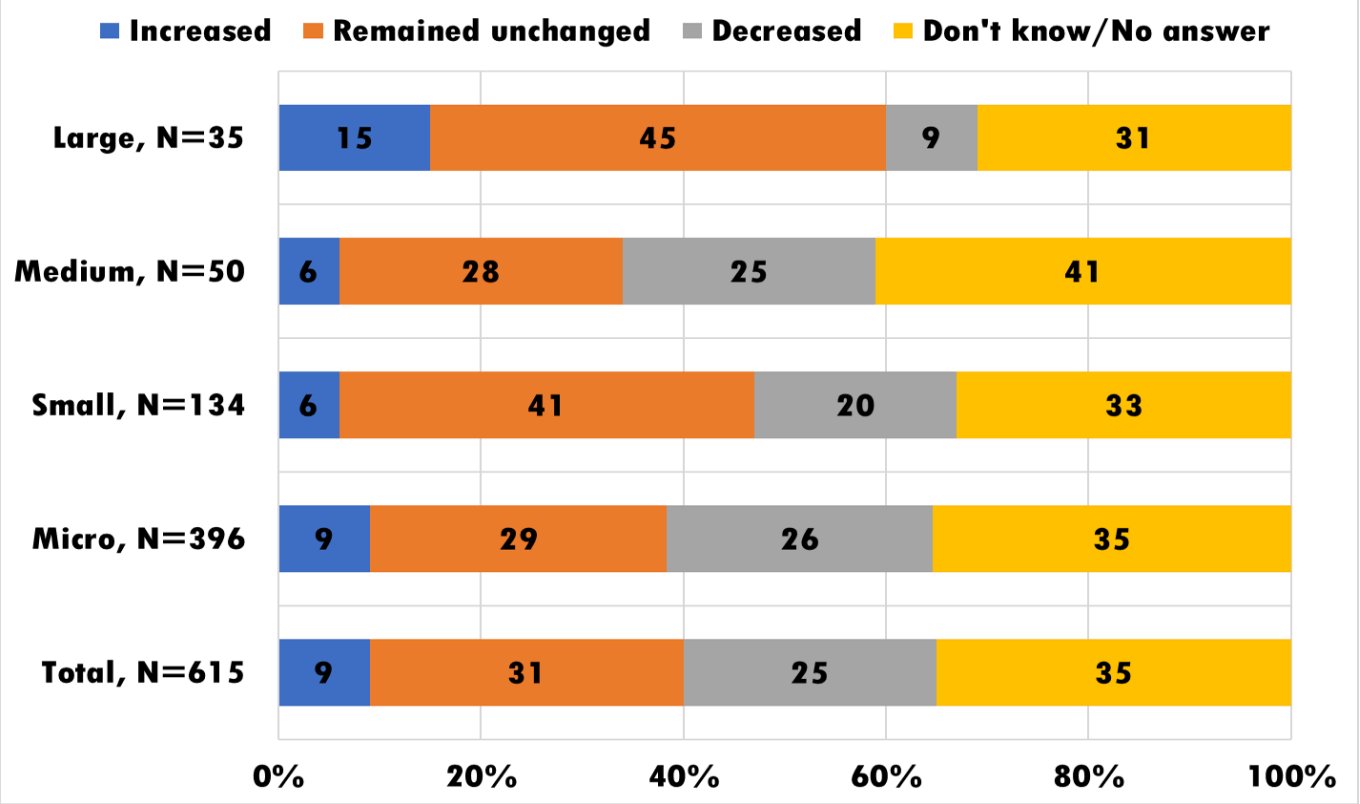


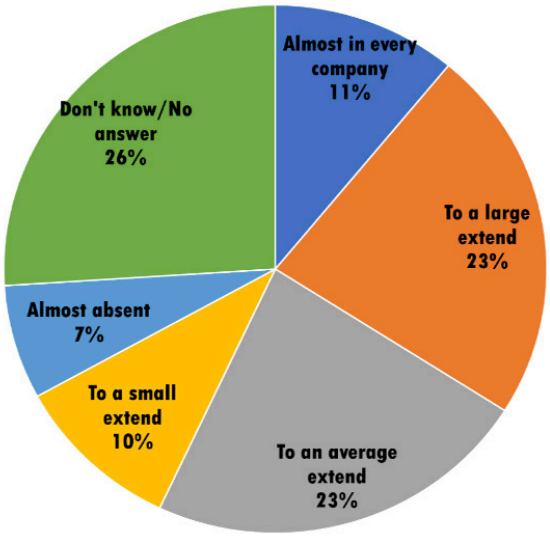
Figure 14: Opinion about changes in the share of salaries paid "in the envelope" in the companies from respondents' industries, as a result of COVID-19, „Q27. In your opinion, as a result of COVID-19, the share of salaries paid "in envelope" (or without paying all the necessary taxes) to employees from companies in your industry in 2020 has ...? (one possible answer)", %



POPULATION PERCEPTION

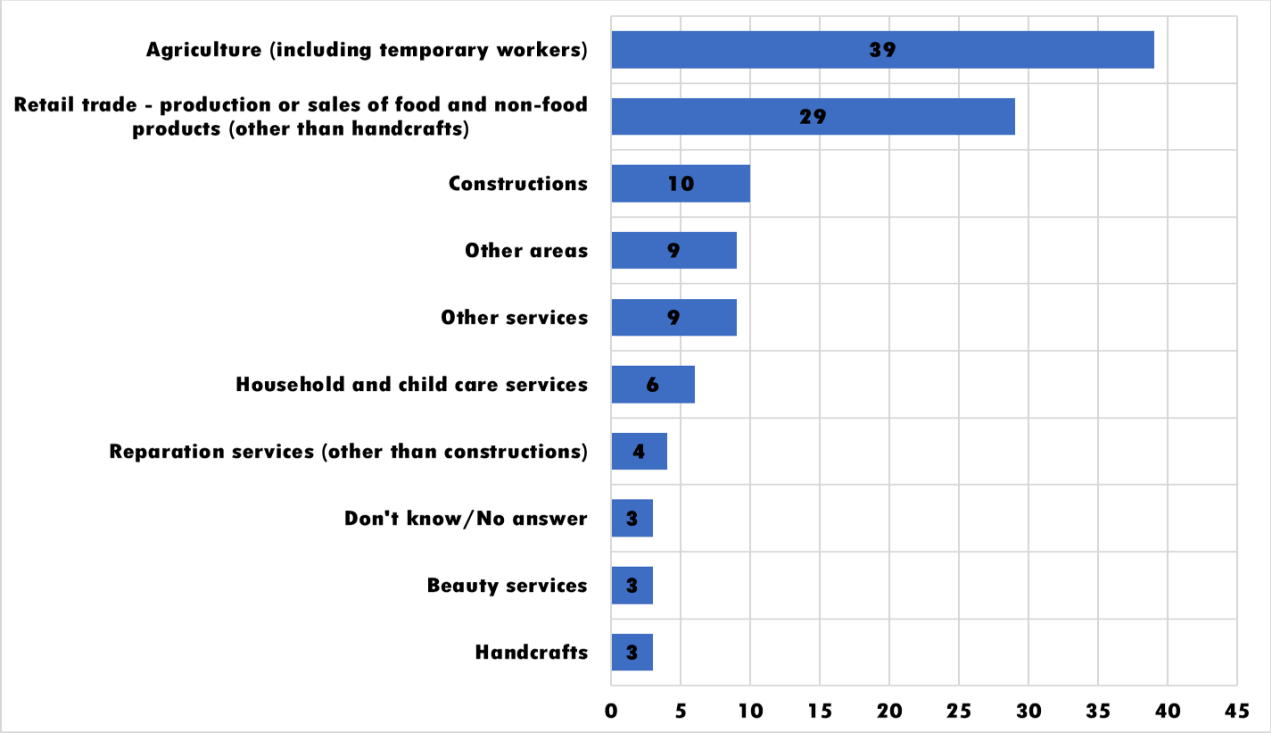
Just like in case of business, about one third of respondents – individuals consider that the unofficial salary payments are widely spread in the Republic of Moldova (figure 15).

Figure 15. Respondents' opinions regarding the extent to which unofficial salary payments are spread in the Republic of Moldova. „Q35. In your opinion, to what extent the unofficial salary payments (in envelope) are spread in the Republic of Moldova? (one possible answer)", N=1230, %



Informal employment has the highest spread in sectors with least incomes: agriculture, food trade (including cafes and restaurants) and non-food trade. These sectors represent over half of total number of informal places of work (figure 16).

Figure 16. Answers to question "From what area is (was) this activity (which generates income and the agreement with the client is verbal)? (multiple answer)" – among the persons who are employed now or were employed in the past in the informal sector, N=223, %



A relevant indicator for identifying informal employment practices is the way in which the salaries are paid: in cash or on card. According to the survey, the employees who stated that the amount of their salary coincides with the one mentioned in the contract (the salary is paid officially) register the highest rate of fully paid salaries on card - 74% as compared to 63% general average. The situation is different in the case of employees who are paid informally: only 50% of those who receive a higher salary than the one indicated in their contract receive their wages on card. Hence, informal employment and informal economy are closely correlated to use of cash for paying the salaries and, respectively, fueled by companies administrators' access to cash.

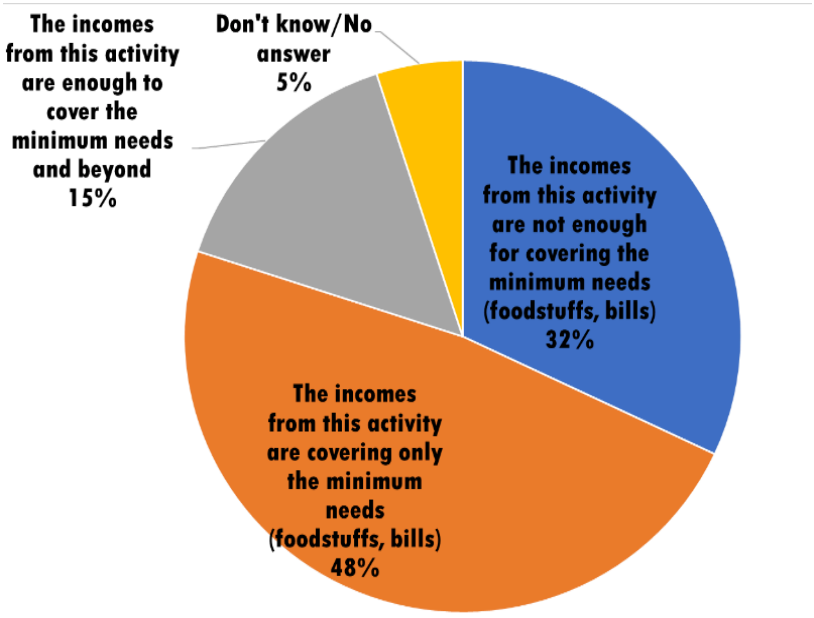
Mostly, the population accepts informal employment practices out of necessity rather than opportunity. Thus, about 59% of interviewed persons think that the employees who receive a part of the salary unofficially are rather forced to accept the salaries in envelopes, and only one third considers that employees rather chose to accept salaries in envelopes. This develops a series of vulnerabilities associated with these employment forms in relation to workers, and namely:

Low level of salaries for informal places of work

According to the survey, those who have declared a household monthly income under 2000 MDL are dealing more with informal activity. Besides, apparently, the Covid-19 pandemic has severely hit the informal sector, because according to the same survey, before the pandemic, the respondents with a household monthly income between 2001-4000 MDL and over 8000 MDL were employed in the informal sector to a bigger extent. Besides, about half of informally employed persons (48%) has indicated that the money from informal activity is enough only for strictly necessary things. At the same time, every third informally employed person (32%) states that the obtained income is not enough for strictly necessary things, especially women (36%, as compared to 29% in case of men) and population from rural area (41% as compared to 13% in case of population in urban area).

Figure 17.

The extent to which the income obtained from informal activity covers the respondents' needs. „Q27. Which of the following statements describes better the extent to which the income from this activity covers your needs? (one possible answer)" – among the persons currently employed in informal sector, N=81, %

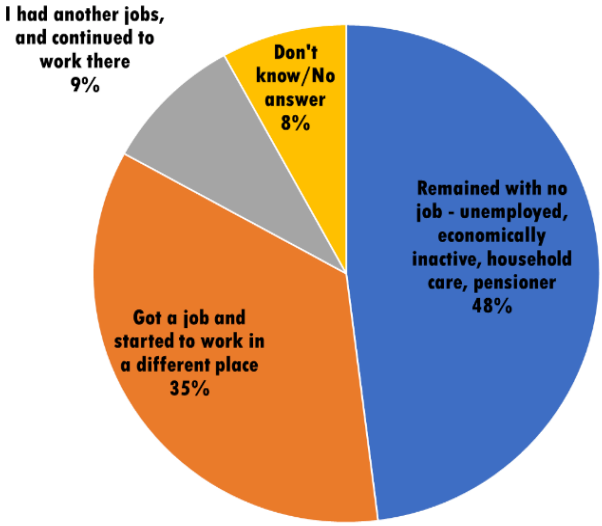


Transition to formal employment is difficult

Only 35% of those who finished their informal activity got a formal place of work, and 48% remained unemployed. The transition towards a formal place of work proved to be even more difficult in case of women, with 60% of those who finished their informal activity remained without a job (35% in case of men). Other vulnerable categories in this respect would be the people over 56 years old, for whom the respective share is 71%, rural population with a share of over 55% (37% in case of urban population), with relatively low level of education and low incomes. At the same time, according to the respondents who finished their informal activity, the most frequently invoked reason (25%) was the insufficient level of incomes, hence confirming the above-mentioned vulnerability regarding the low level of salaries among informal workers and respectively their exposure to poverty risks, especially during the pandemic crisis period.

Figure 18.

The way in which the respondents' employment changed after finishing their activity in the informal sector. „Q22. How did you employment change after finishing this activity (which generated income and was provided without contract/receipt)? (one possible answer)" – among the persons who were employed in the past in the informal sector, N=143, %

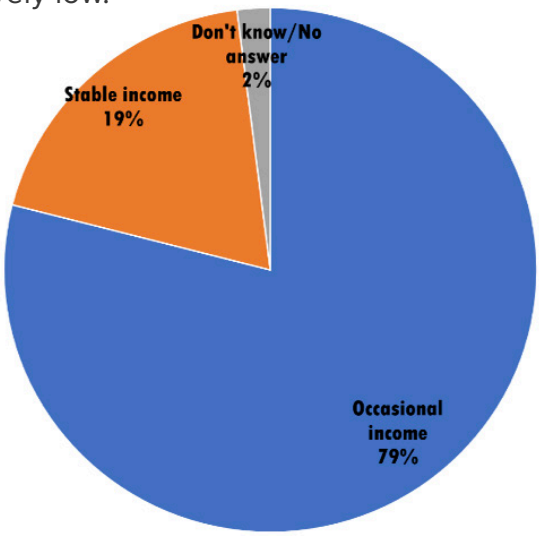


Uncertainty at the workplace

According to most of the persons currently employed in the informal sector (79%), the practiced activity mainly provides them an occasional income, hence implying that incomes are not stable and certain, and that these workers are deprived of labour and social protection. About 19% of this category have mentioned that they rather have a stable income from informal activity. This vulnerability is valid especially for the young and aged population, as well as for the one from rural area – meaning the persons whose incomes tend to be relatively low.

Figure 19.

Type of income obtained from informal activity. „Q26. Does this activity generate a stable or an occasional income? (one possible answer)" – among the persons currently employed in the informal sector, N=81, %

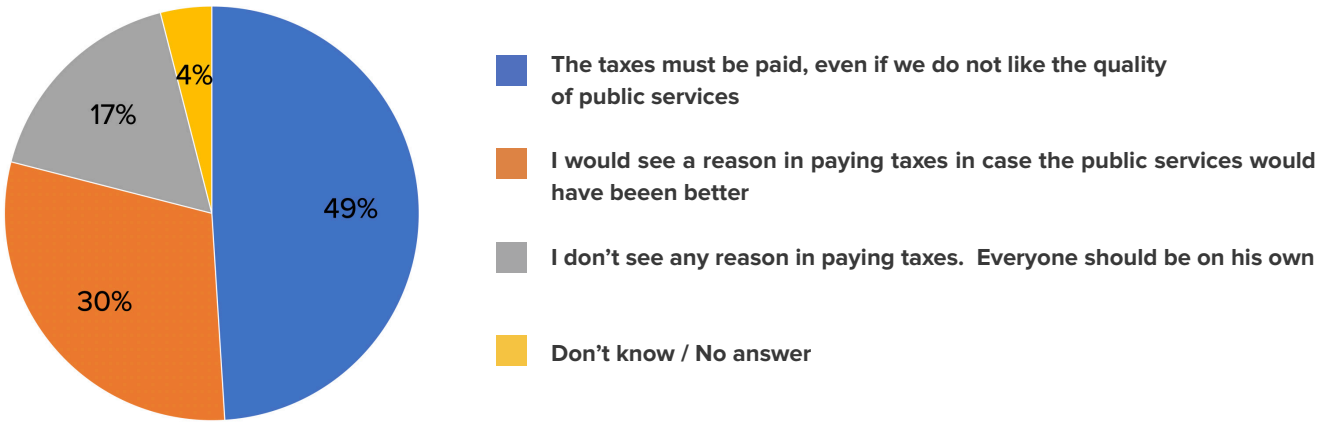


Tax morality and tax compliance among population and business

POPULATION PERCEPTION

The intrinsic motivation to pay the taxes is the main factor determining participation in economy and informal employment. According to the survey, every second respondent considers that "taxes should be paid even if we do not like the quality of public services, otherwise it is going to be even worse". This result should be tackled with caution, taking into account the sensitive nature of the question. Even so, it should be noted that the other half may be considered as having certain propensity for tax evasion. About 30% of respondents are part of this category, which stated that they would see the tax payment as something meaningful, if public services would be better, and other 17% mentioned that "they do not see the point in paying the taxes and fees – everyone has his/her way of getting by".

Figure 20. Attitude towards payment of taxes and fees. „Q33. Which of the following statements describes better your attitude regarding the payment of taxes and fees in relation to quality of public services (taxes and fees mean the contributions from the salary or payment of such taxes and fees when buying different products and services)? (one possible answer)", N=1230,



A number of factors were identified as influencing the motivation for tax compliance or for tax evasion, which are assessed as follows:

Insufficiency of employment alternatives and the low level of income

Most of the times, the persons decide/accept to practice informal activities out of necessity rather than opportunity. This refers mainly to the narrow range of economic and employment alternatives, as well as the low level of incomes, the constraints being rather acute especially in rural areas. Hence, according to the survey, about 45% of persons employed in informal sector, were not work-

ing before starting an informal activity (not employed / unemployed / pensioners / home-keepers), and about one third were employed, but they left their jobs and now informal activity is their only source of income. At the same time, the majority of those who are involved or/and continue to practice informal activities were motivated by the wish to "make some additional money" (66%), in spite of the fact, as mentioned above, that the level of income in the informal sector is much lower as compared to formal sector, as in majority of cases this income is occasional.

Level of benefiting from public services and health and social insurance system

One of the main factors determining persons' propensity to pay the taxes is the extent to which they benefit from the respective taxes, as well as the time distance until obtaining the benefits provided by the social and health insurance system.

For instance, certain differences regarding tax morality are aged-determined. Hence, while persons aged over 56 years old opt to a greater extent for taxes to be paid "even if we do not like the quality of public services", young people agree to a greater extent to pay the taxes "only if public services are better". Hence, besides the fact that about half of respondents are prone to avoid paying taxes, there is a potential to increase the respective propensity in future in the context of the young people who get more and more engaged in economic activities while getting older. An explanation of these differences depending on the age refers to the variations for public services' use (especially health and social assistance service), which is of higher level among elderly persons[13]. Hence, the young people who use less the public healthcare system and will benefit from the age-limit pension within a rather long period of time, are rather more reticent to contribute to taxes as compared to the older population.

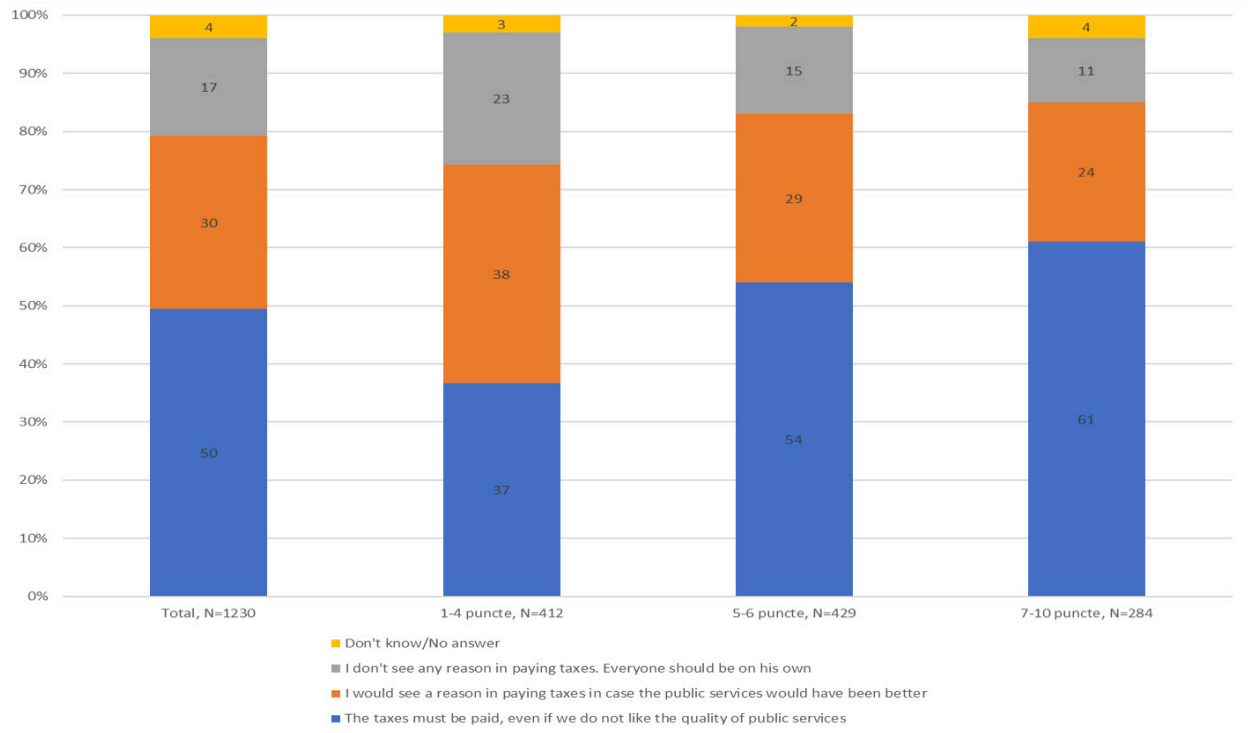
Nevertheless, certain youth groups are rather prone to pay the taxes. These would be those who benefit or plan to benefit from maternity or paternal leaves. Hence, while 59% of respondents mentioned that they prefer a smaller but completely declared salary, the respective share is higher in case of beneficiaries of the respective leaves (71%), which is similar to the beneficiaries of pension system (71%). At the same time, the respective share is the lowest among those who do not benefit or do not plan to benefit in near future from the social insurance system: students (50%), independent workers (52%) or those who do not work and are not looking for a job (53%).

Another piece of evidence that tax morality is directly linked to the current or anticipated level of benefiting from the respective taxes is the fact that the biggest share (52%) of those who would be motivated to switch from informal to formal employment is their willingness to get a higher pension. Other factors have a lower share: the possibility to receive easier a loan (16%) and the willingness to contribute to the benefit of the society and public services (15%).

[13] "Demography matters: What is the impact of population dynamics on the economy of the Republic of Moldova", Expert-Grup and UNFPA, 2017,https://www.expert-grup.org/media/k2/attachments/Demografia_conteazI_-_Care_este_impactul_dinamicii_populaAiei_asupra_economiei_Republicii_Moldova.pdf

The propensity to pay the taxes is directly influenced by the level of satisfaction with the way in which the state manages the respective resources. Only one quarter of respondents stated that they are satisfied in this respect, hence revealing a certain propensity to tax evasion for the majority of population. Thus, the respondents' opinions regarding the payment of fees and taxes differ depending on the level of satisfaction with the way in which the state institutions are managing taxes and fees. The persons with a lower level of satisfaction (provided a score between 1-4 out of 10 maxim) support to a higher extent the position of not seeing the payment of taxes and fees as meaningful (23%). While those satisfied with the way in which the taxes are managed stated to a greater extent that taxes should be paid even though they do not like the quality of public services (figure 21).

Figure 21. Attitude towards paying taxes and fees depending on the level of satisfaction with the way in which the state institutions manage the taxes and fees in general, %



Level of financial education

The survey reveals that the persons who do not know the difference between the net salary and the gross salary are more engaged in informal activities. Thus, while 55% of respondents stated that they know little or nothing about these notions, the respective share accounts for 70% in case of those who work without a contract (based on verbal agreements), and it is the lowest (37%) in case of those who work based a long-term contract. The respective share is also rather high in case of persons with the lowest incomes (75% for household with incomes up to 2000 MDL and 71% for those with incomes between 2000 and 4000), and significantly lower in case of those with

relatively high incomes (34% in case of households with incomes over 8000 MDL). The respective problem is more serious in rural area, where 61% of respondents know little or nothing about the different between the net and gross salary (48% in case of urban population).

Latent tolerance or indifference towards tax evasion

Another aspect refers to acknowledging the importance of tax compliance, revealed by people's attitude towards cash receipts. According to the survey, one quarter of respondents consider that they do not need the receipt and that it is meaningless. This is mainly noted in case of young people (28%), persons with low education level (34%), but most importantly – among those with the increased likelihood to practice informal activities: those working on patent basis (39%), short-term contracts (30%) or verbal agreements (28%), as well as the employees whose salary mentioned in the contract is lower than the one which is de-facto received – most probably those who receive the salary "in the envelope" (42%).

Besides, many prove to have certain tolerance towards or even encourage tax evasion practiced by companies. This can be noted in case of persons who do not ask for the receipt if the seller does not offer it (20% of respondents) or do not take intentionally the receipt so as to encourage the seller (5% of respondents).

Self-employed reluctance to registere their business

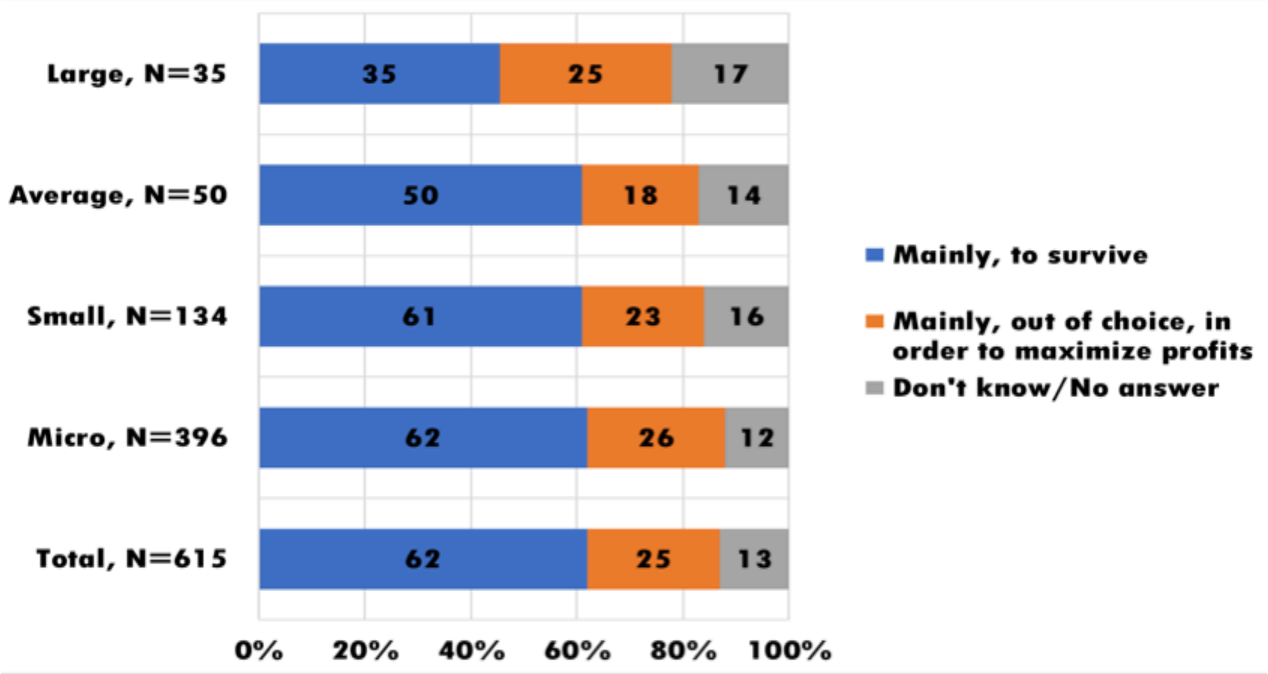
Many of the informal activities are carried out by persons who work and get incomes without having the status of legal entity: patent holders, providers of different services, seasonal workers, etc. As a rule, these persons work at a small scale, and their incomes are unstable and relatively low. Nevertheless, the big number of such persons leads to a rather important contribution from them in total informal activities. Hence, the state should seek to integrate this category of persons in the formal economic circuit, based on some incentivizing policies, as well as information and awareness raising activities. These should start from the following barriers and fears perceived by the self-employed people and communicated within focus groups:

- Amount of fees and taxes imposed to legal entities;
- Need to report and submit reports;
- Unstable economic situation caused by COVID-19;
- Unstable political situation in the country;
- Credits offered to companies are not advantageous from the point of view of crediting conditions and payback period;
- Uncertainty of getting profit from the business;
- Lack of state support for business in Moldova.

BUSINESS PERCEPTION

Just like in case of individuals, the business perception is that informal economy is the result of some development constraints and not a source of illicit opportunities. Two thirds (62%) of respondents mentioned that companies from their industries use unofficial payments rather to survive (the share of cases in the SME sector is higher than in the big companies' sector). At the same time, about one quarter thinks that legal entities opt for unofficial payments out of choice, to grow rich (figure 22).

Figure 22: Opinion about the reason why companies from respondents' industries use unofficial payments, „Q23. In your opinion, the companies from your industry, which use unofficial payments (in envelope) do it for ... (one possible answer)", %



This statement is supported also by the focus group participants. The representatives of legal entities consider that those companies which deal with tax evasion, mainly do it out of need in order to survive. In respondents' opinion, the following factors and conditions would determine the companies to start not declaring all payments/revenues:

- Survival of the company on the market;
- Insufficient revenues for the business to pay taxes and to cover all other costs (salaries, rent, etc.);
- Perception that taxes and fees are not managed accordingly;
- Lack of governmental support during the crisis period caused by COVID-19;
- The willingness of employees to be partially paid "in envelope" – "people themselves do not want to pay to the state ... seeing that pensions, salaries for doctors and teachers are not increased";
- The interest of company's management to pay less taxes.

The survey results suggest that, most of the times, tax compliance among companies should be fostered more through incentives and institutional measures, rather than constraint. Hence, the coercive measures are perceived in general as being rather tough. About 63% of respondents consider that if a company is "caught" that it intended not to report real values, it would have a big fine (23% think that the fine would be very big, and 40% - rather big fine), the respective share being even higher in case of big companies (78%). This finding is supported as well by the focus group participants, according to whom the sanctions are too tough or maximum in case of small and medium enterprises. In this respect, the participants stated that sanctioning the non-declaring of some payments should depend on how severe the violation is and the very first violation should be punished only with a warning or small fine.

At the same time, it is necessary to streamline the controls for certain types of tax evasion so as to increase the probability of detection. Hence, on one hand, the majority of interviewed companies consider that it is to a certain extent easy for an enterprise "to be caught" with not reporting the entire amount of revenues (71%) or the real number of permanent employees (70%). On the other hand, the respective share is smaller in case of under-reporting of salaries (the "salaries in envelope" phenomenon) – only 56% of companies consider that such practices may be easily detected. A lower level is registered for the perceived probability to detect the non-reporting of real number of seasonal workers and the unofficial payments for facilitating the award of contracts (corruption). For these cases, it is necessary to build the institutional capacities of the State Labor Inspectorate to streamline its activity of identifying such practices.

Figure 23: Opinion about the consequences that a company from the respondents' industries would have, if caught that it intended not to report real values „Q29. In your opinion, if a company from your industry would be caught with not reporting real values, what would be the consequences for it? (one possible answer)", %

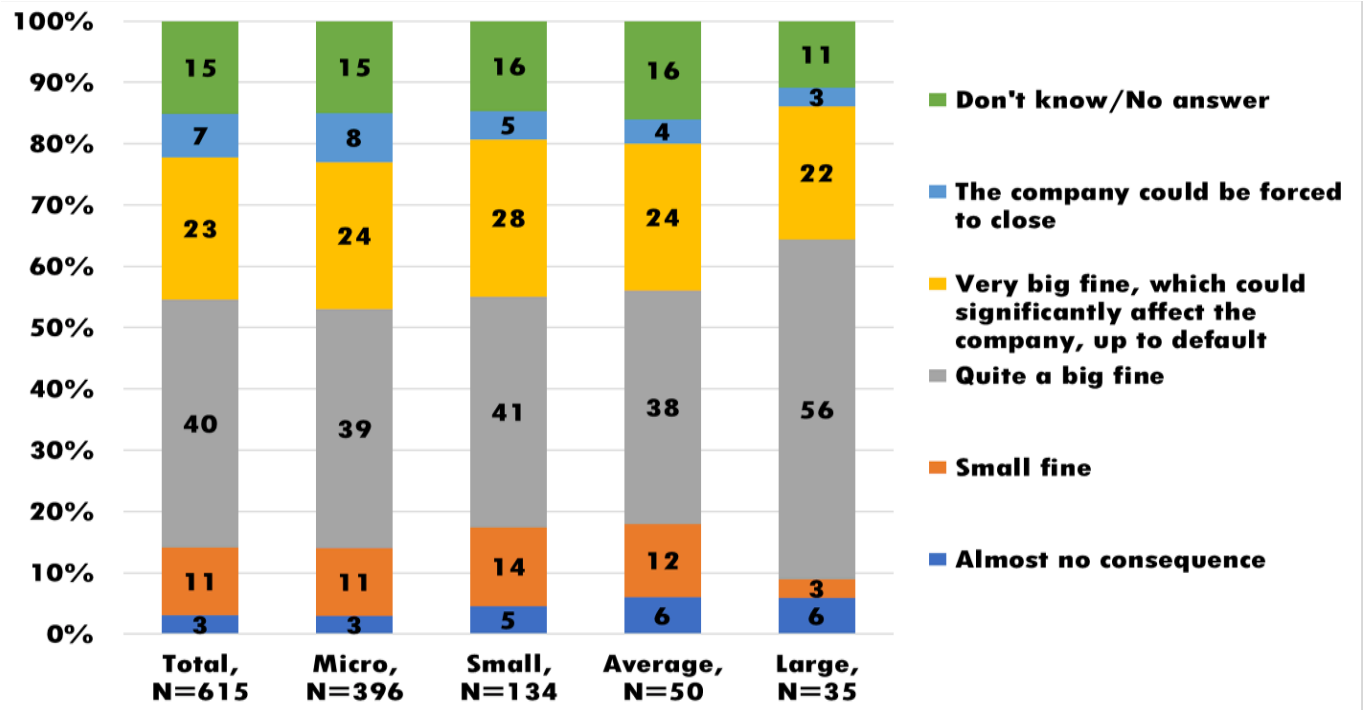
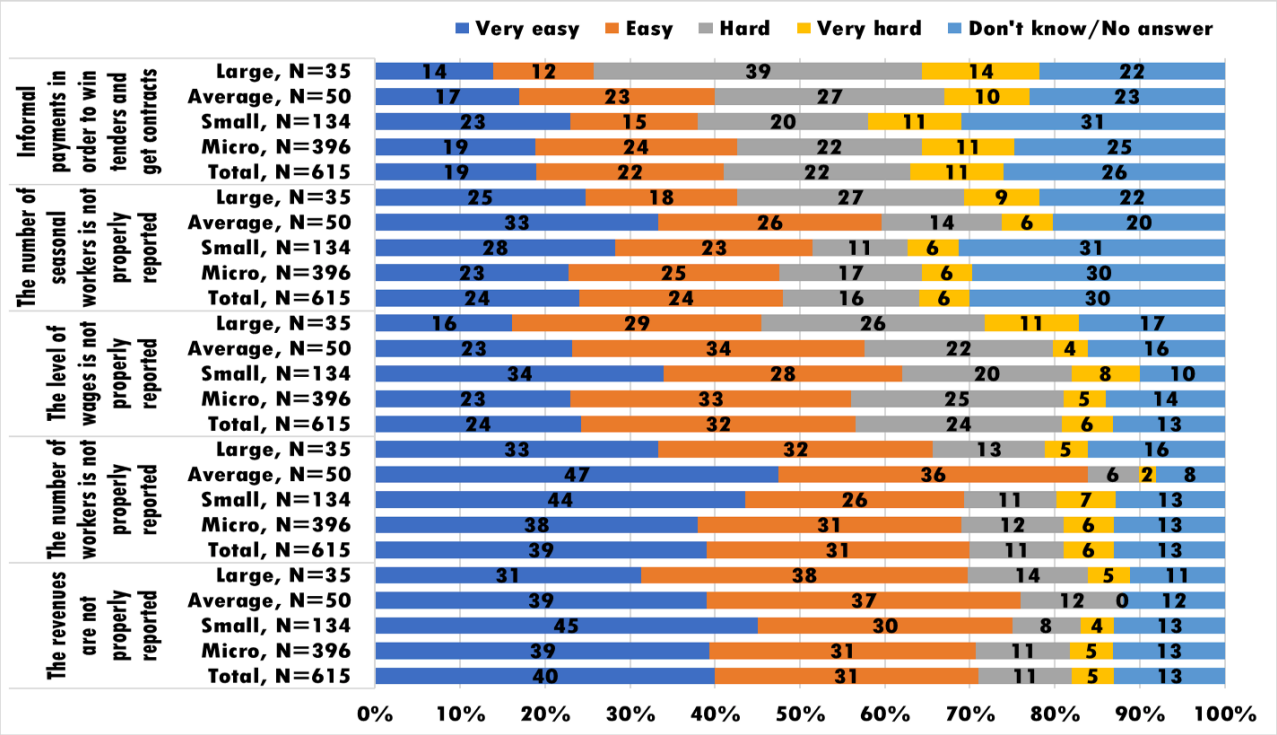


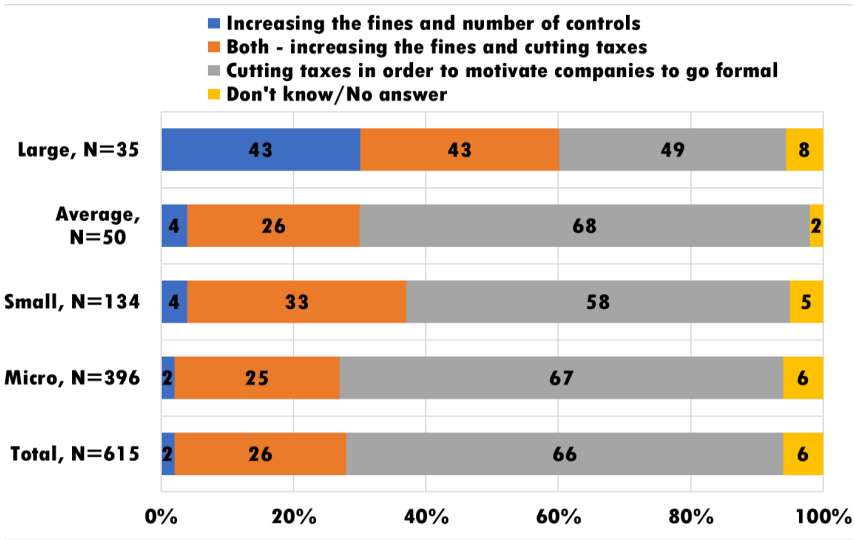
Figure 24: Easiness or difficulty for a company from respondents' industries "to be caught" with carrying out some activities, „Q28. In your opinion, how easy or difficult is it for a company from your industry "to be caught" if: (one answer per row)", %



Additionally, for the purpose of promoting tax compliance, the majority of companies, which is hardly surprising, advocate for reducing taxes (66% of total) and, to a lower extent, for a combination between reducing taxes and increasing fines (26%). Nevertheless, in case of big companies, the share of those advocating for such a combination of constraint and incentive measures is higher (43%), probably because these companies have a better financial situation and may afford themselves to cope with an eventual increase in constraint measures (figure 25). At the sectors' level, the biggest share of respondents opting for reducing taxes to encourage companies to get out of informal economy is found in information and communications (82%). This is a rather suggestive fact, taking into account that IT sector benefits from preferential tax treatment, which would motivate many entrepreneurs and specialists to declare their revenues.

Figure 25:

Measures that would function the best to encourage companies to declare all payments, „Q22. In your opinion, which of the following measures would function the best to encourage companies to pay / declare all the payments? (one possible answer)", %



The discussions from the focus groups have confirmed the survey conclusions regarding the need of incentive policies to promote compliance and discourage informal activities. Hence, the majority of participants stated that measures are necessary to optimize the regulatory framework, to reduce taxes, to simplify tax procedures and to support financially small and medium enterprises. Such measures are mainly necessary for companies practicing informal activities to survive, while for those which opt for such practices due to opportunistic consideration – tougher coercive measures are necessary.

Budgetary losses caused by unobserved economy

METHODOLOGICAL GUIDELINES

In general we can talk about 2 approaches in calculating the missed tax revenues because of economic units' activity in unobserved economy. The first approach refers to estimating the so-called "tax discrepancies", which represent the difference between the potential value of tax obligations and the effective amount of tax revenues. In simpler terms, tax discrepancy represents the dimension of tax evasion[14]. As a rule, tax discrepancies associated to different types of taxes are determined. Most frequently, the VAT-specific tax discrepancy is estimated, but there are also quantifications for excise duties and direct taxes. There are direct and indirect methods for determining tax discrepancies. The indirect methods imply calculation of the potential level of tax revenues by using the information regarding the international accounts. The direct methods include selective statistical surveys (establishing the sample and questioning the people from the sample) or auditing a determined group based on risks' analysis. Subsequently the results obtained in the sample are extrapolated for the entire population.

An essential effort from state authorities is required to estimate directly the tax discrepancy. On the other hand, although easier to be carried out, the indirect estimating based on macro-economic data has some omissions:

- The macro-economic approaches provide for general information about the tax gap. Nevertheless, these methods do not allow determining the influence of different entities (households, companies, etc.) to setting the gap;
- Estimation of the tax gap depends on the availability of detailed data. For instance, in case of VAT, it would be good to disaggregate the data by products, for the VAT rate to be attributed correctly to goods and services. This is rather important if several VAT rates are applied to goods from one sector;

[14] Novysedlák V., Palkovičová J., The estimate of the value added tax revenue loss, Institute for Financial Policy/The Ministry of Finance of the Slovak Republic, 2012, p. 7, available on: https://www.mfsr.sk/files/archiv/priloha-stranky/4382/72/EA25_DPH_uniky_201203_EN.pdf

The quality of macroeconomic data is very important. For instance, the national accounts already contain estimates for unobserved economy. An incorrect estimation influences the accuracy of quantifying the tax gap;

At the same time, even the detailed macroeconomic data are not always enough to estimate the gap and it is necessary to use additional information[15].

These factors explain why only a few states at the international level regularly estimate the tax gap. The following are among the European states that fulfill this exercise in a systemic way: Great Britain, Denmark, Sweden, France, Slovenia and Czech Republic[16].

Another approach in estimating the budgetary losses is based on the presumption that the state could collect tax revenues from unobserved economy at a similar rate with the tax revenues collected from formal economy. To determine potential revenues, a ratio is calculated between the tax revenues and GDP or observed GVA, and afterwards this ratio is applied to unobserved economy. This approach has been used in a number of studies. For instance, Schneider (2015) estimated the tax losses for OCDE states[17], and Raczkowski (2015) has quantified the non-collected budgetary revenues for European countries[18]. The main problem of this approach refers to the fact that it is rather difficult to confirm or infirm the hypothesis that taxes may be collected from unobserved economy at a similar rate as that in formal economy. In spite of this disadvantage, namely this approach was used in the Republic of Moldova to estimate the losses generated by unobserved economy. On one hand, it is easier to carry out, on the other hand it provides a general picture on all tax losses.

RESULTS

The methodology for calculating tax losses for the Republic of Moldova is based on several iterations.

- The ratio between tax revenues (collected from direct taxes, indirect taxes, social insurance contributions and compulsory health insurance premiums) was determined.
- This ratio was applied to the added value constituted in unobserved economy. In its turn, the households' production for their own consumption was excluded from unobserved economy. This treatment was used because the households' production for self-consumption is not placed on the market and does not generate revenues. Hence, to perform the calculation, the unobserved economy was limited to hidden production in formal sector and non-formal sector.
- The mathematical calculation of tax losses may have the following formula: Tax losses = (Tax revenues /GVA from observed economy)*GVA from unobserved economy.

[15] Ibidem, p. 10
[16] Raczkowski K., Measuring the tax gap in the European economy Journal of Economics and Management/ Vol. 21 (3), University of Economics in Katowice, 2015
[17] Schneider F., Tax Losses due to Shadow Economy Activities in OECD Countries from 2011 to 2013: A Preliminary Calculation, Center for Economic Studies and Ifo Institute, 2015
[18] Raczkowski K., Measuring the tax gap in the European economy Journal of Economics and Management/ Vol. 21 (3), University of Economics in Katowice, 2015

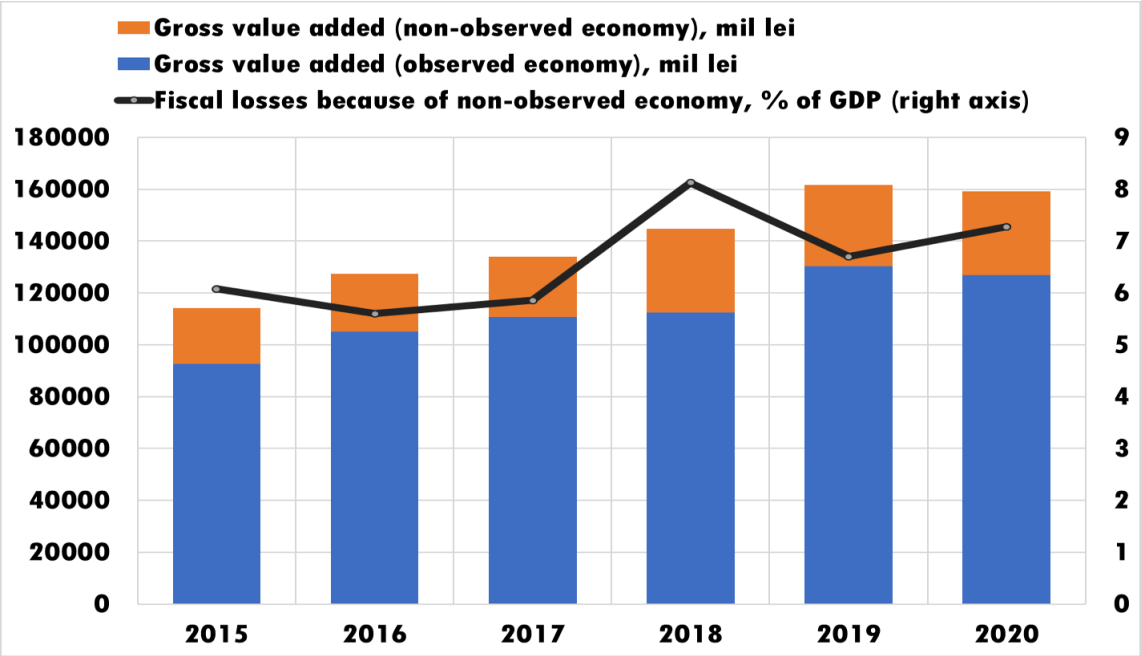
Table 5. Tax losses associated to unobserved economy

Economic activities	2015	2016	2017	2018	2019	2020
Tax revenues associated to unobserved economy, mil. MDL	38111	38111	49988,2	54815,5	58458,1	58987,3
GVA (observed economy), mil MDL	92678,05	92678,05	110804,11	112514,05	130211,20	126879,79
GVA (unobserved economy), mil MDL	21550,72	21550,72	23226,22	32105,91	31401,31	32304,07
Ratio between tax revenues and GVA associated to observed economy, %	41,12	41,12	45,11	48,72	44,89	46,49
Tax losses (not-collected revenues) associated to unobserved economy, mil. MDL	8862,07	8862,07	10478,29	15641,61	14097,56	15018,39
Losses associated to unobserved economy/ Tax revenues associated to	23,25	23,25	20,96	28,54	24,12	25,46

Source: NBS, authors' calculations
Note: It was considered that unobserved economy has 2 components: hidden production in formal sector and informal sector. The level of unobserved economy for 2020 was estimated based on authors' forecasts.

The tax losses generated by unobserved economy during 2015 – 2020 increased from 8,9 billion MDL up to 15 billion MDL annually. When reported to the Gross Domestic Product, the respective losses registered an ascending trend (with several episodes of moderate decrease in 2016-2017 and a more pronounced increase in 2018 and 2020), growing from 6.1% in 2015 up to 7.3% in 2020. A similar dynamic is registered for Gross Value Added generated by informal economy in total Gross Value Added in economy, from 18.8% in 2015 to 20.3% in 2020. At the same time, the ratio between the tax losses and tax revenues varied around the level of 25%.

Figure 26. Dynamics of losses related to informal economy



Source: Authors' calculation based on data from the NBS and MinFin

Theory of change

PROBLEM ANALYSIS

The formulation of policy interventions should be based on analysis of the problem "roots": the fundamental factors feeding the unobserved economy, and if not eliminated, it would be not possible to eliminate the problem itself. Based on the analysis of statistical data, surveys, focus groups and interviews with relevant actors, the respective description of the problem was formulated (figure 30).

Population or business decision to enter/remain in unobserved economy

The unobserved economy is based on population and business decisions to accept/enter/remain in informal economy activities.

- In case of population, it means employment without contact (especially, in case of seasonal workers and day workers) or/and with informal remuneration ("salaries in envelope"), unregistered economic activity (e.g.: market sellers, entrepreneurship patent holders), intentionally not requesting the receipts or intentional payment in cash to help the seller/service provider not to report the revenues, fully or partially.
- In case of business, it refers to imposing an employment model without contract (especially, day workers and seasonal workers) or/and informal payment of salaries ("salaries in envelope"), as well as tax evasion (under-reporting revenues and profits, to minimize/avoid paying taxes).

The respective decisions represent the middle of the theory of change. Hence, on one hand, they directly determine the dynamic of unobserved economy and, respectively, of all its consequences (e.g.: failure to collect them to the national public budget, distortion of the competitive framework, limitation of access to financing due to lack/insufficiency of official/reported revenues/assets, and last but not least, uncertainty, instability, lack of security and increased vulnerability for those who are part of unobserved economy. On the other hand, the respective decision is based on a series of preconditions, factors and rationale that ultimately the respective problem depends on – unobserved economy – and which should be the main target of policy interventions. These can be divided into two major categories:

1. Preconditions which make it possible for informal activities to exist.
2. Fundamental causes feeding the preconditions and population and business decisions.

Next, we will analyze the link between the population and business decisions, preconditions and fundamental causes, to formulate subsequently relevant policy interventions.

Precondition no. 1: Availability of cash

Cash availability is the main precondition for existence of informal economy activities, as it is much more difficult to account for and monitor them as compared to bank transfers and card payments. Respectively, companies' easy access to cash enable them to make informal payments, especially in relation to their employees (e.g.: "salaries in envelope" or salaries with no contract) or for corruption.

In its turn, cash availability is caused by the following basic factors:

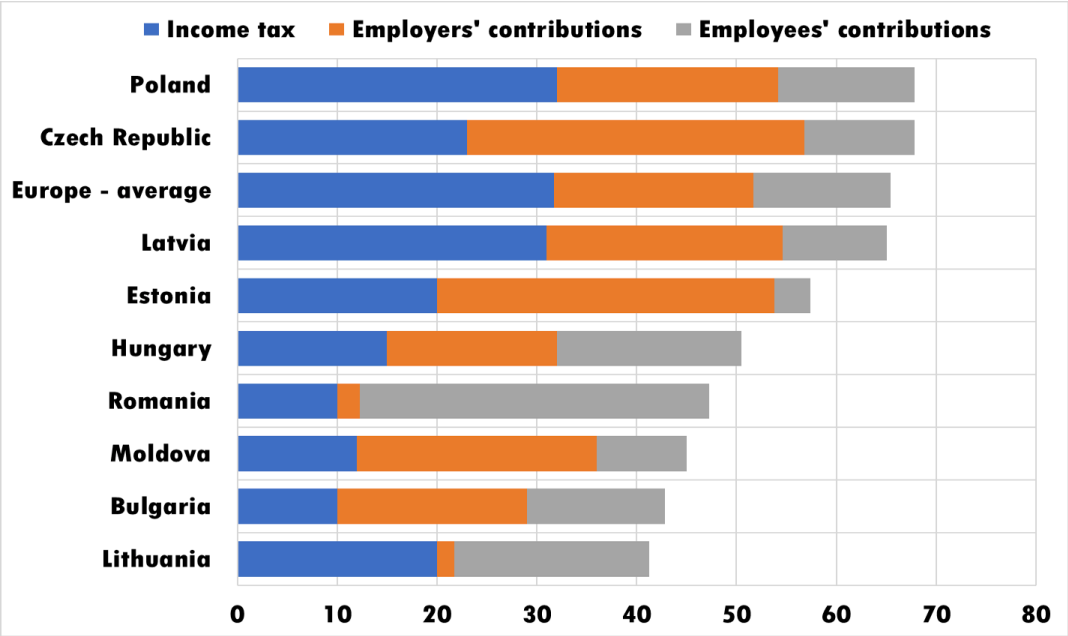
- Costs related to installation of payment terminals, as well as the bank fees applied to card transactions. This is mainly valid for market traders and/or holders of entrepreneurship patents, which represent one of the main sources of cash in the economy.
- Low level of financial education among population (a large part of population is reticent to card payments or is not used to such payments).
- Non-acceptance by many traders, especially market sellers and professional services' providers, determines the population to pay with cash.
- Regulations that allow paying the salaries in cash (it is a problem especially in case of big companies).
- Tolerance of a part of population towards tax evasion, as a measure to support the traders (surveys revealed that some persons intentionally do not request the receipts).

Precondition no. 2. High compliance costs

The propensity for tax evasion is determined by compliance costs: the more costly to work officially, the higher the motivation to enter/remain in informal economy. The respective precondition is fueled by the following basic factors:

- The perception regarding the level of taxes, fees, social and health contributions (especially, in case of paying the salaries "in envelope" and employing without contracts). Nevertheless, this perception is rather determined by low competitiveness of economy and poor financial position of population and private sector, as the level of taxes related to salaries is rather reduced as compared to neighboring countries (figure 27).

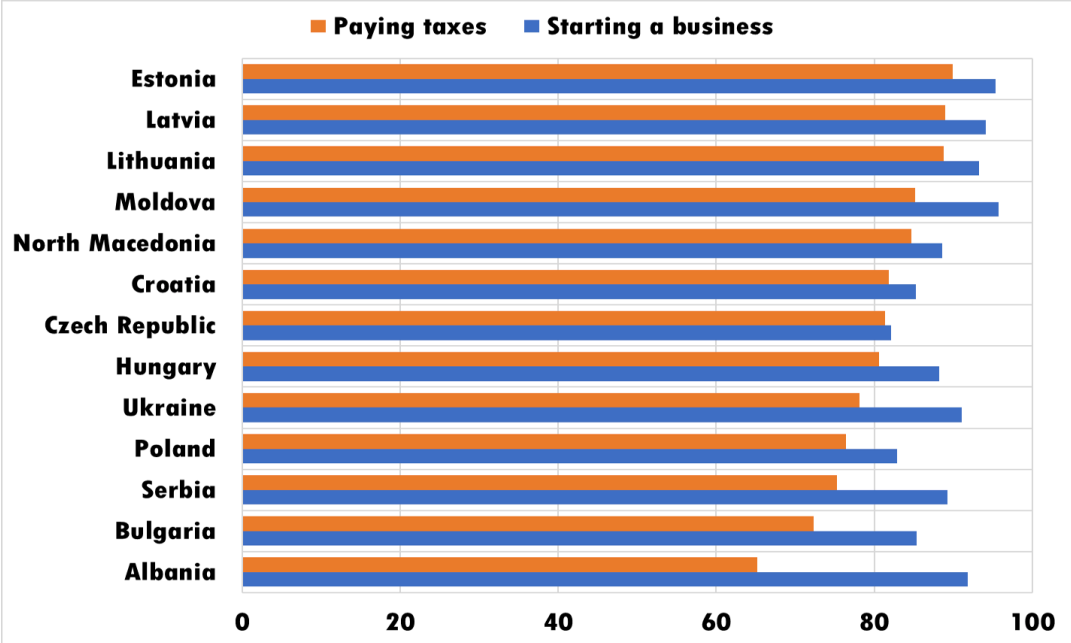
Figure 27. Level of salary-related taxes and contributions, %



Source: KPMG, 2021

- The perception regarding the high costs related to keeping the accounting records (especially, in case of entrepreneurship patent holders). Just like in case of above-mentioned perception on tax pressure, this is not determined by certain objective constraints regarding tax administration. Actually, according to "Doing Business 2020" Report, the Republic of Moldova is rather well positioned as related to other countries in the region, hence revealing that the procedures related to formalizing business or keeping the accounting are relatively favorable for business development (figure 28).

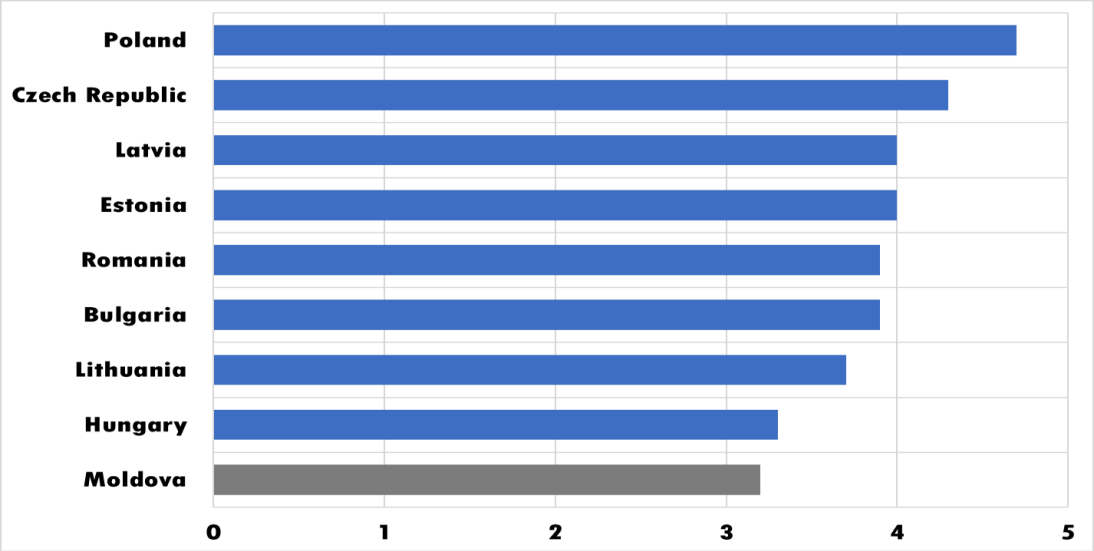
Figure 28. Doing Business 2020 scores for business registration and tax administration



Source: World Bank, "Doing Business 2020" Report

- Fierce competition that determines many companies, especially micro and small ones, to enter informal economy to survive on the market. Unlike the perception regarding the regulatory framework and tax pressure, the problems related to competition framework are confirmed by different studies of reference. Hence, according to the last edition of the Global Competitiveness Report, the Republic of Moldova registers one of the most difficult competition frameworks in the region, accumulating a rather low score for competition quality (high probability of commercial activity in diverse sectors is dominated by a small group of companies or group interests).

Figure 29. Quality of the competition framework from the perspective of the probability of domination by a small group of companies or group interests



Source: Global Competitiveness Report, 2019

Precondition no. 3. Reduced costs of non-compliance

If the previous precondition refers to formal activity costs, another precondition that feeds the unobserved economy refers to the low costs for practicing these activities. In particular, the problem lies in the low probability of identification and, respectively, sanctioning of informal employment practices, mainly in case of paying the salaries in envelope and informal employment of day workers and seasonal workers. The fundamental problem refers to the reduced capacity of the State Labor Inspection to fulfill its mandate, especially after the legal amendments operated in the Law no. 131 on state control of the entrepreneurial activity[19], which had the purpose to enhance the business climate, but had a collateral effect on the capacity of this institution. As a result, currently, the institution cannot perform unannounced controls, the number of inspection personnel was reduced over the last years, and cannot enforce any fines because they are subject to Court decisions. This has reduced substantially the costs of informal employment, fueling the motivation of companies to resort to such practices. The respective problem was reflected also in the Declaration of the 4th joint meeting of the Republic of Moldova – European Union Domestic Advisory groups on Trade and Sustainable Development[20], which focused on the need of aligning the institutional framework on state controls in the labor area with the ILO Conventions.

[19] http://lex.justice.md/viewdoc.php?action=view&view=doc&id=344613&lang=1
[20] https://www.eesc.europa.eu/sites/default/files/files/final_statement_eu-md_dags_5_july_2019.pdf

Another problem is related to the informal employment in agriculture, where the costs for non-compliance decreased after the adoption of the Law no. 22 of 23/02/2018 on day workers[21], which allows companies working in agriculture to hire temporary workers with no employment contract, no fiscal obligations or labour security. This problem is especially acute given the fact that agriculture is the main sector employing unskilled workers in Moldova, accounting for about 60% of all unskilled workers employed, who are most likely to be hired informally, based on the provisions of this law. In 2020, there were 6,5 thousand unskilled workers in agriculture, mostly men – 4.8 thousand). Still, the real number of day workers employed informally can be much higher, because often, under the provision of this law, there are hired workers with some level of qualification who cannot be considered unskilled (e.g. tractor drivers).

Precondition No. 4. Low tax morality

Alongside formal and informal employment costs, which traditionally are analyzed as basic factors fueling unobserved economy, the behavioral factors are invoked more frequently. They refer to the motivation to enter/remain in the unobserved economy based on mentality, perception or individual preferences. According to a number of economic experiments organized by Expert-Grup in 2019-2020[22], the tax morality in the Republic of Moldova is lower than the level registered in France (in comparison with which the analysis has been performed), and the main factor determining the difference between both countries is related to the quality of institutions. The fundamental factors undermining tax morality refer to:

- Negative perception of population regarding the way in which the state manages taxes and/or quality of public assets and services (according to the survey, the population with the most negative perceptions is also more prone to informal economic activities).
- Tolerance to tax evasion is confirmed by the survey. For instance, the population that does not request intentionally the receipts is more prone to informal economic activities.
- The level of financial and tax education. According to the survey, the persons who do not understand the different between net and gross salary, or those who use more rarely the card payments, are more prone to informal economic activities.

Precondition no. 5. Employees' low bargaining power

One of the most widely spread forms of unobserved economy refers to informal employment which represents, mainly, the phenomenon of "salaries in envelop" and employment without contract, es-

[21] Law no. 22 din 23/02/2018 regarding occasional unskilled workers by day workers: https://www.legis.md/cautare/getResults?doc_id=105407&lang=ro

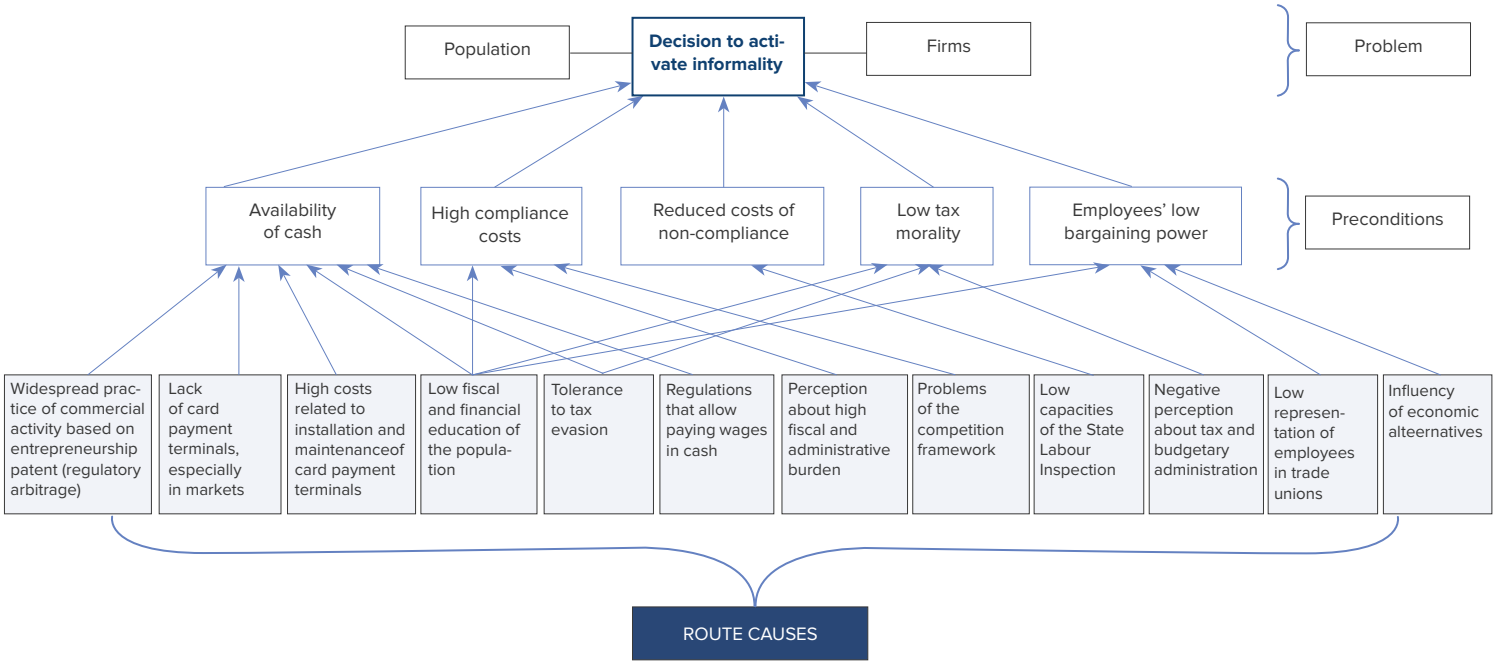
[22] According to the results of the economic experiments from 2019-2020, described in the study "Testing policy options for combating tax evasion using behavioral perspectives", Expert-Grup, 2020, https://www.expert-grup.org/media/k2/attachments/Rezultatele_experimentelor_comportamentale_evaziunea_fiscall.pdf

pecially of day workers and seasonal workers. Hence, these forms of informal activities imply the acceptance of two parties: employer and employee. The motivations of the employer are clear, taking into consideration saving of costs related to taxes and contributions calculated based on the official salary. While, the motivations of the employees are less clear, taking into account the fact that according to the survey, informal employees receive smaller and more unstable salaries as compared to the formal ones, as well as the limitations regarding social insurance and obtaining the right to allowances and other social benefits, which are calculated based on the official salary. Under these conditions, a major reason explaining why employees accept these forms of informal employment in spite of the disadvantages and losses they incur refers to the poor negotiation power of employees as compared to employers, the latter being those, who most frequently insist on informal employment practices. This conclusion is based on the results of the survey carried out among population, according to which 58% of the respondents consider that companies use these practices "rather out of their choice, in order to enrich themselves", and 59% of respondents consider that the employees use these practices because they have to accept them. The respective problem is determined by the following fundamental factors:

- Lack of insufficiency of economic alternatives, that practically leave the employees without any other option than accepting the conditions set by the employer. Hence, according to the survey among the population, about half of respondents did not have a place of work before starting informal employment, and about two thirds of those who are informally employed have accepted the respective job "so as to make additional money".
- The poor level of employees' representation in trade-union organizations. Hence, according to a representative survey implemented by ILO[23] in 2019, 82.5% of interviewed companies did not have trade-union organizations.
- The low level of tax and financial education influences also the acceptance by employees of informal employment practices, as they do not fully acknowledge the costs and the risks of such working conditions, and also do not have information and tools which would allow them to defend/promote their rights in front of employers.

[23] https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_736665.pdf

Figure 30. Preconditions and roots of the unobserved economy problem in the Republic of Moldova



Policy interventions

The immediate measures for mitigating the problem of unobserved economy should focus on its two basic components:

(i) informal activities in the formal sector, which mainly includes informal employment ("salaries in envelope" and workers without contract, especially the day workers and seasonal workers) and tax evasion;

(ii) that part of informal sector which generates revenues which are not reported intentionally in order to avoid taxes, which mainly include unregistered entrepreneurial activity and the one based on entrepreneurship patent.

The state policies should cover a complex set of measures which, on one hand, would motivate population and companies to give up informal activities, and, on the other hand, to create an environment in which it would be risky, costly and even impossible to practice informal activities. In parallel, the government should provide the entire possible information support to encourage the formalization of economic activities.

Based on the analysis of the problem provided in the previous section, it may be concluded that policy interventions should target the preconditions and fundamental factors fueling the problem of unobserved economy. Hence, the policies would eliminate the following 5 preconditions which feed the unobserved economy through a number of measures targeting the "roots of the problem".

Also, for each recommended policy intervention, we will formulate ideas for programmatic interventions of PNUD and other development partners.

1. DISCOURAGING CASH TRANSACTIONS

Informal economic activities could not take place without cash. Hence, it is necessary to encourage cashless transactions and to discourage, in parallel, use of cash. The following policies are necessary for this purpose:

- **Policy intervention 1.1:** Boosting the activity of the National Council of Payments. Promoting cashless payments and reducing cash out of circulation was one of the strategic objectives included by the NBM in the strategic plan for 2013-2017. The respective objective should have been achieved, including by establishing a National Council of Payments, which was established on September 16, 2013. Unfortunately, the activity of the respective council was not sufficiently visible during the implementation of the strategic plan. The functions of the council include the following: identification of existing impediments in the normative acts for the activity and daily operations of the participants on the payment services' participants, as well as the interests of final consumers. The role of this professional forum is crucial in achieving the objective of promoting cashless payments, hence its visibility should be increased considerably[24]. One of the key points to be coordinated and solved by the Council is related to the high commissions related to the inter-bank transactions and those related to card payments, which is currently a crucial barrier for promotion of cashless payments.

- **Policy intervention 1.2:** It is necessary to develop a support program for small and medium enterprises that would subsidize the costs related to installing the terminals and the fees related to card transactions. This would allow to diminish directly the costs associated with the card payments, which currently are incurred by the entrepreneurs and fuel their reticence towards transition to cashless payments. This refers mainly to transactions in the markets, activity of micro and small enterprises, start-ups and holders of entrepreneurial patents.

- **Policy intervention 1.3:** Extending the possibility to pay for all public services through cashless payments (via electronic platforms or banks' subsidiaries), without fees and commission. The development of the M-pay system proves the potential of implementing an enabling framework for promoting cashless payments, thus it is imperative to extend the possibilities to pay for any public service via electronic means. Additionally, until currently, a fee is collected when paying for certain public services via banks. The respective fee is intended to cover the operation costs of banks and

[24] "Diminishing corruption by developing cashless payments", Eugen Ghilețchi, Expert-Grup, 2019, https://www.expert-grup.org/ro/biblioteca/item/1727-economia-informal%C4%83-%E2%80%9Ela-punct%E2%80%9D-diminuarea-corup%C8%9Biei-prin-dezvoltarea-pl%C4%83%C8%9Bilor-f%C4%83r%C4%83-numerar

payment processing companies. In case of paying for private transactions with a bank card, the economic units are the ones to cover the transaction costs, while in case of public services' context, the state leaves the costs on citizens' account. Besides, in some cases, the possibilities to pay for services are limited at a certain bank, or a limited number of means of payments. As banks are among the main beneficiaries of the cashless payments, the banks could share the burden of the fees associated to card payments, with all the banks being obliged to accept payments for public services[25].

- **Policy intervention 1.4:** Prohibition of payments of salaries in cash. Taking into account the restrictive nature of this measure, at the very beginning it can be applied only for big enterprises and, subsequently to be transposed to all enterprises. The respective measure will contribute to popularizing card payments and will discourage the use of cash.
- **Policy intervention 1.5:** Promotion of financial and tax education of population that would cover the importance of card payments, their peculiarities, including about frauds' avoidances by using bank cards. At the same time, financial education should focus on diminishing the population tolerance to tax evasion, by informing the general public about the costs and risks of these activities.

2. MITIGATION OF COMPLIANCE COSTS

The most frequently invoked measures to mitigate informal costs refer to reducing taxes and fees. Nevertheless, this measure not necessarily would have the expected effect, taking into account the fact that the level of tax pressure in the Republic of Moldova is not higher than in the countries from the region, and the tax preferences provided in the agricultural sector proved that they not necessarily contribute to solving the problem of informal economy. Hence, for the purpose of mitigating the compliance costs, it is necessary to come up with measures targeting the most vulnerable groups of enterprises: micro and small enterprises, as well as unregistered businesses, including those operated by individuals holding entrepreneurial patents. The following actions are necessary in this respect:

- **Policy intervention 2.1:** Formalization of activities undertaken by holders of entrepreneurial patents and easing the activity costs of SMEs. The holders of entrepreneurial patents and the markets where they work represent one of the main sources of cash and informal economic activities. The problem is not the patent per se, but the fact that these entrepreneurs do not use cash registers and do not pay taxes, hence creating unfair competition conditions as compared to those who pay all their tax duties. Thus, these enterprises should be encouraged to formalize their activities, by installing cash registers, terminals for card payments and keeping the accounting

[25] Ibidem

records. In this respect, measures for direct support to the respective enterprises are needed, especially to cover the costs related to formalization of their activity. It could take the form of vouchers for covering the costs related to installing the card payment terminals and accounting services for certain period of time (e.g. 1 year) for the holders of entrepreneurship patents. Also, for micro businesses that will remain to activate under patents, the Government should exclude the retail and wholesale trade from the list of eligible economic activities to be conducted under this permissive act. Besides, the reporting and accounting keeping requirements set for micro and small enterprises should be substantially simplified. Also, accounting procedures should be digitalized in order to ease the administrative burden of bookkeeping on businesses, especially on SMEs. And last, but not least, the control institutions (especially the State Tax Inspectorate, the State Labor Inspectorate, the National Food Safety Agency) should review their approaches so as to focus on offering consultancy to companies in relation to compliance with legal provisions.

- **Policy intervention 2.2:** Improving the competition framework by identifying and counteracting anti-competitive practices. In this respect, it is necessary to strengthen institutionally and to raise the accountability of the Competition Council, for it to become more proactive in fulfilling its mandate. Namely, the Council should pass through a functional assessment and benefit of an institutional strengthening program, by endowing it with more staff and financial resources that would allow it to exercise its mandate properly. Also, it is necessary to conduct an assessment of the competitive framework in the key sectors of the national economy in order to identify the risks and formulate priorities for interventions.

3. INCREASING THE COSTS OF NON-COMPLIANCE

Policies should lead to higher likelihood of identifying and sanctioning those who practice informal economic activities.

- **Policy intervention 3.1:** The role, prestige and institutional competences of the State Labor Inspection in relation to preventing, identifying and penalizing informal employment practices should be substantially enhanced. These problems should be tackled via an ample reform of the Institution, which should implement the provisions of the ILO Conventions ratified by the Republic of Moldova, focusing on:
    - allowing the Labour Inspection to organize unannounced controls based on identified risks;
    - increasing the staff for the purpose of fulfilling the mandate completely;
    - enhancing the capacities of the institution, with focus on identifying practices of “salaries in envelope”, informal employment of seasonal workers and day workers;

- improving communication and exchange of information/data of the institution with other relevant institutions, for the purpose of finding at early stage or ex-officio (without performing controls) potential practice of informal employment;
- increasing the accountability of the institution and minimizing the discretion of inspectors, so as to decrease the risks of corruption and abuse, enhancing at the same time the above-mentioned control function.
- elaboration of an informational system for recording employment contracts that should be managed by the State Labor Inspection, with the introduction of the obligation to register the contract before the first working day of the employee.

- **Policy intervention 3.2:** Revising the Law no. 22 on day workers in order to ensure their integration into labour regulatory and fiscal space. While the simplification of employment terms for day workers in agriculture in 2018 was a necessary step towards easing the costs of doing business, especially for companies/farmers employing large number of temporary and seasonal day workers, with whom it was very difficult and, often, impossible to sign employment contracts, this measure should not undermine the social and economic rights of these workers. It is important to revise the above-mentioned Law, and other relevant regulatory framework, in order to integrate these workers into the legal and fiscal space (e.g. examine the opportunity to ensure that the fiscal obligations are paid by the employed on the account of employee – similar to regular employment contracts; granting the labour security to day workers hired under the scheme stipulated under the above-mentioned Law).

4. INCREASING POPULATION TAX MORALITY

Alongside increasing the cost non-compliance and decreasing the compliance costs, it is necessary to have policies with a longer-term impact to change population perception on payment of taxes, to change social norms in favor of tax compliance and to inform population about the importance of formal activities and costs/risks of informal activities. Namely:

- **Policy intervention 4.1:** Launching an information and tax education campaign for population[26]. People tend to copy a positive or negative behavior, meaning that there is strong correlation between the declaration rate of one person and the average declaration rate of other persons from the respective group. Negative behavior is more contagious than the positive one: it is sufficient for a group to observe tax evasion (even at low rates) for the members of the group to adopt actively a dishonest behavior (hence leading to a cascade of dishonest behaviors). The campaign should focus on: permanently informing the population about the tax compliance in the country/community (spreading positive information) in

[26] According to the results of economic experiments from 2019-2020, described in the study "Testing policy options for combating tax evasion using behavioral perspectives", Expert-Grup, 2020, https://www.expert-grup.org/media/k2/attachments/Rezultatele_experimentelor_comportamentale_evaziunea_fiscall.pdf

order to motivate the population to copy/replicate this behavior, disseminating information materials (infographics, videographics, toolkits) on the benefits of tax compliance, organizing talk-shows on TV and radio on this topic.

- **Policy intervention 4.2:** Developing a program for voluntary denunciation[27]. When citizens may mutually observe positive and negative social behavior, denunciation may contribute to reducing the frequency of dishonest behavior. The social information messages may indeed be completed with a denunciation program. If negative information reaches a community and its members may denounce those who do not declare all their incomes to tax authorities, the frequency of tax evasion could be drastically reduced. The potential benefits of introducing such a denunciation program should be weighed against the marginal costs of such a program operation (public resources should be allocated for taking over the calls from those who denounce and to investigate the denunciation reports). Nevertheless, the economic experiments performed in Moldova show that the simple threating with denunciation may act as a powerful incentive to avoid tax evasion. Actually, the experiments performed in Moldova show that participants are very sensitive to auditing within an environment in which others may denounce. Hence, although the introduction of a denunciation program would need initial public investments to ensure its correct functioning, the data suggest that the program may function as a simple threat in the long run and would need fewer public resources. The success of this program would be ensured by three key elements: (i) rapid responsiveness of the tax authority to all denounces; (ii) legal and personal protection for whistleblowers, including the preservation of their full anonymity; and (iii) active promotion of this instrument in the community/society as a tax compliance mechanism.

- **Policy intervention 4.3:** Developing a feedback mechanism for current and potential taxpayers. Even though the payment of taxes is mandatory, the state should treat the current and potential taxpayers as "its clients who pay (contribute with taxes and fees) to benefit from services". The surveys show that the level of tax compliance grows to the extent in which the taxpayer consumes or anticipates the benefits in the near future from the paid taxes. The most eloquent examples would be pensioners, persons who get close to their retirement age and the beneficiaries of maternity leaves. At the same time, the population that does not rely intensely or at all on public services and do not plan to do it in the near future (e.g.: youth), shows an increased propensity for informal activities. Hence, it is necessary to develop for the population which does not benefit actively from public services a feedback / information exchange mechanism to fill in the lag between the payment of taxes and the moment in which the taxpayer benefits from the respective taxes (e.g.: obtains an allowance, gets a childcare leave, goes to the doctor or obtains the right to pension). In this

[27] According to the results of economic experiments from 2019-2020, described in the study "Testing policy options for combating tax evasion using behavioral perspectives", Expert-Grup, 2020, https://www.expert-grup.org/media/k2/attachments/Rezultatele_experimentelor_comportamentale_evaziunea_fiscall.pdf

respect, it is necessary to extend the existing information system, which already provides data about paid taxes and fees, available on the platform mcabinet.gov.md. First of all, this should be promoted more intensely among the population. Secondly, besides the information about the paid taxes and contributions, it is necessary to provide additional information regarding the anticipated benefits for taxpayers, as well as for potential taxpayers: the approximate amount of the allowance for raising the child or unemployment allowance, the approximate amount of the pension, and other rights of the taxpayer to call upon the social or health insurance system that depend on the amount of taxes paid (in the case of potential taxpayers, there could be provided comparative estimations about the amount of social benefits, depending on the potential taxes that could be paid). The respective information has critical importance for promoting benefits of tax compliance and should complement the data on paid taxes, so as to avoid adverse reactions (e.g.: transition from formal to informal activities in situations when the taxpayer knows the volume of paid contribution and taxes without acknowledging the benefits).

5. ENHANCING EMPLOYEES' POWER OF NEGOTIATION WITH THEIR EMPLOYERS

Taking into account that most of the times the informal workers do not have the possibility to negotiate with their employers better working conditions, measures are necessary to equip the employees with information and tools in this respect. In particular:

- **Policy intervention 5.1:** Facilitating the training of trade-union organizations and providing support for their development. This could be possible based on a dedicated program, which would encompass the development of practical guidelines for training trade-union organizations, consultancy and mentorship, as well as grants for their institutional development.
- **Policy intervention 5.2:** Developing and promoting at the level of the State Labor Inspectorate of a mechanism for anonymous reporting of informal employment cases. The success of this tool will depend on the sensitivity of the institution to the respective notifications and the impact of these denunciations. Hence, it is important for the implementation of this mechanism to be in parallel with the reform and strengthening of the institution according to the above-mentioned recommendations.
- **Policy intervention 5.3:** Promoting an information campaign regarding the rights of employees, as well as the risks and costs of informal employment. Although such campaigns were implemented previously, it is necessary to focus more on increased visibility, and more practical and accurate information about this subject.

Figure 31 shows the relation between objective actions and goal, which resonates with the illustration of preconditions and basic factors of unobserved economy problem in Figure 30.

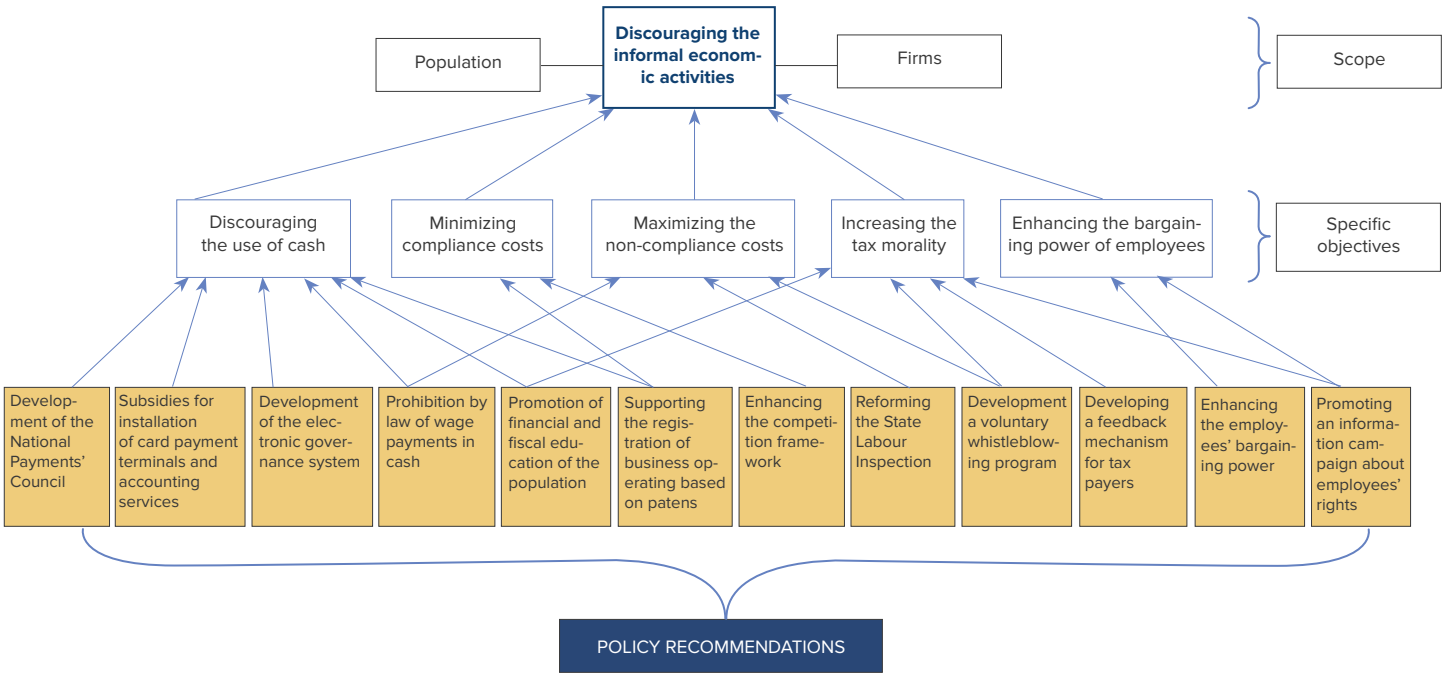



Figure 31. Preconditions and roots of the unobserved economy problem in the Republic of Moldova