This short note has been prepared at the request of the Ministry of Social Policy of Ukraine to the World Bank.

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Executive summary

Informal employment—that is, work that in itself is legal but not declared to the authorities for tax, social security and/or labor law purposes—plays an important role in virtually all economies. Detecting illegal employment and enforcing the law in cases of undeclared work remains highly problematic in practice. Due to fiscal losses resulting from undeclared economic activities and negative economic and social effects of informality, many countries are trying to enhance formal employment. Based on an international survey, this paper identified a series of policies that have been successful in reducing informal employment to some degree in a number of countries. The next step would be to evaluate the extent to which these policies could also be successful in the Ukrainian context. Here are some of these policies:

- The main instrument available to labor, social security, or tax inspectorates to detect undeclared work are unannounced visits to the work site, which determines the identity of all persons found there with subsequent sanctions for non-compliance. While several public institutions are and will remain involved in addressing informality, international experience suggests that a single authority should be charged with giving them coherence and pushing their implementation - a governmental champion. Institutional strengthening (staffing, training, technical assistance) of the agencies involved with compliance as well as information exchange (linking computer databases) and more close cooperation between labor, social security and tax inspectorates is important for achieving better detection.

- Although the strengthened control measures (improved inspections and higher penalties) have facilitated the increased transfer of people from illegal employment to partly declared work, they have failed thus far to eliminate or significantly reduce illegal employment. Transition into the formal market has not been ensured only by prohibiting illegal employment and increasing penalties for offenders. A combination of both deterrence policies and policies encouraging transition into the formal market seems to be necessary.

- Preventive measures encompass simplification of procedures and pulling off constraints which limit the creation and development of businesses, in particular start-ups and small undertakings; removing disincentives to declare work on both the demand and the supply sides.

- Reforms of employment regulations ensuring protection of workers but allowing greater flexibility in the labor market are important to improve incentives for firms to increase registered employment (see also the separate Technical Note for the Government of Ukraine ‘Reforms in Employment Regulations: International Experience Applicable to Ukraine’).

- Involving the social partners (registered employers and trade unions) that have strong and shared motivations is important to reduce the prevalence of undeclared work in their sectors and workplaces. They could be encouraged to work together to explain the problems with informality to their constituencies while, at the same time, committing themselves to fighting undeclared work in collective agreements.

- Altering perceptions about informality is usually also part of the effort to reduce informality. Public information and education is the final element in a comprehensive strategy to reduce undeclared economic activity. Many potential beneficiaries may ignore or are simply unaware of the costs while working informally, such as lack of access to sick
leave and maternity leave benefits and to unemployment or pension insurance for the years worked informally, or may not know about available financial or technical support to SMEs by the public sector, or of simplified requirements for SMEs to promote formalization. The government could use media, in particular public service campaigns on television and radio, to spread information on the benefits of formalization of employment, in particular in SMEs. Campaigns could also focus efforts on sectors where undeclared activities are significant. Successful enforcement and sanctioning of tax evasion cases involving the rich and powerful could be widely publicized. Campaigns could be directed especially towards the younger population.
I. Introduction

The informal sector is present even in the most developed countries, and has some important social and economic functions. First, it provides job opportunities to workers who cannot find jobs in the formal sector. As such – by providing income opportunities of last resort – the informal sector is a social safety net for the poor. Second, informality is often a way to start a business and can be a stepping stone to formality. However, the social costs of informality – forgone tax revenues, lower productivity and lack of social security coverage – outweigh the potential social benefits outlined above (a social safety net, a trampoline to formal business). Accordingly, effective policies to promote formal employment enhance social welfare.

This survey is intended to assist the Government of Ukraine in its efforts to promote formal employment by presenting examples of policies used in other countries. However, the evaluation of those policies was not carried out and their impact on informal employment is difficult to estimate. Nonetheless the examples discussed show main directions for reforms aimed at reducing informality. Workers and firms choose not to register their activity if the benefits associated with registration fall short of the costs. The benefits of registration include access to credit and other business services as well as access to social security benefits. The costs of registration include payment of taxes and social security contributions, costs imposed by government regulations, and other administrative barriers.

Policies to promote formal employment consist of lowering the costs and raising the benefits associated with formalization. They also include policies that raise the cost of non-compliance with statutory regulations, such as inspections. They fall into four groups: (a) tax policy, including social security contributions, (b) labor regulations, (c) broader business regulations, and (d) institutional reforms, including sanctions for non-compliance. In the longer run, formality is fostered by economic and institutional development, including human capital formation, wider access to finance, and so on. Within those four broad groups governments were adopting different mix of policies, depending on country specific circumstances. For example, to lower the costs of formality governments adopted a range of measures meant to improve the business environment, including lowering taxes and simplifying tax administration, simplifying the business registration procedures, removing bureaucratic barriers to firm activity (for example, by reducing the number of permits), and liberalizing labor regulations. In order to increase the benefits of formality governments tightened the link between social security contributions and benefits so as to strengthen the incentives for workers to formalize their employment status. They also have strived to improve access to credit and other business services to strengthen the incentives for firms – especially small ones – to register their activity and pay taxes.

The note starts with a brief presentation of main issues related to informal employment. It then proceeds with a review of policies to reduce informal employment adopted in recent years in OECD and EU countries. The policies are discussed under four headings, which correspond to
the policy groups mentioned earlier: taxation, labor regulations, business regulations, and administrative measures. The last section concludes.

II. Informality – key issues

The informal economy refers to activities and income that are partially or fully outside government regulation, taxation, and observation. The main attraction of the undeclared economy is financial. This type of activity allows employers, paid employees, and the self-employed to increase their take-home earnings or reduce their costs by evading taxation and social contributions. On the one hand, informal employment can provide a cushion for workers who cannot find a job in the formal sector. But, on the other hand, it entails a loss in budget revenues by reducing taxes and social security contributions paid and accordingly less provision of public goods and services. A large informal sector also invariably leads to a high tax burden on registered labor and firms because of the narrow tax base.

A high level of informality also can undermine the rule of law and governance. The fact that a large share of the population is openly ignoring laws, regulations and taxes can weaken the respect citizens have for the state. This situation also means that a significant share of the population does not have access to formal social protection instruments to protect itself against economic risk.

Informal employment (including self-employment) plays an important role in virtually all economies. It can provide “work of last resort” for displaced workers from contracting enterprises and others who cannot find jobs in formal sector. In addition to this “safety net” role, informal employment may represent the beginnings of entrepreneurship. Not surprisingly, a significant portion of independent or self-employed workers are voluntarily informal, attaching significant value to the non-pecuniary benefits of autonomous work and choosing to “exit” from the formal social protection system.

There are various reasons why governments may be concerned about large informal sectors. These include potentially negative consequences for competitiveness and growth, incomplete coverage of formal social programs, undermining social cohesion and law and order, and fiscal losses due to undeclared economic activity. For most governments, these concerns outweigh any advantages that the informal sector offers as a source of job creation and as a safety net for the poor. But it also reflects an increasing awareness of the potentially negative economic and social effects of informality.

Efforts to enhance formal employment have focused not only on removing barriers but also on improving the incentives to opt for formalization. This requires an understanding of the motivations for operating informally. Where undeclared economic activity is the result of exclusion due to constrained opportunities in the formal sector, policy reforms need to be directed towards minimizing or removing any regulatory barriers. The classic example is a minimum wage set too high that constrains employment in the formal sector. However, when
informality is seen through the lens of voluntary exit, policy-makers need to focus more on reforms that are likely to shift the cost-benefit assessment of entrepreneurs and workers in favor of operating formally. This includes measures that both increase the relative cost of undeclared activity ("sticks") and increase the relative benefits of declared activity ("carrots"). Identifying effective carrots and sticks requires an understanding of why entrepreneurs and workers choose not to declare activities and income.

The large informal sector has important ramifications for the economy. Informal firms cost developing countries between 1-2 percentage points in annual GDP growth, according to various studies. This is due to two related effects. First, firms and workers who may have avoided being formal because of the high costs involved, which can lead to significant productive resources being "trapped" in low productivity operations with little access to capital. Second, the growth of formal firms can be significantly slowed because of fiscal and regulatory obligations that prevent these firms from out-competing informal firms, despite the fact that they are more productive. In other words, a high degree of informality can result in a low-productivity equilibrium.

A significant portion of self-employed workers are voluntarily informal, attaching significant value to the nonpecuniary benefits of autonomous work and choosing to ‘exit” from the formal social protection system. Also, informal employment may reflect exclusion from the formal job sector, and can be the last resort given the lack of better alternatives.

Workers uninsured against health, old age, and other risks may have lower productivity and fewer incentives to invest in human capital accumulation. Irregular firms are likely to have a harder time attracting more educated workers and engaging them in a longer-term relationship—and that in turn affects their incentives to invest in training and capital goods.

Firms unable to access credit, larger sales/product markets, and sources of innovation, and those evading taxes may operate at a suboptimal scale. Competition with non-complying firms leads to productivity losses in formal firms. At the aggregate level, a large concentration of workers in small firms rather than larger firms may lead to lower productivity growth. On the other hand, low productivity may be the main reason why many small firms and their employees remain informal. The fact that many small firms operate in the informal sector (that is, size dualism) may just be a natural result of their lower managerial ability.

Formality tends to increase rapidly with firm size and productivity, and it is higher among those who voluntarily enter self-employment. Similarly, young firms tend to have higher costs and high failure rates and, at the same time, are more likely to be informal. Moreover, in most countries, the informal sector tends to expand during downturns, partially due to the fact that as the economy slows, formal sector hiring falls sharply while informal hiring falls much less. Overall, informality, measured as the share of the workforce, falls with development.

Undeclared activities tend to be concentrated in certain sectors of the economy. The majority of workers in the informal sector are in marginalized economic activities and in labor-intensive
sectors such as agriculture, construction, retail trade, catering, and domestic services. Self-employment accounts for the bulk of employment in the informal sector. In particular, in Ukraine, the informal sector represents around 22.1 percent of total employment.

III. Policies to reduce informality
In the European Union, relevant policies on the issue are based on four main pillars:

- **Preventive actions**: the aim is to simplify procedures and reduce the costs and constraints which limit the creation and development of businesses, in particular start-ups and small undertakings; to remove disincentives to declare work on both the demand and the supply sides;
- **Sanctions**: the aim is to strengthen surveillance and to apply appropriate sanctions in respect of those who benefit from clandestine labor and also to protect the victims, notably through better coordination between the relevant authorities (tax offices, labor inspectorates, police);
- **Cooperation between Member States** with a view to combating social security fraud and undeclared work in the framework of transnational economic activities;
- **A campaign to raise social awareness** as regards the negative implications of undeclared work for social security and the consequences of undeclared work for solidarity and fairness.

Therefore, policies to address undeclared work have usually found a balance between preventative measures and sanctions. Countries in the EU, elsewhere in the OECD, and many transition countries have had a great deal of experience in attempting to reduce undeclared work and informal economic activities. Efforts have largely fallen into four broad categories:

- Tax and other direct fiscal measures,
- Labor regulations and other employment interventions,
- Broader business regulations, and
- Administrative measures.

**A. Tax policy**

Tax policy has been a major instrument in combating informality. The tax and fiscal category include two types of measures. The first focuses on removing incentives for evading tax liabilities by lowering payroll taxes, social security contributions, or other taxes for firms and/or employees. The second category, direct fiscal measures, attempts to capture the people that would otherwise not pay taxes using tools such as presumptive tax systems which put the burden of proof on the employer.

Since the mid-1990s, a number of emerging market economies have implemented important reforms to their tax systems, in particular, aimed at reducing the tax burden on labor,
particularly at the low-middle end of the pay scale, and at reducing corporate income tax rates while broadening bases. Slovakia implemented a comprehensive tax reform that unified tax rates and eliminated most exemptions. Top corporate income tax (CIT) rates now vary between 28 percent in the Czech Republic and 15 percent in Latvia and Lithuania, while Estonia has no tax on re-invested earnings. Standard value-added tax (VAT) rates vary between 18 percent in the Baltic countries and 25 percent in Hungary. Slovakia and Estonia have flat rate personal income tax (PIT). For example, Estonia is going to gradually reduce income tax rate from 26 percent in 2005 to 18 percent by 2011, and increase tax deduction level to about USD 250 per month.

Bulgaria has increased the level of non-taxable monthly incomes from 100 levas in 2002 to 180 levas in 2006, which is above the level of minimum wages of 160 levas. Moreover, Bulgaria decided to replace the three-bracket personal income tax rate system with a flat rate of 10 percent. Also the Government is expected to introduce further a 3 percentage points cut in the social security burden.

Various countries such as Belgium, Netherlands and France have introduced special payroll tax reductions for low-wage earners. The estimated employment effect, however, has varied. In Belgium, for example, the tax cut seems to have had a significant impact on registered employment but not in the Netherlands.

Many countries have introduced various tax concessions and benefits to certain categories of employees:

- Ceilings on social security contributions, which make this component of the personal tax system regressive, are a significant feature in Austria, Canada, France, Germany, Greece, Ireland, the Netherlands, Spain and Turkey. However, in several cases, they apply only to certain categories of contribution, and the schedule for social security contributions combined with personal income tax may remain progressive.
- The self-employed in the Czech Republic, Greece, and Portugal were allowed to pay lump-sum contributions or lower contribution rates than employees, and the self-employed in Hungary, Mexico and Spain had access to special simplified tax regimes.
- A number of OECD countries gave full relief from double taxation on profits distributed as dividends.
- Several European governments, such as France, Belgium, the Netherlands, have introduced tax concessions in sectors where the incidence of undeclared work is high (e.g. domestic staff, home improvement and repair services).

For example, France introduced payroll tax subsidies in 1993 and the system is still in place in a modified form. The program provides payroll tax exemptions for low-wage workers according to a sliding scale up to a threshold of 1.33 times the minimum wage, when the subsidy is stopped.
Broadening the tax base is important for tax policy reform owing to the urgent need to increase government revenue, reduce fiscal deficits, and ensure macroeconomic stability. The potential for raising more revenue through the application of presumptive taxation methods to bring hard-to-tax groups into the tax net has not yet been fully exploited in the countries with high informal economies.

Imputed or presumptive taxes are taxes based on notional income calculated based on key factors which are associated with income generation. These might be sales, turnover, number of employees, size of firm, assets of the taxpayer, and so on. Presumptive taxation ideally involves simple and cost-effective techniques to capture domestic transactions and sources of income that frequently escape taxation under conventional norms. These techniques include lump-sum levies on small-scale business activities (standard assessments); the assessment of taxes through indicators or proxies that help estimate a taxpayer's income (estimated assessments); and the collection of minimum taxes irrespective of a taxpayer's actual level of business activity (presumptive minimum taxes).

Forms of presumptive taxation can be found in transition countries as well. In Bulgaria since 2003, to improve revenue collection, minimum social security contribution levels are negotiated between the social partners – by 73 sectors, branches and activities, and nine professional groups in each of activity. For the self-employed, the minimum monthly taxable income was established at 220 Leva; in agriculture, 110 Leva; and the maximum taxable income was set at 1,400 Leva (in 2006). This measure, plus mandatory registration of labor contracts with the National Social Security Institute (NSSI), and a more rigorous enforcement of labor legislation by the State Labor Inspectorate, as well as by tax and NSSI authorities, has led to rapid growth in the number of registered new labor contracts, by almost 600,000 new insured persons between 2002-2006, and thus in revenues to the social security system.

For a given tax revenue, a partial shift from social contributions to income or consumption taxes may have favorable employment effects, including reducing incentives for under-declaring earnings per employee and thus increasing tax revenues. As well, strengthening the links between taxation and expected benefits may help reduce the adverse employment effect of the tax wedge -- for example, creating a stronger link between contributions paid and expected pension benefits or access to health services.

These reforms would often need to be done in a budget neutral manner. While lowering the tax wedge might partly finance itself through increased revenues due to higher employment and output, these are likely to be insufficient to fully compensate for the lower contribution or tax rates. Additional revenue measures or preferably expenditure cuts would likely be required.

Also simplification of tax administration through online filing and tax payment lowers transaction costs and minimizes opportunities for corruption. Complicated tax systems lead to high evasion even when rates are low. Moreover, simplifying the tax regime by reducing tax rates and eliminating exemptions is the main way to reduce corruption in tax administration.
Finally, criminalization of certain tax offenses in combination with a modernized tax administration agency has been credited with playing a key role, among other factors, in Spain’s success in drastically reducing tax evasion and eventually doubling the ratio of tax revenue to gross domestic product.

B. Labor regulations

Labor regulation and other employment interventions encompass all issues related to hiring practices and ensuring basic labor rights through minimum wage and various local policies, as well as employability programs to help workers access formal jobs. Labor market policy reforms can reduce incentives on the part of firms and workers to operate informally, while employment programs can better equip workers for the formal labor market. Labor regulations, in particular, have been an important focus of efforts to reduce informal employment. For example, improving the flexibility of employment protection laws and reducing minimum wages can reduce the costs of hiring formal workers and, thus, can improve incentives for firms to increase registered employment.

Many countries in EU have initiated measures to transform illicit (household) service jobs into legal jobs, and reducing legislation on temporary work to prevent evasion of taxation liabilities. For example, in 2002, Germany conducted extensive labor market reform to improve its efficiency and address concerns of long-term unemployment through recommendations of the Hartz Committee. The reforms were a series of graduated employment programs, ‘mini-jobs’ and ‘midi-jobs’, to assist individuals that were unemployed or employed in the informal sector transition to normal employment. Until 1999, mini-jobs were completely exempt from social security contributions with a lump sum tax of 23 percent for employers and none for employees. The program provided liberal eligibility requirements with limits on income and work hours and was generally enjoyed by students, pensioners, and families as second income who were considered small enough that tax and social security exemptions were not thought to be a threat to the state financial system. However, the prevalence of mini-jobs increased dramatically in the 1990s to 6.5 million and accounted for 60 percent of all catering jobs and 70 percent of all cleaning jobs creating a need for reforms.

Employee rights to social security benefits or employment protection can create an incentive for employees to inform the authorities when they are laid off, even from undeclared work. In Japan, the public employment service (PES) accepts claims for unemployment benefit even when the employer has not actually paid insurance contributions. An enterprise that does not pay insurance contributions thus runs a risk of detection when a former worker applies for benefit. A system of insurance benefits, although it may lead to some fraudulent claims, can make a significant contribution to suppressing undeclared work in the economy as a whole if workers losing jobs are actively encouraged to claim the benefit.

Incentives to formalize especially casual employment and to combat undeclared employment have been proposed in many countries. For example, in Hungary, programs such as START; START PLUSZ, and START EXTRA have been introduced to facilitate the employment of
underprivileged persons (recent school graduates; people above the age of fifty; job seekers seeking employment after providing child care or care for other dependant relatives, and on internship employment) through tax exemptions and reduced tax and social security contributions.

In the field of labor relations, strengthening the capacities and competencies of labor inspection authorities is usually a very important tool in the fight against informality. Improved law enforcement and the application of sanctions can be achieved through (i) better cooperation between the relevant authorities (inter alia tax offices, labor inspectorates, police); (ii) reinforcement of the number of labor inspectors, better working conditions and performance based remuneration systems; (iii) investment in training and participation in international conferences to update knowledge and develop skills in relevant areas of expertise.

This would lead to more frequent controls of enterprises in order to evaluate the compliance with labor relations and work conditions legislations. Also it seems that fees and penalties for violation of labor laws do not have a desired impact given that violations are found in two thirds of firms and employers under investigation.

Also the European Commission's Green Paper (2006) on Labor Law highlighted a need for more effective cooperation at national level between different government agencies, such as labor inspectorates, social security and tax authorities, and stated that "improvements in the resources and expertise of these law enforcement authorities, and in their cooperation with partners, can contribute to reductions in the incentives to undeclared work".

Trade unions (or other representatives of the employees) can also play a role in reducing undeclared work. They are best positioned to assess the situation in their enterprises and industries and, through collective bargaining, develop rules that determine such important matters as wages, benefits, and overtime and part-time work arrangements, without sacrificing an appropriate level of social protection. This would enable workers to benefit from de facto rather than just de jure employment protection because, by being partners in a negotiated settlement, their employers would have less incentive for non-compliance, and enforcement would be easier.

Collective agreements may commit both parties to denounce black-market work. In Belgium, a recent agreement with the Labor Ministry commits the cleaning and transport sectors to informing the public about the quality and guarantees offered by enterprises which respect the law, to notify illegal practices to public authorities and themselves take cases to court. In Switzerland, collective agreements in construction, plasterwork, painting, hairdressing, heating, ventilation, plumbing, metalwork and carpentry contain measures against black market work, and have been extended to all employers in these sectors.
C. Business regulations

Business regulations deal with business practices such as registration, procedures, and general business environment. Business regulations, more generally, can also affect decisions firms make about whether to operate formally or not. For example, easing requirements and costs of registration and licensing can improve incentives for firms to declare themselves. Simplifying procedures can have a similar effect. It is also beneficial for governments to create an environment where enterprise assets are protected and where disputes can be handled expediently and fairly. Good governance has been shown to be a positive force in encouraging formal economic activity.

Thereby, a favorable business environment is essential for promoting creation of new businesses, growth of established firms, and job creation – especially in the formal sector. In the last seven years, the World Bank has published a series of annual reports investigating the regulations that enhance business activity and those that constrain it. Doing Business presents quantitative indicators on business regulations and the protection of property rights that can be compared across economies, and over time.

It would be critical to make the starting and closing a business administratively as easy as possible. Experience shows that the impact of taking a substantial step in this area is much more significant than that of a series of small steps. In many EU countries, a fast-track business registration service has been introduced as a way of facilitating this process.

In Italy, since 1998 in each municipality “one-stop-shops” have been established for existing and potential entrepreneurs conceived as help-desks and geared towards customer satisfaction. They provide companies (mainly start-ups) with information in order to reduce administrative, time and financial burdens on business. Ukraine introduced a one-stop-shop for new business registration, and Lithuania created a virtual one. Similar programs and approaches have been developed also in other countries in Europe.

Portugal is singled out as a top performer in business entry in 2005/06. The reform took 5 months. The country managed to reduce the time to register a company from 54 to 8 days within a year. This success was achieved by introducing a new fast-track registration service, which provides a choice of pre-approved names at the registry’s website. The registry deals with tax, social security, and labor registration and publishes the incorporation notice website of the Ministry of Justice. Standard articles of association make the application fast and error-free—with no need for a notary. Within a year, the number of companies using the new service rose from 12 to 75 per day.

Other countries in Europe have also focused on cutting costs or simplifying registration—eliminating stamp duties in Switzerland for the first EUR1,000,000 of start-up capital; abolishing the registration fee and piloted online registration in Belgium and reducing minimum capital requirements by 90 percent in Georgia. The Business Information System (BIS) introduced in Finland in 2001 is maintained jointly by the National Board of Patents and Registration and the Finnish Tax Administration. Entrepreneurs only need to fill in a single registration application when establishing a company submitted to one contact point. In
connection with this reform, all the entities under this system receive a single common Business Identity Code instead of the previous register numbers and other codes.

In short, improving the business and investment environment, making it easier for firms to formalize, has been one of the most fundamental tasks taken by countries seeking to reduce the size of the informal sector.

D. Administrative measures

Administrative measures have primarily included efforts to strengthen enforcement and compliance. This includes a wide range of interventions including reorganization of agencies involved with compliance; strengthening their capacity; and imposing stiffer penalties for non-compliance. However, administrative measures can also incorporate better public education and information to shape the perspectives of enterprises and individuals in terms of whether they choose to operate in the formal sector or not.

While tax policy and business and labor market regulations may define the substantive conditions governing the formal economy, institutions also matter since they strongly shape perceptions regarding the costs and benefits of operating formally vs. informally. For example, the efficiency and reliability of public services such as the provision of health care and pension benefits affects individual assessments about whether social contributions are pure taxes (and thus to be avoided) or reasonable payments for important services. Another important institutional factor is the effectiveness of enforcement which provides the “stick” in the overall strategy to combat undeclared economic activity.

While several public institutions are and will remain involved in addressing informality, international experience suggests that a single authority should be charged with giving them coherence and pushing their implementation—a governmental champion.

The main instrument available to labor, social security, or tax inspectorates to detect undeclared work is the unannounced visit to a work site, which determines the identity of all persons found there. This instrument is often effective enough to ensure that the majority of workers are registered. Belgium even introduced a social security card (SIS) in 1998, with a requirement on all employees to have the SIS card with them at the workplace: this allows for faster and more foolproof controls by the social inspectors of the Labor Administration.

To achieve relevant policy objectives, institutional strengthening (staffing, training, technical assistance) of the labor ministries and coordinating of relevant public agencies (social security administration, enterprise development agencies, and competitiveness councils) are needed so that those ministries and agencies can assume their increasingly more complex role of facilitating labor productivity growth.
Detection and enforcement measures applied in particular in OECD countries include information exchange (linking computer files); unique social security numbers; co-operation between labor, social security and tax inspectorates; administrative requirements for immediate declaration of new hires; making chief contractors responsible for tax compliance by subcontractors; encouraging employer and trade union denunciation of unfair competition; enforcing employees’ rights such as protection against unfair dismissal, even within undeclared relationships; and strict sanctions. The possibilities of introducing/ expanding e-government, on-line registration and exchange of information between administrative databases could be explored in Ukraine.

Public information and education is the final element in a comprehensive strategy to reduce undeclared economic activity. How employers and individuals assess the costs and benefits of declaring economic activity or not is influenced by their perceptions and attitudes about the informal economy, the efficiency of government services, the risk and costs of being detected, the fairness of the “system”, and so on. When combined with sound framework conditions (i.e., reasonable taxes and regulations, strong institutions), public education can make a difference in bringing a society to a “tipping point” where undeclared work becomes a deviant and irregular proposition.

A good communication strategy to publicize increased benefits of and reduced costs for formalization is also an important component of policy reforms oriented toward reducing informality. Many potential beneficiaries may ignore or are simply unaware of the costs while working informally, such as lack of access to sick leave and maternity leave benefits and to unemployment or pension insurance for the years worked informally, or may not know about available financial or technical support to SMEs by the public sector, or of simplified requirements for SMEs to promote formalization. Government could use the media, in particular public service campaigns on television and radio, to spread information on the benefits of formalization of employment, in particular in SMEs. The emphasis has usually been on transparency and inclusion. Campaigns have often been directed especially towards the younger population.

Many countries have launched communication campaigns to change public perceptions. These campaigns have tried to emphasize different core messages. In 2006, the U.K. focused on positioning tax evaders as a minority that damaged the interests of the majority. Some campaigns have targeted high-informality sectors. The Canadian construction industry focused on consumers, informing them of the legal and financial disadvantages of “cash deals” and linking quality and professionalism with registered contractors. Hungary’s “Fair Play” campaign in 2007 emphasized, among other messages, the damage that tax evasion does to the country’s financial situation. A serious evaluation of the effect of this campaign would be important for informing future communication efforts.

In Sweden, one of the campaigns was specifically directed towards young people. Through free information to vocational schools and media campaigns, information was given about the risks of not participating in the social security system. Publicity has the double effect of
highlighting the risk of disclosure and strengthening taxpayers’ trust in the system. A poll conducted in 2003 indicates that the fraction of the young population that considered undeclared work to be acceptable fell from 29 percent in 2002 to 21 percent.

**Measures aimed at altering perceptions about informality in the international experience have included** the following:

- Information campaigns with segmented communication plans. Public opinion polls show that different groups have different attitudes and behaviors regarding the undeclared economy. For example, young people appear to have a relatively high acceptance level; this group could therefore be a priority in communication efforts, with messages that not declaring work and income are old and outdated practices and underlining their criminal aspect. A common objective of information campaigns has been to position tax evasion as a deviant and increasingly marginal activity, with serious personal consequences. For example, successful enforcement and sanctioning of tax evasion cases involving the rich and powerful could be widely publicized. Campaigns could also focus efforts on sectors where undeclared activities are significant.

- Educating the public on the fundamentals of public finance. This involves providing transparent information about how the government spends tax revenues and showing how the payments made by entrepreneurs and individuals are linked to the public benefits they receive.

- Involving the social partners. Registered employers and trade unions have strong and shared motivations to reduce the prevalence of undeclared work in their sectors and workplaces. The international experience indicates that these groups should be encouraged to work together to explain the problems with informality to their constituencies while, at the same time, committing themselves to fighting undeclared work in collective agreements.

**IV. Conclusions**

In sum, there is a wide range of interventions that could be implemented in order to reduce informality – these, in the international experience, have usually included a combination of “carrots” and “sticks”. Unfortunately, there has been very little serious evaluation of these efforts so it is not possible to provide quantitative estimates of the likely effects of individual actions nor to empirically demonstrate that certain types of interventions have a stronger impact than others. Much more empirical analysis is required. However, the conclusion of this review is that effective strategies to reduce undeclared work require a combination of “carrots” (reforms and actions to facilitate, reduce the costs, and increase the benefits of formalization) and “sticks” (enhanced, even-handed enforcement of such improved laws and regulations). In addition to the need to use a number of strategies, the existing studies conducted on undeclared work emphasize the lack of a one-size-fits-all policy for countries. The next step is to
evaluate the relevance, desirability and potential effectiveness of these measures for the specific context of Ukraine. Moreover, selected measures will need to be further tailored to the political, historical, and economic conditions of Ukraine.