

# Legal Needs of Informal Employees in Ukraine: causes, consequences, possible solutions

## *Executive Summary*

### **Background**

Informality is a complex, multidimensional, and confusing social phenomenon that is faced by any country in its various manifestations, regardless of economic development. Difficulties in the study of this phenomenon are due to 1) the nature of the object itself, hidden from the eyes of the researcher; 2) blurred boundaries of the sphere of informal employment; 3) the difficulty of determining the scale and evaluation of the parameters of the phenomenon due to the lack of reliable information about it and the significant discrepancy between the results obtained by different evaluation methods; 4) the lack of a clear and structured concept that defines the object of study and clear criteria that allow it to include a particular type of work, which qualifies as employment.

At the international level, a final agreement has not yet been reached in discussing common terminology for describing forms of employment that do not meet the law's requirements. The methodological provision on the statistical definition of informal employment, approved by the 17th International Conference of Labor Statistics in 2013, proposes to define **informal employment** as the total number of informal jobs in any formal or informal sector enterprises or households over a period of time. The International Labor Organization (ILO) and the European Commission also use the term "**undeclared employment**" - any type of paid activity that is perfectly legal in origin (i.e., criminal activity is completely excluded) but undeclared in the relevant government agencies.

In Ukraine, the concept of undeclared work is known only to a narrow circle of interested professionals. Ukrainian authorities use two concepts: the *shadow economy* and the *informal economy*, to describe various forms of employment that do not meet the legislation requirements. **Informal economy** is any activity of employees and economic units that is not covered by law or in practice or is not sufficiently covered by formal norms (does not include illegal activities). **Shadow economy** - the activity of business entities that is not prohibited by law, which is hidden from public authorities to evade taxes, social security contributions, compliance with minimum wage standards, maximum working hours, safety standards, and sanitation, from specific administrative procedures, in particular the completion of statistical reports and other administrative forms.

In essence, this understanding of the "shadow" economy is in line with the international definition of the "informal economy" and European "undeclared activities" in the formal sector. But this approach is aimed

at studying the activities of only economic entities and estimates only the value component of the "shadow" economic turnover. This approach does not allow single out the workers involved in the "shadow" circulation and to establish to what extent the undeclared nature of their activities violates social and labor rights.

Informal employment creates many negative consequences and risks both for the employees and society as a whole. Employees are deprived of the state-guaranteed salary, violated working time restrictions and illegal dismissals, lose their length of service, opportunities to use state guarantees and benefits, and their chances of obtaining legal protection are minimal. For society, informal employment is, first of all, a decrease in budget revenues at all levels, which affects the government's ability to provide public services, implement socio-economic development programs, and maintain the social security system.

In addition to affecting the deteriorating public health, the COVID-19 pandemic has had a significant impact on the economy. A substantial proportion of businesses with the introduction of lockdown restrictions faced a decrease in the number of customers and, consequently, a reduction in the volume of work. In this regard, employers had to reduce working hours or reduce the volume of work and, accordingly, reduce employees' salaries, sending employees on long-term leave at their own expense, reducing staff, and closing the company. This situation has significantly affected informally employed people.

The COVID-19 pandemic has also profoundly affected rethinking the role of social protection in ensuring social justice. Demographic shifts, prolonged urbanization, and decentralization of public services have profoundly affected the population's needs. The existing social protection system no longer meets these needs. The problem of informal employment exacerbates the situation. Informal laborers do not fall into any of the categories covered by social protection: they are not extremely poor, they have an income, but they do not have an employer who pays social security contributions for them. It is difficult for the government to identify informally employed workers and develop effective protection mechanisms for them, as this population group is largely invisible or excluded from official statistics.

Reducing informal employment is a structural problem that requires applying a set of actions, methods, and efforts of all stakeholders - central and local authorities, employers, trade unions, and civil society.

## About the study

The study's objective is to obtain data on informal employees' legal needs and problems in the labor sphere to develop recommendations for overcoming these problems.

The study covered people involved in informal employment, including those who:

- work informally / informally (refusal of legal employment or the desire of the person not to formalize the employment relationship);
- receive part of the salary informally / informally ("in an envelope");
- provide "home" services, carry out handicraft production;
- work informally / informally part-time;
- perform temporary or one-time services.

The study lasted from November 2020 to May 2021 and included three components:

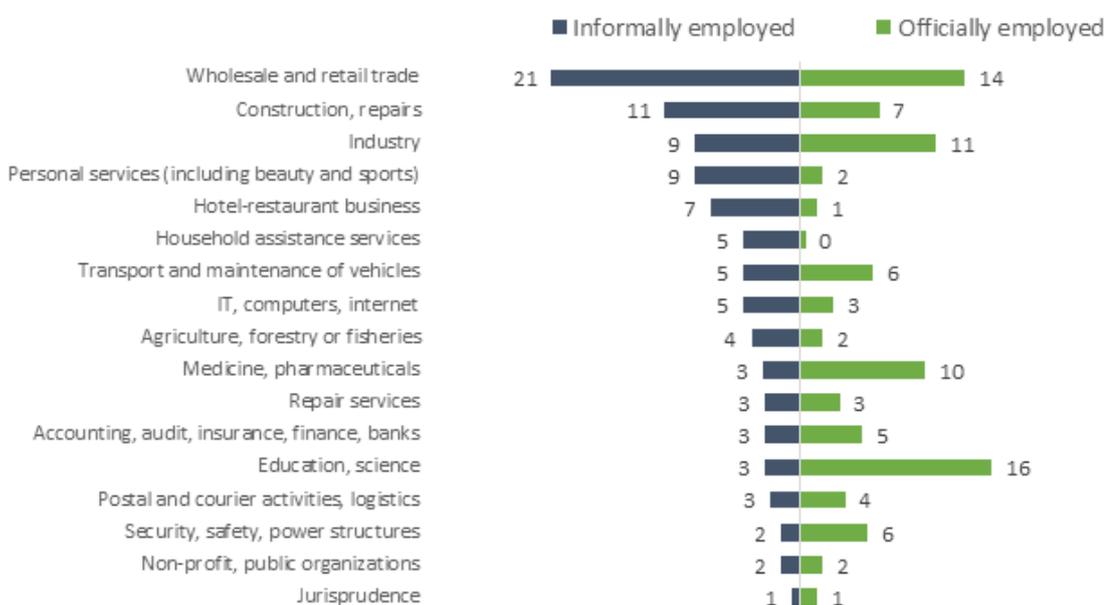
- 1) analytical component (analysis of relevant Ukrainian and international legislation, scientific publications, administrative and statistical data);
- 2) qualitative component (6 focus group discussions with more than 50 informal laborers and 15 in-depth virtual interviews with experts using video communication);
- 3) quantitative component (survey of 808 respondents by telephone interview and online survey: 213 officially employed and 595 informally employed).

## Study findings

### Informal employment in Ukraine

- Representatives of working professions, low-skilled, technical professions, which are replaced by the latest technologies, professions in the field of intellectual labor, work mostly informally.
- On the scale of the settlement: both in small towns, villages, and large cities, there are prerequisites for forming the informal employment sector. Despite this, in small towns, villages, hamlets, the probability of developing informal employment is higher.
- Informal employment is more typical of such industries as trade, construction and repairs, personal services, hotel and restaurant business, household assistance. According to the State Statistics Agency of Ukraine, it is also common in agriculture, forestry, and fisheries. Informal employment is widely represented in small and medium-sized businesses, to a lesser extent in the large business, almost absent or very rare in the public and communal sectors (mainly in the form of fixed-term civil agreements).

### The sectors of the economy in which formally and informally employed work



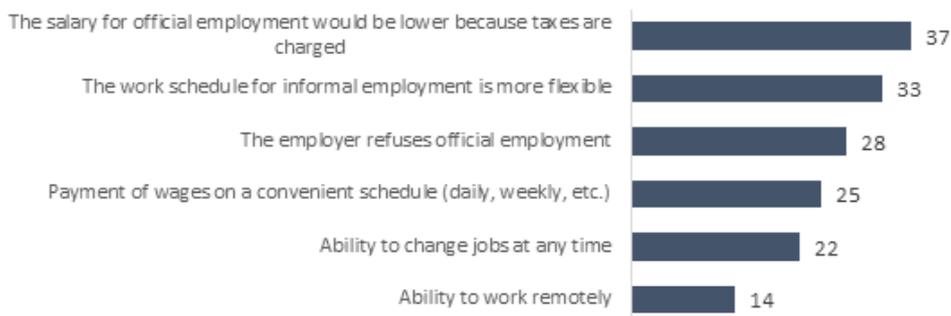
- According to a quantitative survey, which is more characteristic of urban and better educated workers of pre-retirement age, the most prone to informal employment were younger and middle-aged women. The informally employed were slightly less educated and reported lower average monthly incomes of their households compared to the officially employed. The assumption that vulnerable groups and recipients of state social assistance are much more prone to informal employment has not been confirmed. Among the informally employed, part-time work, combining work or part-time work with study, retirement, or maternity leave are more common. The average duration of informal employment was four years, and formal - 9.5 years. There is a combination of two or three forms of employment at the same time.

## Gender and age distribution among formally and informally employed

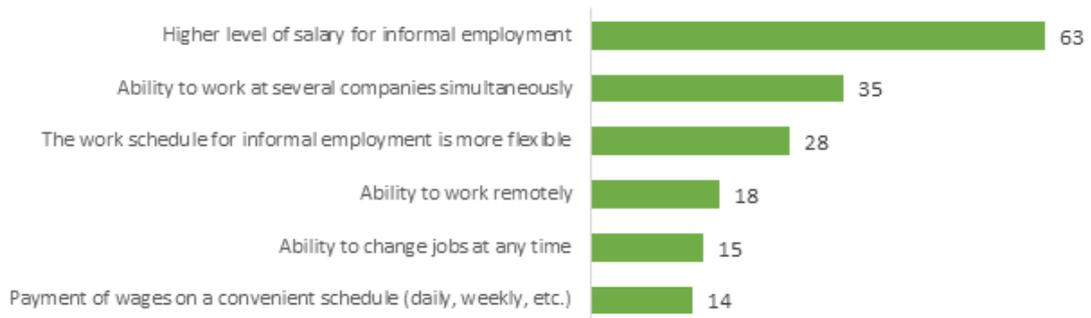


- The main factors that motivate people to work informally are higher salaries due to tax avoidance and a more flexible work schedule. Other advantages are the ability to receive cash payments at a convenient time, the ability to quickly change jobs and remote work. At the same time, such reasons as lack of specialized education for a specific position, unwillingness to collect the necessary documents for official employment, unwillingness to have a record of a particular place of work in the employment record, the ability to receive benefits (subsidies) or unemployment benefits from employment services were much less common choose this form of work (based on the results of a quantitative survey).

### Top 6 reasons for informal employment among the informally employed



### Top 6 incentives to resort to informal employment among the officially employed

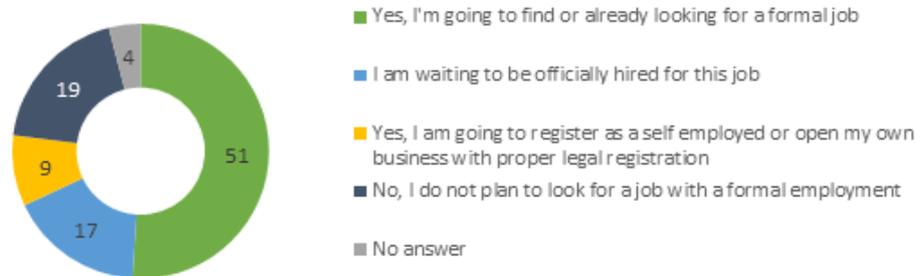


### Incentives for formal employment

- Although less than a third of informally employed respondents stated that their employment situation was due to the employer's reluctance to employ them properly, six out of ten respondents officially reported unsuccessful attempts to find formal employment. More than three-quarters of informally employed respondents perceive their situation as temporary and are going to find a job or register their employment properly. Only 19% of respondents are not going to get a formal job. Thus, the main barriers to the mass transition of workers from the category

of informally employed to the category of officially employed are the inability or unwillingness of employers to meet such a request from employees. This study revealed only indirect reasons for this position of employers, but this information is not enough. There is a need for additional studies of informal employment through the prism of business needs and business problems, especially small and medium.

### Intentions to get a formal job among the informally employed



- The first incentive for formal employment is financial. If the level of wages is high enough, it will be a very significant advantage in favor of formalization for eight out of ten respondents. In addition, there is an increased interest among respondents in the "social package," paid leave and sick leave. And the least important incentive is the accrual of retirement age.
- Informally employed workers are ambivalent about future retirement or lack thereof. Some focus group respondents do not consider it necessary to accumulate work experience due to distrust in the stability of the social protection system. Older respondents, who have spent most of their lives informally, are indifferent to this issue. If it is impossible to count on the length of service required to receive a decent pension, they focus on today's earnings, even if the work is informal.
- Although the state has taken significant steps to inform society about the negative consequences of informal employment in recent years, improving the regulatory framework governing business activity, government measures to deregulate economic relations, which would affect the reduction and informality, are imperfect, complex, and contradictory. The regulatory framework still needs some simplification so that the benefits of moving to a formal sector outweigh the costs, both in terms of time and money. Employers' control over compliance with current legislation and, accordingly, punishment for offenses are carried out selectively, which leads to a general perception by all parties of the ineffectiveness of laws and, as a consequence, increases the cases of irresponsible behavior of employers and employees.
- According to respondents, the most critical factor in informal employment is employers' reluctance to employ laborers officially. In second place - the imperfection of government policy and legislation in the field of labor. Among the measures that could promote formal employment and reduce the number of unemployed without proper registration, the most popular was the creation of a simple way of legal registration for small or irregular jobs and simplification of the tax process, and the least popular - informing the public about the negative consequences of unregistered work for the state.

## The most important reason for the emergence of unregistered employment in terms of formally and informally employed



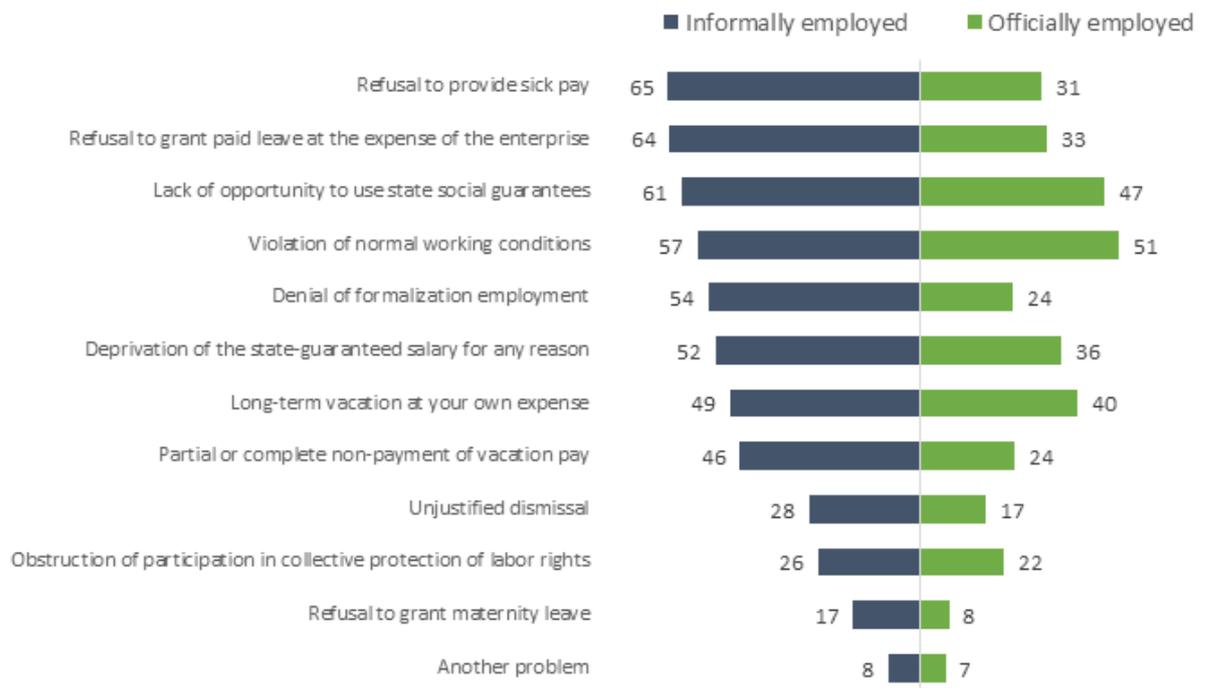
## Factors that will promote formal employment / reduce the number of informally employed, in terms of formally and informally employed



### Legal problems of informal workers

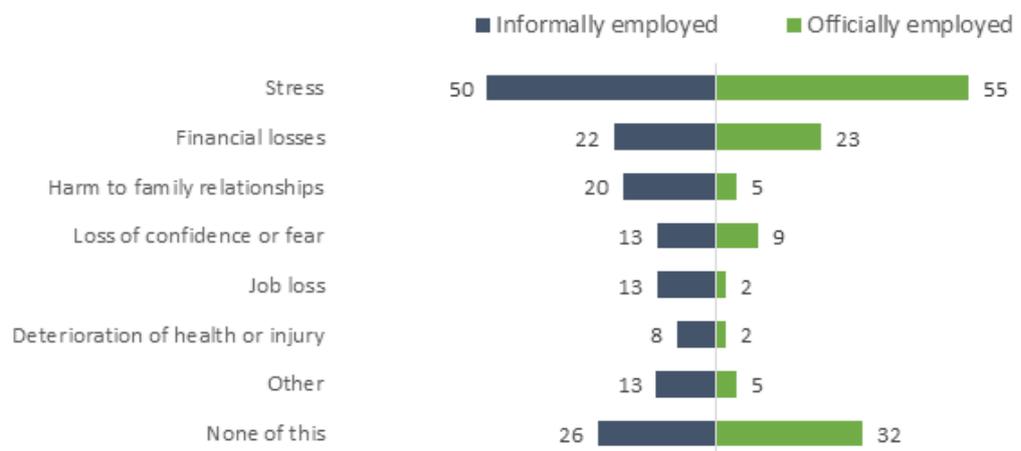
- Informal laborers reported more legal problems than those officially employed. They were much more likely to face problems such as denial of paid sick leave, denial of paid leave, denial of formalization, partial or complete non-payment of leave, and denial of maternity leave.

## The content of the problems in the labor sphere faced by formally and informally employed



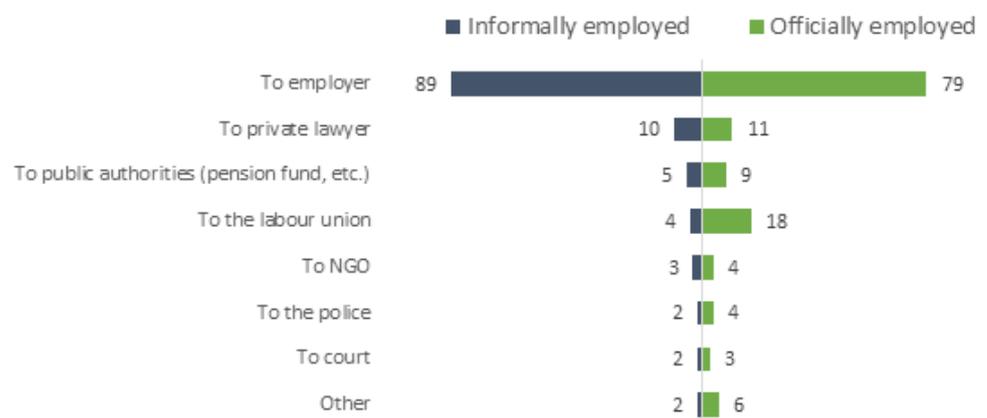
- Almost half of those formally and informally employed (48% in each category of respondents) tried to solve their legal problem. In most cases, the situation remained unchanged. The lack of a difference in the effectiveness of efforts to resolve their legal problems between the officially employed and the informally employed may indicate the ineffectiveness of formal procedures to protect labor rights. Among the informally employed, the problem worsens and becomes more complicated over time, although this is an atypical development for the formally employed. The main reason for both inaction in solving existing legal problems and failure to try to solve their legal problems was disbelief in the possibility of achieving justice and achieving change. This factor was more common among the informally employed than the officially employed.
- Among those who solved their problem in whole or in part, almost no one had expenses in the process. The duration of solving the problem for those who solved it in whole or in part, in most cases (59%) did not exceed two weeks. At the same time, the informally employed more often answered that they had coped during the day, while the majority of officially employed people dealt with the issue for up to 7-14 days. For more than a month, 17% of informal and 23% of formal employees solved the problem.
- The employment problems of the informally employed had a more significant number of negative consequences than those of the officially employed. In particular, they were more likely to have deteriorating family relationships, health, and job loss. At the same time, attempts to defend their labor rights for informally employed people are 6.5 times more likely to lead to job loss than for officially employed people.

## Consequences of problems in the labor sphere in formally and informally employed persons

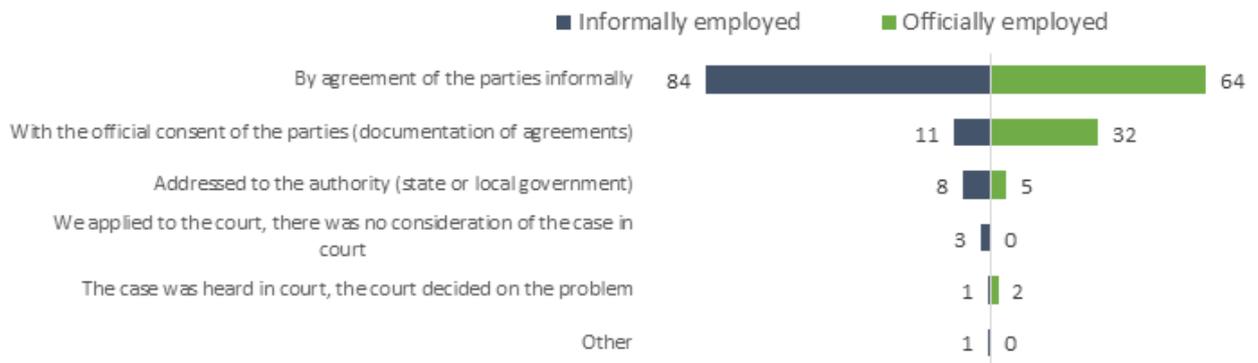


- Most problems are solved by agreement of the parties informally. If among unregistered workers this method was used by 84% of those who solved their problem at least partially, then among officially employed - 64%. A small group of respondents sought legal assistance from their legal acquaintances or governmental and non-governmental organizations that provide free legal aid. Some respondents indicated that trade union activities in the country were not effective or perceived as such at the general societal level, which could also influence citizens' choice of informal employment. If a person knows that a trade union protects them, they will rather choose a formal job. Officially employed people are much more likely to settle issues with the official consent of the parties with the documentation of agreements and have more opportunities to seek help from the union. They are also more likely to recommend legal solutions: seek professional advice or apply to court.

## Persons and organizations formally and informally employed applied to solve the problem in the labor sphere



## A way to solve the problem in the labor sphere in formally and informally employed persons

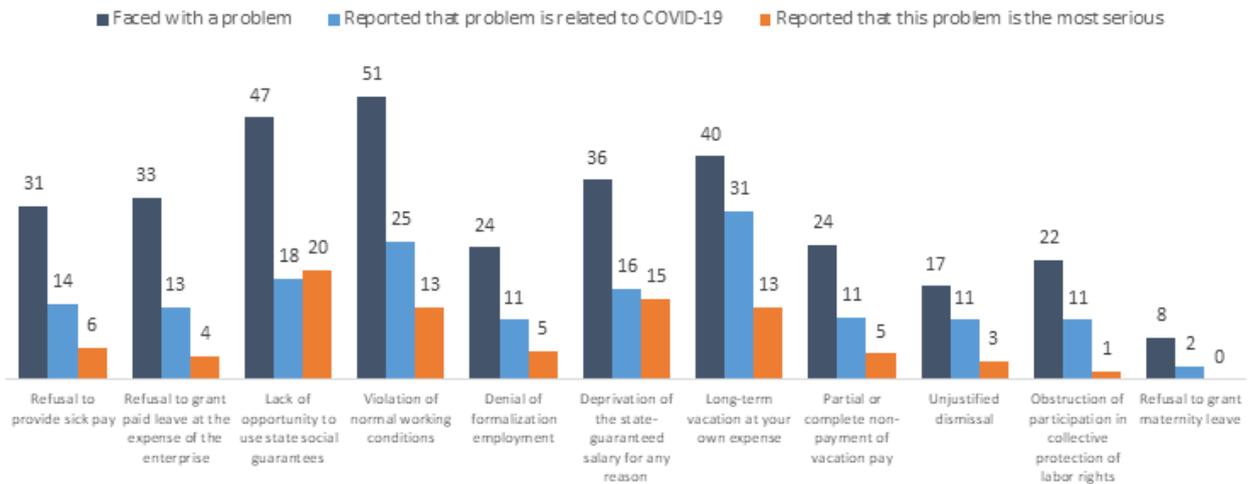


- Focus group participants were unfamiliar with organizations dealing with informally employed people. However, the vast majority expressed a desire to receive information about such organizations. According to the results of focus group discussions, the most convenient sources of information were (in descending order of mention): the Internet, television, outdoor advertising, hotlines of government agencies, the application diia.gov.ua, printed information materials. Respondents to the quantitative component of the study would find it most convenient to receive information on opportunities to get help, advice, or counseling in solving problems related to informal employment, from social networks or Internet sites, as well as mobile messengers, hotlines, television, and e-mails, but booklets and brochures in administrative institutions were the least convenient source of information.

### Impact of the COVID-19 pandemic

- During the COVID-19 pandemic, the problems faced by informally employed workers persisted and even intensified: wages for low-skilled workers were reduced, the number of jobs was reduced, and there were no social guarantees. Additional challenges for the informally employed brought by the pandemic are: lack of hospitalization, lack of safe working conditions, often inability to work remotely, parents find it harder to work because they have to care for children who study remotely or cannot attend preschool and school due to quarantine restrictions, it is likely that in the near future employers will deny employment to those who have not been vaccinated.
- Each respondent (both informally and formally employed) reported an average of 2 problems related to COVID-19. More than 60% of unjustified dismissals and long-term leave at one's own expense were caused by a pandemic. More than a third of denials of maternity leave, inability to use state guarantees, and deprivation of guaranteed wages are also caused by COVID-19. However, the legal problems of the officially employed show a stronger connection with COVID-19 than the problems of the informally employed. In other words, a relatively smaller proportion of problems among unregistered workers are caused by employers' response to anti-epidemic measures.

## The most serious problems in the labor sphere faced by the officially employed and their connection with COVID-19



### Needs, attitudes, experiences, and opinions of informally employed people

- The vast majority of participants in focus group discussions would like to get a formal job, because the status of an official worker provides legal protection in the workplace, access to social guarantees. The possibility of formal employment is perceived as a manifestation of loyalty and trust on the employer's part.
- People do not believe in transparent and fair competitions in government agencies.
- People question the state's ability to pay pensions in the future.
- People are willing to put up with employers' refusals to take up formal employment with no alternative.
- People believe that informal employment provides an opportunity to earn more because it does not pay taxes, but in practice, informally employed receive really less than officially employed.
- The desire to earn a high income today outweighs future social guarantees, including pensions.
- People need to have a flexible work schedule, a convenient way to get paid, and reduce dependence on the employer.
- A sense of independence is becoming more critical, especially among those who have experienced informal work, self-employment, and one-off work. The ability to set the price of goods and services, excluding taxes, to agree on wages directly with the client or employer - increase the feeling of independence.
- Being able to leave quickly without consequences is essential, especially for those working in temporary jobs.
- People are willing to put up with over time to keep their jobs.
- The most understandable negative consequences of informal employment are lack of social guarantees and social package from the employer, violation of working day and working week restrictions, loss of opportunity to use state guarantees following current legislation, loss of length of service when calculating pensions, penalties for self-employed economic activity, impossible or complicated process of appealing against illegal actions of the employer.
- Very painful for people are non-payment or incomplete payment of promised wages, collection of informal fines, inability to apply for a subsidy or receive full maternity benefits, refusal to provide paid leave and sick leave, partial or complete non-payment of maternity benefits, lack of proper conditions in the workplace, overtime working day/week.
- People associate the pandemic with additional problems: reduced wages, forced long-term leave at their own expense, job loss, the need to incur additional costs for personal protective equipment and testing for the presence of disease, additional treatment costs, loss of earnings during incapacity for work.
- Having legal problems in the workplace, employees usually do not try to protect their rights and legally resolve disputes. In most cases, they are fired and go in search of a new job.

- People tend to resolve misunderstandings at work through conversations with the employer. In cases where a consensus cannot be reached, people often threaten.

## Recommendations

### Government policy

- Initiate a broad expert discussion on the need to improve the existing state policy on informal employment through the prism of the protection of human rights - both officially employed and informally employed.
- Build policies based on a deep understanding of the problem and data on the real needs of employees and employers, focusing on obtaining such information directly from media through participatory tools, dialogue platforms, research, improving the collection and use of administrative and statistical data.

### Understanding the problem

- To form in Ukraine a single approach in defining the meaning of the concept of "informal employment," which will take into account the categories of concepts "informal economy" and "shadow economy."
- Introduce the practice of conducting regular national surveys of legal needs and problems of employees and employers, systematic monitoring of the implementation of policies in the field of labor relations.
- Take into account the activities of production units of the informal sector (individual employees, self-employed persons who work without proper registration, household members, etc.) in the Methodological provisions for determining informal employment of the State Statistics Service of Ukraine.

### Building partnerships and communication with society

- Building interagency and intersectoral partnerships. Involvement in solving the problems of informal employment of all parties to the social dialogue (government, employers, laborers, and their associations in the form of trade unions). At the same time, the state's role is critical in regulating labor relations because the very nature of these relations has such a specificity that the employee usually has less opportunity to act and influence these relations, unlike the employer. Such interaction is possible by monitoring the population's legal needs and cooperation between government and non-government legal service providers.
- Strengthening the role of trade unions as a safeguard against job losses for employees who dare to enter into labor disputes with employers. Trade unions must find their role in protecting the interests of informally employed workers and workers in under-regulated, new areas.
- Based on a common expert understanding of the concept of informal employment to form a state communication strategy that would explain in simple language the negative consequences of informal employment for the general public, as well as help involve people in policies, change public attitudes to pay taxes, including awareness of responsibility not only by employers but also by employees.

### Improving legislation

- Improving labor legislation with a focus on simplifying formal employment in small or irregular jobs, in new areas of the economy, the need for flexible work schedules and overcoming the challenges of reorienting to remote work formats, and overcoming other negative consequences of the COVID-19 pandemic.
- Support for employment in general, the introduction of temporary measures to apply tax benefits that would allow deferred payment of taxes, provided tax rebates to small businesses, which suffered most from the adverse effects of the COVID-19 pandemic.

- Government initiatives on the legislative regulation of labor relations should be considered, take into account all possible risks, based on the results of independent research on the needs and problems of both employees and employers.

#### **Creating economic incentives to formalize employment**

- Creating favorable conditions for small and medium-sized businesses by (1) simplifying the procedure for registration and licensing of activities, (2) reducing taxes, especially on the salary fund, (3) providing benefits to entrepreneurs who create additional jobs, (4) providing financial support small businesses by means of flexible credit and tax policy (example city.dia.gov.ua – a legal regime for the IT industry, which provides a special model of taxation, flexible employment conditions and a separate procedure for interaction with government regulators).
- Increasing the attractiveness of the formal employment sector by creating additional financial incentives to (1) increase employment opportunities in the field of formal employment, (2) encourage employers to increase wages and comply with labor laws, (3) introduce additional voluntary mechanisms to protect workers' rights in enterprises formal sector.
- Introduction of an employment formalization procedure in which employers receive additional material incentives for their enterprise (for example, participation in an interest-free lending program, obtaining business development grants, etc.).
- Introduction of the social insurance system, in particular medical insurance.
- Introduce preferential taxation for some categories of workers (e.g., young people in the first place, homeworkers, people of pre-retirement age, small entrepreneurs implementing innovative approaches/technologies in their field).

#### **Overcoming barriers to formal employment**

- When formulating an employment policy, it is necessary to use information about employers' real needs and problems, the satisfaction and solution of which will create a situation in which running a legal, declared business would be more profitable than working in the shadow and informal economy.
- In the field of relations between employees and employers and employees with the state, it is necessary to focus on protecting individual labor rights, taking into account information on the specifics of legal needs and problems of certain categories of workers, industry, and sector of the economy, as well as belonging to age groups of workers.

#### **Application of people-centered approaches**

- Introduction of accessible and effective mechanisms for resolving labor disputes through the administrative settlement procedure, particularly with the involvement of the State Labor Service of Ukraine and trade unions.
- Facilitating the availability of judicial procedures for settling labor disputes, particularly with the introduction of more effective mechanisms for providing legal support to employees and improving the procedure of online litigation (the possibility of resolving disputes remotely, from filing a lawsuit to a decision).
- Improving the efficiency and practical dissemination of out-of-court mechanisms (State Labor Service of Ukraine), particularly through negotiation procedures and mediation.
- Broad involvement of non-governmental organizations providing legal assistance and education in the field of labor relations by the government and local authorities and establishing effective cooperation with the state system of free legal aid.
- Conducting coordinated information campaigns between the government, local authorities, and non-governmental organizations aimed at empowering people to protect their labor rights and raise awareness of institutions and mechanisms designed to help people along the way.
- Development of a system of complementary safeguards against abuse of their rights and opportunities for the state, employers, and employees, which, in turn, will help reduce the use of threats as a means of resolving labor disputes.

- Development and implementation of government programs to support employees in overcoming the negative consequences of unresolved labor problems as one of the priority areas of the State Employment Service of Ukraine.
- Taking into account the physiological and psychological needs of employees.
- Raising awareness of employees about their labor rights and ways to protect them.
- Improving occupational safety and health practices, investing in health, sanitation, and hygiene, in particular to prevent or reduce the spread of infectious diseases.
- Providing conditions for remote work for all who can switch to this format of work.
- Strengthen work to prevent discrimination against employees in the workplace.
- When introducing additional and improving existing procedures for solving legal problems, be guided by the approaches of people-centered justice and focus on meeting the following needs of employees: receiving hospital care; prevention of unjustified dismissal; safe working conditions; children's access to education; vaccination issues; access to state guarantees, in particular in the provision of maternity leave; prevention of deprivation of guaranteed wages.



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