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TABLE OF CONTENTS

ACKNOWLEDGEMENTS	4
EXECUTIVE SUMMARY	5
I. INTRODUCTION AND MOTIVATION	7
II. LABOUR MARKET DEVELOPMENT AND INFORMAL EMPLOYMENT	9
III. UNDERSTANDING INFORMAL EMPLOYMENT Concept, Size and Determinants	23
IV. TOWARDS MORE POLICY COHERENCE FOR JOB CREATION AND SOCIAL PROTECTION	52
ANNEX 1	60
ANNEX 2	64
REFERENCES	72
OTHER TITLES IN THE SERIES/ AUTRES TITRES DANS LA SÉRIE	76

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EXECUTIVE SUMMARY

Informal employment is one of the key features of the Romanian labour market and the main concerns of the Romanian government. Informal employment is not new in Romania. A second economy was present in the communist era, and took various forms, ranging from family farming to off-the-books payments and misappropriation in state-owned enterprises. It is extremely important for policy making to understand the forms that informal employment takes as well as its determinants. This study attempts to shed light on the issue of informal work in Romania. First it reviews the evidence on informal employment, distinguishing its different forms. Second, it provides a detailed description of the characteristics of people in informal employment and the sectors where informal work is most prevalent; and, further, it analyses the factors responsible for the persistence of informal employment. Finally it discusses policy options and measures to deal with informal employment, recognising its role for poor and vulnerable groups of workers.

Informal employment persists in Romania, in spite of continuous economic growth in recent years. It represents today between 20 and 50 per cent of total employment, depending on the definition used. Two main groups can be identified among those in informal employment: those who work informally because they have no real alternative and for whom informal employment constitutes a survival strategy, and those who deliberately evade taxes and social security contributions. The first group includes some forms of informal work in agriculture¹ and contributing family workers. The second comprises non-registered firms, or firms which do not register their workers and hire them without labour contracts, firms that under-report their sales and workers who under-declare their earnings and receive so-called “envelope payments” (payments in cash). It should be noted that most people in informal employment around the world are in that situation against their will and informal work provides their only opportunity for generating income. Identifying the groups of individuals in the two distinct groups is extremely important for policy making as there are different factors driving them into informal employment and their status has different implications for their wellbeing and for policy making

Three main groups of factors can explain the persistence of informal employment in Romania. First, socio-economic developments following transition, such as economic restructuring and privatisation of state owned enterprises, low or negative economic growth, unemployment, and increased poverty and inequality are among the main reasons pushing people into informality. Moreover, emigration abroad with its links to informal employment is an additional determinant of informal work, as many temporary migrants return to Romania for short periods of time and engage in informal work. Second, institutional factors, such as labour

¹ It should be noted however that not all work in agriculture is informal and that some participants, such as small farmers, are likely to remain as a result of the support offered by the EU.

market regulations and the structure of the tax and social security systems, also determine informal employment. In addition bureaucracy, heavy public administration and the subsequent corruption are thought to be connected with informal work. Last but not least, informal employment is also determined by a number of behavioural/societal factors such as the culture of non-compliance, the lack of trust in public institutions, the negative perception of the role of the state, partial understanding or underestimation of the benefits derived from social security.

Addressing the issue of informal employment is of primary importance for the Romanian government. Some efforts have been made in recent years, especially with the reform of the tax and benefit system and the introduction of the new pension plan. However, until recently most efforts focused on punishment rather than on prevention of informality or the creation of appropriate incentives for formal versus informal work. In addition policies to help the most vulnerable groups and offer them the necessary skills and assets to participate in formal work are uncommon. Nonetheless, serious efforts have been made, such as the introduction of a flat tax rate, the reform of the labour code, a higher minimum wage and national campaigns against informal work. For policies to be effective, they have to take into account the dualistic structure of informal employment. On the one hand, active labour market policies combined with well designed social assistance programmes can be used to address informal work for those with no other alternatives. On the other hand, better control, inspection and enforcement are needed for those who choose to be informal. In addition, simplified procedures for business and workers' registration would reduce the cost of formalisation. Overall, improving the quality of public services provided and communicating effectively the benefits of formal work and the costs of informal employment are necessary actions to bring people back into formal work.

I. INTRODUCTION AND MOTIVATION

Labour markets in Romania have seen important developments in recent years following the transition period. Chief among them the expansion of informal employment, combined with low participation rates and falls in real wages. Adverse economic conditions and increases in poverty levels during the transition period led to expansion of informal work with serious consequences for the economy and workers' lives. Informal employment not only undermines tax revenue, but also increases vulnerability for certain groups of the population that are most affected. The recognition that informal employment will not go away with economic growth has altered the debate about informal employment and has highlighted the need for effective policies to reduce informality and improve working conditions for all. Indeed, informal employment is among the major preoccupations of the Romanian government and appears at the top of the list of the main challenges that the country is facing today, ahead of reducing poverty and increasing wages.

The rise of informal employment is not a unique feature of the Romanian labour market. On the contrary it is a common feature of many OECD and non-OECD countries and is particularly prevalent in transition countries (OECD, 2008a). It has traditionally taken place outside formal structures such as official credit markets, tax administration, labour law and social security schemes. However, in more recent years informal employment has been increasingly present in formal jobs and the formal sector. Subsistence agriculture, "envelope" payments, false self-employment and unregistered work are the most common forms of informal employment in Romania. For some groups of the population informal work leads to poverty and exclusion whereas for others it serves as a safety net.

Understanding the characteristics of informal employment, its causes as well as consequences is of primary importance for policies effectively to address the issue. Moreover it is important to understand the incentives of people in informal employment and the factors that lead them to work outside the formal structures of the economy. The heterogeneity of the phenomenon in Romania, as elsewhere, makes it unlikely that one policy would fit all. "Killing the beast" of informal employment is not necessarily the only way to go nor the most appropriate approach to the phenomenon. After all, informal employment is an important livelihood strategy for many poor households that have no other income-generating opportunities. Social policies should therefore target those segments of the informal sector while fiscal, labour and other policies should provide the right incentives for people to join formal employment.

This report provides a critical discussion of the phenomenon of informal employment in Romania. After reviewing the recent economic and labour market developments, it first provides descriptive evidence on the size and forms of informal employment and their evolution over

time. Second, it attempts an investigation of the characteristics of the people in informal employment and the reasons that have pushed them into informality. The report concludes with a discussion on the policies implemented by the Romanian government and policy domains which can play a role in addressing the issue of informal work.

II. LABOUR MARKET DEVELOPMENT AND INFORMAL EMPLOYMENT

In Romania, as in other transition countries, the fall of communism and the move towards a market economy have shaped the size and particularities of informal employment. Understanding the size and evolution of informal employment requires a good understanding of the underlying economic and labour market conditions. This section aims to sketch the general economic and demographic background. First general economic trends are presented. Second, a brief overview of labour market conditions is provided, including migration and demographic developments.

II.1 General economic trends

A central feature in the economic context of Romania relates to its turbulent process of transition to a market economy, which started at the end of 1989 with the fall of the communist regime. As in many other transition countries, overall the 1990s were a period of deep recession. Recently growth has picked up significantly, reaching 6.3 per cent in 2007, and EU membership in 2008 has set the pace for even more optimism regarding the future. Nonetheless, the influences of the economic transition on socio-economic circumstances today are still pervasive.

Table 1: Basic Economic Indicators, Romania, 1989-2006

	Real GDP Growth (per cent)	GDP p.c. lei, constant prices (2001 base year)
1989	-5.8	5 988
1990	-5.6	5 645
1991	-12.9	4 923
1992	-8.8	4 509
1993	1.5	4 603
1994	3.9	4 813
1995	7.1	5 187
1996	3.9	5 422
1997	-6.1	5 121
1998	-4.8	4 899
1999	-1.2	4 866
2000	2.1	4 993
2001	5.7	5 302
2002	5.1	5 594
2003	5.2	5 907
2004	8.4	6 428
2005	4.2	6 713
2006	7.9	7 107

Source: IMF World Economic Outlook Database

Romania was among the last countries of the former communist bloc to implement the substantial reforms necessary for the transition to a market economy. In fact, the country experienced two different phases of transition, starting with a very gradual transition path in 1989 and a more radical reform programme in 1997 (Ibrahim and Galt, 2002).

Adverse economic conditions with negative GDP growth persisted for a long time, starting with the final crisis of the communist regime in the eighties and then continuing with the bumpy “Stop and Go” transition of the nineties (Ghinararu, 2004). The first half of the 1990s witnessed the most dramatic decline in output. As can be seen in Table 1, 1991 output contracted by a striking 12.9 per cent. Romania’s restructuring was particularly painful compared with some other transition countries, partly because unlike some neighbouring countries, before 1989 no significant liberalisation had taken place (OECD, 2000). In the presence of an obsolete, unprofitable industry, restructuring led to massive industrial decline and investment levels dropped. External factors aggravating the domestic problems were the drop of global demand in the 1990s and the break-up of the COMECON (Council for Mutual Economic Assistance) system (Ciupagea *et al.*, 2004). The decline in output translated into massive lay-offs and decreasing real wages, diminished by the staggering inflation. GDP per capita reached a low in 1992 with people earning on average the equivalent of US\$848 (IMF Economic Outlook Database). These developments were accompanied by a significant increase in informal employment, a last resort for laid-off workers and the unemployed.

Poverty rates were characterised by a dramatic increase at the beginning of the 1990s, an improvement in 1995 and 1996 and a further deterioration after that until 2000 (Table 2),

Inequality also rose. While the Gini coefficient had been 0.21 in 1989, it rose 10 percentage points to 0.31 in 1995.

Low growth and increasing poverty levels pushed many people into informal employment. In particular the number of unregistered workers in agriculture increased substantially during this period, as people turned to agriculture as a livelihood strategy. Moreover, adverse economic conditions were the causes behind the increase in urban to rural migration which took place around the same time.

A more radical reform package was adopted by the government in 1997 which included tightening of fiscal and monetary policies, the abolishing of most price controls, the liquidation of loss-making state enterprises, and reforms in the labour market and social security system (Ibrahim and Galt, 2002; OECD, 2000). In the first years of these radical reforms, output again sharply declined. As Table 1 shows, the years 1997-99 saw negative growth. In addition, poverty rose even further with over 35 per cent of the population living in poverty in 2000 (Ciupagea *et al.*, 2004, p.4). Fortunately, however, with the reform package implemented the stage seemed to be set for a sustained period of economic growth.

Table 2: Poverty Indicators, 1995-2006

Year	1995	1996	1998	2000	2003	2004	2005	2006
Absolute poverty (in per cent of population)	25.44	20.07	30.8	35.86	25.1	18.8	15.1	13.8
<i>Urban</i>				25.9	13.8	11.6	8.1	6.8
<i>Rural</i>	37.6	n.a.	n.a.	47.8	38	27.3	23.5	22.3
Extreme poverty	9.38	6.27						
Rural	15.1	n.a.	n.a.	19.3				
Relative poverty (in per cent of Population)				17.1	17.3	17.9	18.2	18.6
Gini (index)	0.32	0.31	0.29	0.29	0.30	0.31	0.31	0.33

Note: Absolute poverty refers to the share of the population that lives below poverty line. This poverty is established by the NIS and World Bank on the basis of a basket of food and non-food items. Relative poverty is an inequality indicator and refers to the percentage of the population living with less than 60 per cent of median disposable income. The Gini coefficient is established on the basis of disposable income and own consumption.

Source: 1995-2000: Tesliuc, E.A., 2003 reproduced in Ciupagea *et al.*, 2004, p.4.

2000-2006: World Bank, 2007a, table 1; annex 3 (produced by NIS).

From 2000 onwards, the Romanian economy has been able to embark upon a sustained positive growth path. Table 1 shows that in 2003 the real per capita GDP surpassed its real 1989 equivalent, and has steadily grown since. The stabilised macroeconomic environment, the stronger banking system, the rise in domestic demand and the opening up of the economy are among the reasons economic prospects picked up in the early years of the millennium. More recently, the 2005 introduction of a flat-tax regime is claimed to have boosted growth, although the full effects are perhaps too early to be assessed (Ghinararu, 2007). In addition, incoming remittance flows from Romanian migrants equalled \$4.4 billion in 2005, which represents an impressive 4.5 per cent of GDP (UNDP 2007, p.102).

Poverty levels have decreased substantially (Table 2) since 2000. While in 2000 35.9 per cent of the population still lived in absolute poverty, this fell to 13.8 per cent in 2006. However the general picture is more complex and not all that positive. Regional disparities in poverty rates are substantial, and poverty in rural areas still affects 22.3 per cent of the population. In relative terms, the picture looks less impressive: from 2000 to 2006, relative poverty (share of population with less than 60 per cent of median income) has actually slightly increased. Likewise, the GINI coefficient has also risen. Although significant progress is observed since 2000, it should not be forgotten that in 2006 Romania's GDP per capita still only amounted to around 37.6 per cent of the EU-27 average (Eurostat Structural Indicators).

II.2 Labour market and demographic trends

As has been shown, adverse economic conditions were the main drivers of the increase in informal employment that Romania experienced in the transition period. During this time, negative growth was translated into low participation and employment rates. This section first looks in detail at the labour market conditions that characterised Romania in the period from 1990 until today. Second, it examines the demographic trends such as population size, fertility and migration which go hand in hand with the expansion of informal employment in the country. Both labour market and demographic trends are likely to shape the size and characteristics of informal employment.

II.2.1. Labour markets

II.2.1.1. Employment trends

In the communist era, the labour market was heavily regulated. Wages were centrally set for all types of workers and labour mobility was strongly controlled (Paternostro and Sahn 1998). In addition, the objective was full employment, irrespective of whether this employment was productive or not. Most people worked as waged employees in large collective or state farms, or in urban areas. However, despite the strict regulations, informal employment was not rare and took the form of barter and off-the-books payments (Ghinararu, 2007; Stănculescu, 2006; Neef, 2002). The situation was quite similar in the former Soviet Union and countries in Eastern Europe (OECD, 2008b). In the 1991 reform process, various measures were taken to liberalise the labour market: wage scales were made more flexible, and a new wage law introduced a system of decentralised bargaining (Sengenberger, 2006). The labour market was therefore dramatically restructured, a fact that had profound impacts on labour market outcomes, including informal employment.

Table 3: Share of Sectors in the Economy, Added Value and Employment: 1990-99

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Share of Industry										
<i>in employment</i>	35.7	...	30.0	...	...	...	27.2	...	23.2	21.8
Share of agriculture										
<i>in employment</i>	29.0	29.7	32.9	35.9	36.4	34.4	35.4	37.5	38.0	41.2
<i>in added value</i>	23.7	20.1	19.4	22.6	21.5	21.4	20.6	19.6	16.2	15.1
Share of Services (public and market)										
<i>in employment</i>	35.3	...	37.1	...	...	...	37.4	...	36.8	36.4

Source: NIS, quoted in Ciupagea *et al.*, 2004, table 1a.2; table 1a.6.

Real wages fell both in rural and urban areas, whereas employment decline was most marked in urban areas. From 1991-93, in the initial years of industrial downsizing, around a million jobs were lost. Many of these losses concerned lay-offs and these people often ended up in long-term unemployment, in subsistence agriculture or the urban underground economy (OECD, 2000). The restructuring of the economy played an important role in these changes. It is indicative that the share of industry in total employment dropped dramatically, from 35.7 per cent in 1990 to 21.8 per cent in 1999 (Table 3).

In contrast, the share of agriculture in total employment increased substantially throughout the entire 1990-2000 period. This rising share of agriculture was driven by the increased urban to rural migration which started following the 1991 land reform. Net urban to rural migration became positive around 1997; and 34 900 people left for rural areas in 2000 according to the NIS (quoted in Ciupagea *et al.*, 2004, table 1a.3). Moreover, many people combined work in the city with subsistence agriculture activities as additional sources of income (OECD, 2000).

Table 3 shows that the share of agriculture in total employment kept on rising during the course of the 1990s, reaching 41.2 per cent in 1999. This share was substantially higher than other Central and Eastern Europe (CEE) countries, with for example Bulgaria registering only 10.6 per cent of employment in agriculture in 2000 (Ciupagea *et al.*, 2004, p.9). It should be stressed, though, that this type of work in Romania mainly concerns subsistence farming, was often done on a part-time basis and in addition experienced important seasonal fluctuations (OECD, 2000). As Table 3 illustrates, although the share of agriculture in total employment continued to rise, its share in added value continued to decline. This may underscore the fact that agricultural employment was often of a very low-productive type.

Table 4: Economic Active Population, by Sector of Economic Activity: 2000-06

	2000	2001	2002	2003	2004	2005	2006
TOTAL (<i>thousand persons</i>)			9234	9223	9158	9147	9313
Agriculture (<i>per cent</i>)	41.4	40.9	36.4	35.7	31.6	32.2	30.5
Industry and construction (<i>per cent</i>)	27.3	27.5	29.5	29.8	31.2	30.3	30.7
Services (<i>per cent</i>)	31.3	31.6	34.1	34.5	37.2	37.5	38.8
MALE (<i>thousand persons</i>)			5031	5057	4980	5011	5074
Agriculture (<i>per cent</i>)	39.3	38.8	34.6	34.3	31.0	31.5	29.8
Industry and construction (<i>per cent</i>)	32.2	31.7	33.7	33.9	35.5	34.9	35.1
Services (<i>per cent</i>)	28.5	29.5	31.7	31.8	33.5	33.6	35.1
FEMALE (<i>thousand persons</i>)			4203	4166	4178	4136	4239
Agriculture (<i>per cent</i>)	43.8	43.3	38.5	37.3	32.3	33.0	31.4
Industry and construction (<i>per cent</i>)	21.7	22.8	24.4	24.9	26.1	24.8	25.3
Services (<i>per cent</i>)	34.5	33.9	37.1	37.8	41.6	42.2	43.3

Note: There is a series change in 2002.

Source: World Bank, 2007b, for 2000-2001; NIS Labour Force Surveys 2002-2006

Since 2000, however, this trend has been reversed. In 2000 employment in agriculture reached a peak at 41.4 per cent of the employed population and went down to 30.5 per cent in 2006 (Table 4). It is expected that this share will continue to decrease by one percentage point per year (Ghinararu, 2004). The decrease of agriculture in total employment has mainly been to the advantage of the service sector. While in 2000 only 31 per cent of the employed worked in services, this rose to almost 39 per cent six years later.

Although growth prospects have picked up since 2000, Romania's recent employment track record is not favourable in all respects. Table 5 lists some key labour market indicators for the period 1997-2006. First, the activity rate has remained rather stable and relatively low, at 62-64 per cent, in recent years. The phenomenon of a stagnant or declining labour force is not specific to Romania. In many transition countries demoralised long-term unemployed workers have ceased looking for jobs, at least in the formal sectors of the economy (World Bank, 2005, pp. 70). Furthermore, the activity rate for women is significantly lower than for men, a phenomenon well in line with the experiences of other transition as well as OECD countries.

The unemployment rate has decreased considerably since the 1990s (NIS, 2006). Registered unemployment reached a peak of 11.8 per cent in 1999 and started to decline from 2000, to reach 5.9 per cent in 2005 and 5.4 per cent in 2006 (Table 5). While in 2002, unemployment was around 8.4 per cent of the male and female population, there was 7.3 per cent unemployment in 2006.

Table 5: Labour Market Trends: 1997-2006

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Activity rate										
<i>Total</i>	64.8	63.6	68.7	68.8	67.7	63.6	62.4	63.2	62.4	63.7
<i>Women</i>	57.7	56.3	61.8	61.9	61.1	56.7	55.3	56.2	55.3	56.6
<i>Men</i>	72.5	71.4	75.6	75.0	73.6	70.7	69.6	70.2	69.5	70.8
Employment rate										
<i>Total</i>	60.9	59.6	63.5	63.6	62.9	58.0	57.8	57.9	57.7	58.8
<i>Women</i>	54.0	52.9	57.5	57.5	57.1	52.0	51.5	52.1	51.5	53.0
<i>Men</i>	68.3	66.8	69.5	68.6	67.8	64.1	64.1	63.6	63.9	64.7
Unemployment (ILO)										
<i>Total</i>	6.0	6.3	6.8	6.9	6.4	8.4	7.0	8.0	7.2	7.3
<i>Women</i>	6.4	6.1	6.2	6.4	5.9	7.7	6.4	6.9	6.4	6.1
<i>Men</i>	5.7	6.5	7.4	7.8	7.2	8.9	7.5	9.0	7.7	8.2
Registered Unemployment (NAE)										
<i>Total</i>	8.9	10.4	11.8	10.5	8.8	8.4	7.4	6.3	5.9	5.4
<i>Women</i>	9.3	10.4	11.6	10.	8.4	7.8	6.8	5.6	5.2	
<i>Men</i>										

Note: All figures are for the fourth quarter of the respective year. Unemployment rate refers to ILO unemployment rate.

Source: Aggregated data for both men and women, 2000-2006, NIS, Household Labour Force Surveys, National Institute of Statistics. Disaggregated data by gender for 2000-2001 are taken from the World Bank, 2007b. Data for 1997-1999 are taken from the Romanian Statistical Yearbook (National Institute of Statistics, 2006). Data on registered unemployment are taken from the National Agency for Employment (NAE).

It is worth noting that there are important differences between the ILO and registered unemployment rates. Although the first has risen from 2002 onwards, this is not the case for registered unemployment (Sengenberger, 2006). The difference between these two can be explained by informal employment. As unemployment benefits are calculated on the basis of contributions in the last 24 months, people working informally are not eligible, pushing further down the registered unemployment rates.

Unemployment rates in Romania have remained at remarkably low levels during the transition in contrast to the situation in other transition countries in Central and Eastern Europe. This phenomenon is partly explained by the economic structure of the country, such as the importance of agriculture and the extent of informal employment.

Overall, the above suggests that there are still not enough decent formal job opportunities in the country despite remarkable levels of economic growth. As is the case in other CEE countries (World Bank, 2005; Sengenberger, 2006; Ghinararu, 2004), a low employment intensity of growth (-0.13 over the 1990-2003 period in Romania) has left many people unable to profit from the new improving macro environment.

The lack of formal jobs and the adverse economic and labour market conditions are behind the increase of informal employment in Romania. Informal employment both in

agriculture and in non-agricultural sectors, has become an important livelihood or additional income generating strategy for many groups in the Romanian population.

II.2.1.2. Labour productivity and wages

Romania has seen important declines in labour productivity as well as real wages. In virtually all regions wages decreased and many people moved to less productive activities such as subsistence agriculture. According to the EBRD (2005), labour market productivity decreases might in fact be lower than registered because of the formalisation of jobs in otherwise declining sectors, following the introduction of the flat-tax regime in 2005.

Table 6: Labour Productivity: 2003-09 (Annual Percentage Changes)

	2003	2004	2005	2006	2007	2008	2009
Labour Productivity (GDP/employed persons)	5.3	9.3	4.2	4.5	4.9	4.9	5.0

Source: National Institute of Statistics, National Commission for Economic Forecasting (National Reform Programme, 2007).

The statutory minimum wage is set in Romania on an annual basis with a government decree and can in some cases be indexed with inflation, as was the case during the high inflation years of the early transition. However, the threshold set by the government is only viewed as a minimum reference level. Social partners come up with a negotiated threshold, usually higher than the government reference, which is then considered as the statutory minimum for all workers². The minimum wage is binding and a large number of people are indeed working for it. Nonetheless, the majority also receive “pocket” or “envelope” payments on top of the minimum wage, a widespread form of informal employment as will be discussed later in this report. In 2007, an important innovation was introduced when a ladder of minimum statutory wage thresholds, according to the educational attainment required for the position occupied was created.

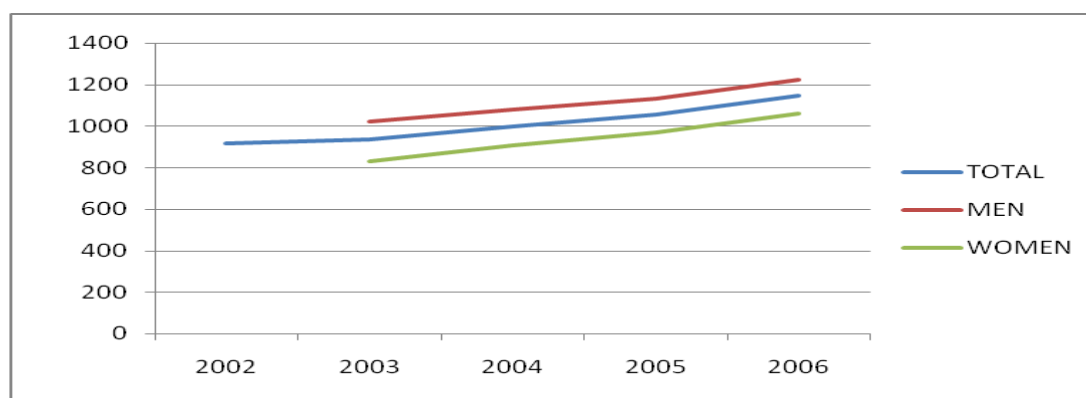
² Following the legislation, collective agreements extend this minimum threshold to the whole of the labour force, irrespective of their union affiliation or non-affiliation and to all enterprises.

Table 7: Average Gross Nominal Earnings, by Gender: 2002-06

	2002	2003	2004	2005	2006	2005	2006
	in "old" lei (ROL)					in "new" lei (RON)	
All	5 320 559	6 637 868	8 183 317	9 68 000	1 146 000	968	1 146
Men		7 273 615	8 859 646	1 037 000	1 222 000	1 037	1 222
Women		5 906 760	7 433 008	891 000	1 062 000	891	1 062

Note: Average gross nominal earnings are deflated against 2006 price level. Data disaggregated by gender were not available for 2002. From section L are excluded armed forces and assimilated. 1 RON = 10 000 ROL.
Source: Labour Cost Surveys (2002-2006), NIS, covering all NACE sections, all size classes.

Figure 1: Average Gross Real Earnings: 2002-06



Note: Nominal wages are deflated against 2006 price level. Data disaggregated by gender were not available for 2002.

Source: Labour Cost Surveys (2002-2006), NIS, covering all NACE sections, all size classes.

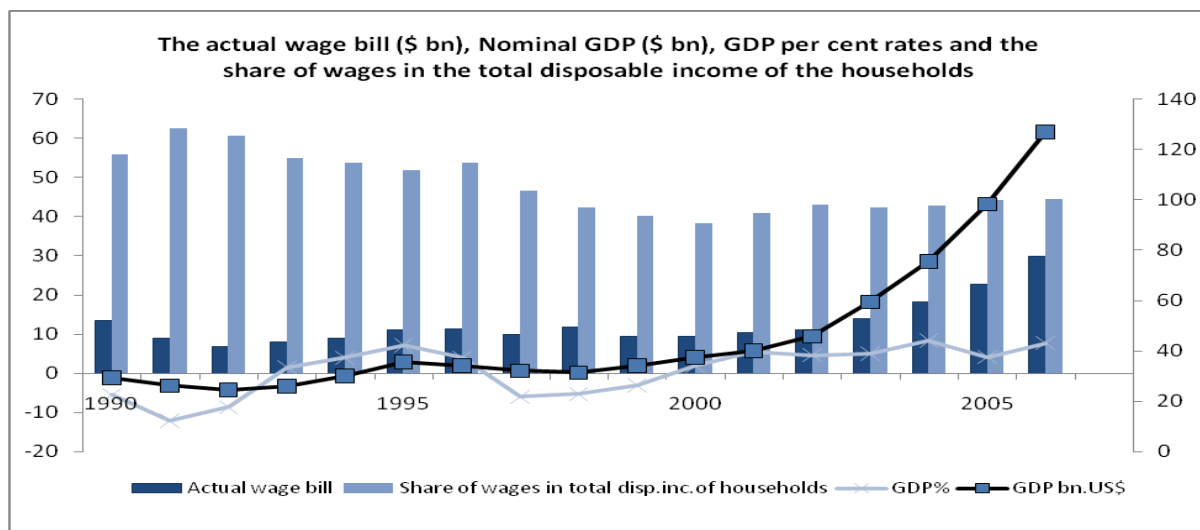
Figure 1 displays real gross earnings for the period 2002-2006 and Table 7 reports nominal gross earnings for the same years, disaggregated by gender. In 2006, average earnings were 1 146 RON, roughly the equivalent of 320 euros.

There is a positive upward trend in wages, which seems to be shared equally among men and women. Yet gender differences in pay remain. Despite the upward trends in wages, the share of wages in total disposable income of the households remains low through the period starting in 1990. Figure 2 presents data on this share and the "actual wage bill"³ expressed both as an absolute value in US\$ billion as well as a percentage share of GDP. The share of wages in total household income remains below 50 per cent and this despite seven consecutive years of growth. The same can be said about the actual wage bill; although this has recently increased in value, its size expressed as a percentage share of GDP remains small. Moreover its growth rate has failed to keep up with GDP, which rose sharply from \$45-50 billion to almost \$100 billion between 1999-2000 and 2005-06. This evidence may suggest that low labour costs have

³ The "actual wage bill" is the product of the total number of salaried employees and the average gross wage. It provides a rough estimate of the total sum of wages actually paid assuming that all salaried employees receive the average salary.

contributed significantly to the high growth rates. Labour seems to be benefiting less from the current growth and globalisation trends than capital (Ghinararu, 2007) providing one more explanation for the substantial persistence of informal employment.

Figure 2: Actual Wage Bill: 1990-2006

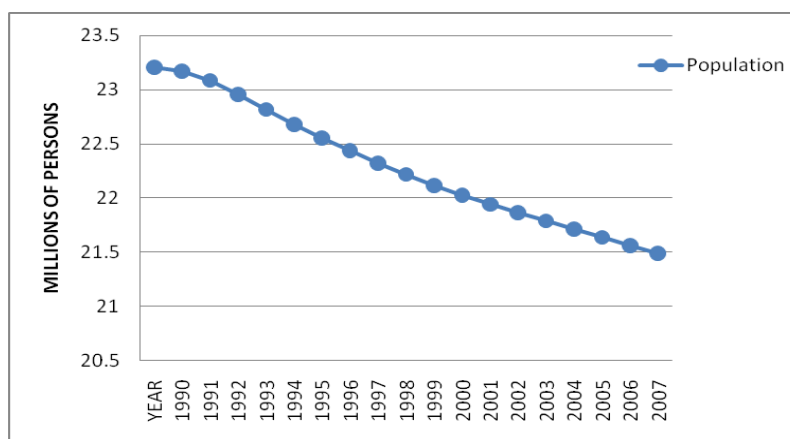


Source: Calculations by Ghinararu (2007), using NIS data.

II.2.2. Migration and demography

There are three main demographic developments that characterise the Romanian population: its declining size; its relative ethnic heterogeneity and emigration abroad. The fall in the country's population is a major demographic trend (Figure 3); while in 1990 there were 23.2 million inhabitants, this had decreased to 21.6 million in 2006. Official estimates are that the crude natural growth of the population is -1.9 per 1 000 inhabitants (UNDP, 2007, p.98). Depending on the scenario employed, estimates for 2025 vary between projected declines of about 1.5 million and 2.5 million. The decrease that has taken place so far can be attributed to two main developments: falling birth rates and, to some extent, a decline in longevity. Regarding birth rates, while in the 1970s there were around 20 live births registered per 1 000 inhabitants each year, in the 1980s they numbered about 15, and in the 1990s this rate fell further, to 10. These recently declining birth rates can arguably be attributed to the harsh restructuring process that has made people cautious in many areas of life, including decisions concerning family size. In addition to these falling birth rates are temporary drops in longevity, related to hardships endured during the communist years, especially by those born around World War II which, can also account for the decline in population (UNDP, 2007, pp. 52).

Figure 3: Population: 1990-2007



Source: IMF WEO database. Data for 2007 are projections.

Table 8: Main Ethnic Groups (2002 census)

Ethnicity	Romanians	Hungarians	Roma	Ukrainians	Germans	Other	TOTAL
No. persons	19 399 597	1 431 807	535 140	61 098	59 764	193 568	21 680 974
As per cent of total	89.5	6.6	2.5	0.3	0.3	0.9	100

Source: NIS 2002 Population and Housing Census

A second important aspect of Romania's population concerns its ethnic composition. Over 10 per cent of the population is reported to be of non-Romanian origin. Table 8 lists the main ethnic groups according to the last national census (2002). The largest ethnic group by far is ethnic Romanian. Substantial minorities are Hungarians and Roma, who register respectively 6.6 and 2.5 per cent of the population. Smaller minorities include Ukrainians, Germans, Russians and Tatars. It has to be noted, however, that the official figures listed below are, at least for some groups, much lower than some other estimates. Especially with respect to the Roma minority, many non-administrative estimates are substantially higher. While the 2002 census recorded over 500,000 Roma, a country-level survey held some years later using key informants came up with estimates of up to almost a million Roma (Sandu, 2005, p.9). Other estimates are even higher, although the validity of these is somewhat questionable (Agency Impreuna, 2006, p.11). It is important to keep in mind the ethnic composition of Romania when examining labour market outcomes and the phenomenon of informal employment. This is because specific ethnic groups, most notably the Roma, are more likely to be found in informal employment and other disadvantaged labour market situations.

The third main population issue concerns international migration. Emigration from Romania abroad is greater than immigration (UNDP, 2007, p.98). Especially in 1990, just after the borders had opened, a massive outflow of Romanians took place, with estimates of almost 100 000 people leaving the country that year (UNDP, 2007, p.97). Many of these were highly educated migrants, and they included a large proportion of non-ethnic Romanians of whom around 60 000 were German (HWWI, 2007). But large-scale emigration also occurred during the transition years, and increasingly by the low-skilled. Adverse economic conditions, limited job

opportunities at home and new opportunities elsewhere following the fall of the communist regime had a dramatic impact on the choice people made to try their luck abroad. In the 1990s, numbers leaving each year fell from around 40 000 in 1991 to 20 000 at the end of the decade. Even when economic prospects started to pick up from 2000 onwards, emigration continued steadily with annual outflows of 10 000 Romanians in recent years (NIS official data, 2007). The same factors that lead people to engage in informal work constitute push factors for emigration abroad. Moreover, it is not rare to find households combining formal and informal employment with migration as their main livelihood strategy.

Table 9: Emigrant Flows by Country of Destination: 2002-06

Year	2002	2003	2004	2005	2006
Italy	1 317	1 993	2 603	2 731	3 393
Germany	1 305	1 938	2 707	2 196	3 110
USA	1 356	2 012	2 049	1 679	1 982
Canada	1 437	1 444	1 445	1 220	1 655
Hungary	903	984	1 553	1 013	900
Austria	293	326	491	421	581
France	233	338	436	343	529
Greece	60	64	97	114	134
Australia	58	45	84	78	125
Israel	106	164	85	64	128
Sweden	42	50	62	29	37
Other countries	1 044	1 315	1 470	1 050	1 623
Total	8 154	10 673	13 082	10 938	14 197

Source: NIS

The destinations of Romanian emigrants have changed considerably over the years. In the early stages access to Western European countries was limited, and many migrated to Turkey, Israel, Hungary and Germany (HWWI, 2007). In the second half of the 1990s the most popular destinations were Spain and Italy. Finally, from 2002 onwards, when visa restrictions were removed for the Schengen area, migration shifted and was extended to Portugal but also to the UK (HWWI, 2007).

Table 9 presents the numbers of emigrants by country of destination for the period 2002-06⁴. The number of migrants to Italy and Germany almost tripled between 2002 and 2006. Particularly in 2006, these two countries received almost half of the total out-migration flows. It is still to be seen how the migration flows will respond to the opening up of borders following

⁴ While all observers acknowledge the significance of emigration in the Romanian economy and society, it has to be noted that data are far from conclusive regarding its extent. The above figures are all registered by the National Office for Statistics, but much of Romanian emigration does not take place in a regular setting. The departures of many emigrants are not registered and this leads to large disparities in estimates. For example, official statistics only registered around 22 000 Romanians who had changed their residence to Italy, while another source estimated that around 500 000 Romanians were living in that country (UNDP, 2007, p.99).

Romania's accession to the EU, which gives Romanians unrestricted access to many Western European countries (HWWI, 2007).

It has to be noted that not all migration flows are well documented. This may particularly be the case with flows of temporary and circular migrants. Although Spain appears among the main countries of destination for Romanian migrants, it is not included in the data collected by the NIS. According to data from the Spanish authorities (*Anuario Estadístico de Inmigración*, 2005 and 2006, published by the Observatorio Permanente de la Inmigración and the Secretaría de Estado de Inmigración y Emigración), there were about 192 000 Romanians in Spain in December 2005, and this number rose to 211 000 in December 2006, corresponding to an inflow of about 19 000 people. Overall, the estimates of Romanians working abroad in mid-2007 were of 1.2 million legal migrants and 2.1 million illegal ones (HWWI, 2007). Often, irregular migrants do not permanently establish themselves abroad, but return to Romania some months a year and often engage in informal employment.

Box 1: Migration Abroad and Informal Employment: Evidence from a Focus Group

"The best thing that happened recently in Romania is that we gained the right of free movement in the EU". This statement clearly expresses the views of a group of return migrants in Romania and highlights the importance they place on migration as a good strategy to improve their living standards. Migrants identify low income, lack of good jobs, poor protection of workers' rights and corruption, especially at the local level, as the main reasons pushing them to migrate abroad, whereas the prospect of better jobs with higher pay is the main pull factor. Furthermore, the existence of informal networks of friends and family members who have had a migration spell abroad facilitates migration and reduces the cost of moving, in accordance with the experiences of other countries (see OECD, 2007).

It is not surprising that the factors that lead individuals to seek work and better opportunities abroad overlap with those that push them into informal employment while in Romania. Hence migration abroad and informal employment are interlinked and often one reinforces the other in a vicious cycle: Romanian migrants work informally in Romania before departure, are engaged in informal work in the destination country and continue to work informally when back in Romania for short or longer periods of time.

Upon return they often find themselves in the same vulnerable jobs they held before leaving, and feel discriminated against in the labour market. Return migrants identify the poor capacity of the relevant authorities to enforce regulations and protect their rights as a major driver of informality. Their intention to evade taxes and social security contributions – apart from health insurance – indicates on one hand their inability to pay but also the scant importance and trust they place on the tax and benefits system of the country. This view is not specific to migrants, but is broadly shared by most population groups. Lack of trust in the state and the culture of evasion are two main factors explaining informality and would need continuous efforts for a long time to change.

Source: focus group discussions (March 2008)

Remittances constitute an important source of finance for Romania. They come in through various channels, but mostly those through official bank transactions reach the official statistics. Data from the National Bank of Romania calculate remittances at US \$1.7 billion in 2004, and US \$4.4 billion in 2005. According to World Bank estimates (World Bank, 2008), the total inflow of remittances was US \$4.7 billion in 2005, US \$6.7 billion in 2006 and US \$6.8 billion in 2007. This makes remittances the second largest external financing source after FDI, accounting for 4.5 per cent of GDP in 2005 (UNDP, 2007, p.102) and 5.5 per cent of GDP in 2006 (World Bank, 2008).

The above demographic developments along with emigration are likely to continue in the coming decades and pose major challenges to the economy and society alike. Most urgently, dependency rates are high and are rising (Vasile, 2004). As a result, social programmes will come under increasing pressure. In addition, if highly skilled young migrants decided to leave the country, this would mean a huge loss of human capital. Moreover, the social costs of migration upon those who stay behind are not negligible. The same holds for the impact of migration on the Romanian labour market and the extent as well as the form of informal employment. On the other hand, the impressive inflows of remittances could offer ways to provide social protection for the elderly and for investments by those who stay behind or those who return, if used in more productive ways (see OECD, 2007 for a general discussion and UNDP, 2007, pp.103-113 for a discussion on this in Romania).

This section has shown that the economic conditions Romania faced in the transition and post-transition period are behind the persistence of informal employment. Despite high economic growth in more recent years and certain improvements in labour market conditions, informal employment remains a major challenge for the country and its government. High poverty levels and the lack of good formal jobs do not only lead to informal employment, but also to out-migration. Migration in turn, is closely linked to informal employment: short-term migrants tend to work informally when they return to Romania for short periods of time and hence a circle of informality is reproduced.

III. UNDERSTANDING INFORMAL EMPLOYMENT

Concept, Size and Determinants

In this section we first discuss what is meant by “informal employment” and we provide an overview of conceptual and measurement issues related to informal employment. Second, we present and discuss the dimensions and recent trends of informal employment in Romania, often comparing them with the respective trends in other transition countries. This is followed by a discussion of the potential determinants of informal employment in Romania and other transition countries. We close the section with a discussion of the characteristics of people in informal employment and the links between informality and poverty.

III.1 Concept and measurement of informal employment

Informal employment is a complex phenomenon and not easy to capture in either conceptual or empirical terms (Jütting *et al.*, 2008). The first standardised definition, from the International Labour Organization (ILO), was agreed upon in 1993, when informal work was defined in terms of production units: informality in this sense refers to whether a firm is formal or not and it included self-employment. This definition was seen as leaving out important segments of informal workers and so was revised to include informal workers outside informal enterprises. According to this broader definition, informal employment is defined as the “*total number of informal jobs, whether carried out in formal sector enterprises, informal sector enterprises, or households*” (ILO, 2002). Informal jobs refer to work outside the regulatory framework because they are not subject to labour legislation, social protection, taxes or employment benefits. Various dimensions here thus determine whether a job is informal or formal, ranging from registration with social protection schemes to compliance with labour or tax law. On the basis of this definition, several types of workers are identified: own-account workers and employers of informal firms, contributing family workers and informal employees (of formal and informal firms).

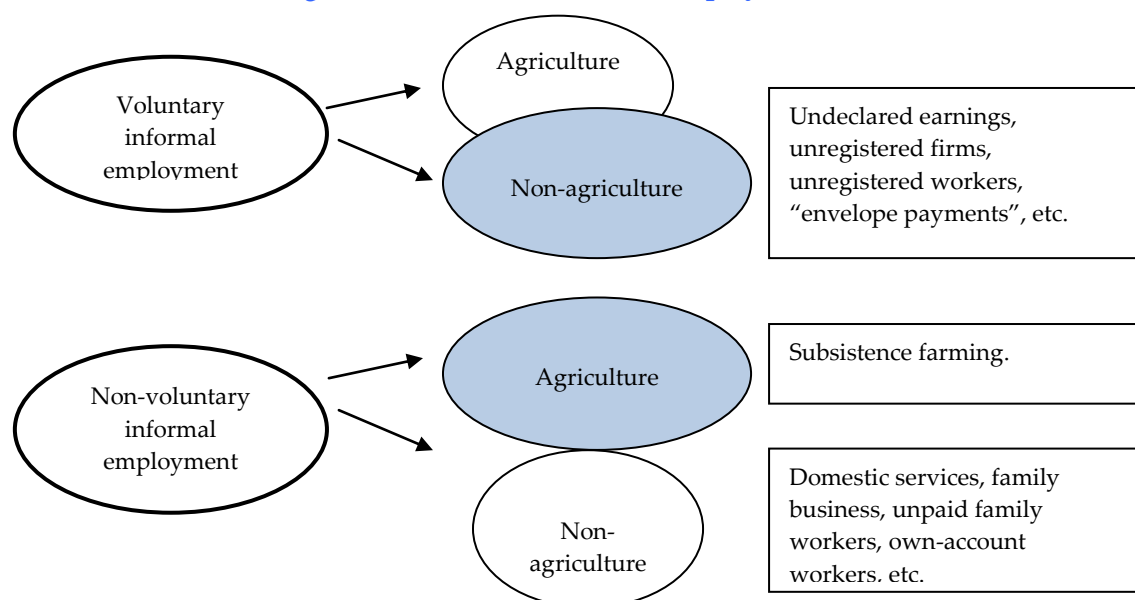
However, in reality the ILO definitions are not always followed and instead a wide range of indicators is used (for an overview of these indicators see Jütting *et al.*, 2008). Data availability drives both the choice of definition and the precise method that is used to measure informal employment. Moreover the precise objectives of the researcher who studies the phenomenon also determine the definition and measure used.

It should be borne in mind that different definitions and measures may give a quite different picture of the size and characteristics of informal employment. An interesting example of this for Romania is given in Stănculescu (2007), where different estimates of informal employment are presented. These figures range substantially from a low of 21 per cent of GDP

(NIS figure of the underground economy), to a high of 45 per cent (USAID estimate of the “shadow” economy). Interestingly a recent OECD report (OECD, 2008b) on the Black Sea and Central Asian countries shows striking differences in the size of informal employment for many countries, depending on the specific definition and measure employed.

But what do people actually mean when referring to informal employment? Informality is often used to refer interchangeably to various concepts such as underground, black or shadow economy, but also subsistence agriculture and irregular, unofficial firms and workers. Informal activities and employment take place outside formal structures such as official credit markets, tax administration, labour law and social security schemes. Distinguishing among these different forms of informal employment is very important, as the reasons behind informality and the relevant policies would differ significantly across them. However, the quantity and quality of data restrict quite significantly the extent to which these forms of informal employment can be studied separately in Romania.

Figure 4: A sketch of Informal Employment in Romania



In Romania, informal employment takes various forms such as subsistence agriculture, wage-employees who do not declare their earnings, employers not registering their employees, workers without labour contracts, tax evasion and social security evasion both by employers and employees, under-declaration of earnings, false self-employment⁵ and many others. Many of these forms constitute deliberate actions to hide earnings in order to evade paying taxes and social security contributions; others represent activities at the subsistence or survival level that can hardly be regarded as evasive. Albu (2004) also highlights the distinction between these two

⁵ False self-employment refers to the situation where some “self-employed sub-contract every day to the same employer, but choose or are forced to operate as self-employed to bypass the legal requirements of a normal employer-employee relationship or reduce their tax liability” (OECD 2008a).

groups of people with different motivations for doing informal work. Albu calls the first the “subsistence” criterion, and the second the “enterprise” criterion.

This type of distinction is in line with the theory that sees the informal sector as composed of two tiers (Fields, 1990; 2005). According to this view, the upper tier comprises the competitive part, i.e. those who voluntarily choose to be informal, and the lower tier those who are there because they do not have other alternatives. It becomes clear that if the informal sector is indeed a two-tier one, then appropriate attention has to be paid to the differences between these two segments in terms of the reasons and motivations of informality as well as the consequences of informal employment. Policies should be designed accordingly to take into account the specificities of these two main parts of the informal sector. Therefore despite data constraints, distinguishing between these two main types of informal employment is of primary importance. Ideally data would be needed on workers’ transitions from formal to informal employment and vice versa, but this is impossible with the existing data on Romania.

The lower tier of the informal sector comprises informal activities serving as livelihood strategies and safety nets. In Romania, subsistence agriculture is the most representative activity in that segment of informal employment, with families cultivating small pieces of land mostly for own production but also partly for sale in the market. Other examples of informal activities in the lower tier include contributing family workers who help in the household or in the small household business and street-vending activities, and others.

In the upper tier of the informal sector, one can find non-registered firms, or firms which do not register their workers and hire them without labour contracts, firms that under-report their sales. Workers who under-declare their earnings and receive so-called “envelope payments” also fit into this category. This is a quite widespread practice in Romania, with only part of workers’ earnings being declared to the tax authorities and social security administration, and the rest being paid to them in cash (the “envelope payments”) or in kind (Ghinararu, 2004, 2007; Albu, 2004, 2007). While this arrangement is in some way a win-win situation for employer and employee – keeping non-wage labour costs down for the employer and increasing net earnings for the worker – in the long run workers’ pension entitlements are eroded and tax revenue to the state forgone. Indeed, according to Toma (2004), on the employer’s side, the main evasion of social security contributions is represented by the under-payment, or late payment of contributions for registered workers and not so much the non-payment of these contributions. Romania is not the only country with a significant share of people receiving envelope payments. Countries such as Hungary, the Slovak Republic and the Czech Republic have an important incidence of under-declared earnings and false self-employment despite a relatively low share of informal employment.

A second important distinction needs to be made between agriculture and non-agricultural activities⁶. In most official statistics around the world, agriculture is kept as a separate sector. According to Charmes (2004, p.3): “the international definition does not recommend to exclude agriculture from the informal sector, but it recommends to clearly

⁶ Separating agricultural and non-agricultural activities is common practice. This is done not only for substantial reasons (e.g. the urban economy differs from the rural one) but also because of data constraints. See also Stănculescu (2006) for a discussion on this.

distinguish the agricultural informal sector (including animal husbandry, forestry and fishery) from the non-agricultural informal sector.” However because of the lack of precise data on agricultural activities, which does not allow researchers to distinguish between market and non-market production, sometimes agriculture is excluded from informal employment altogether.

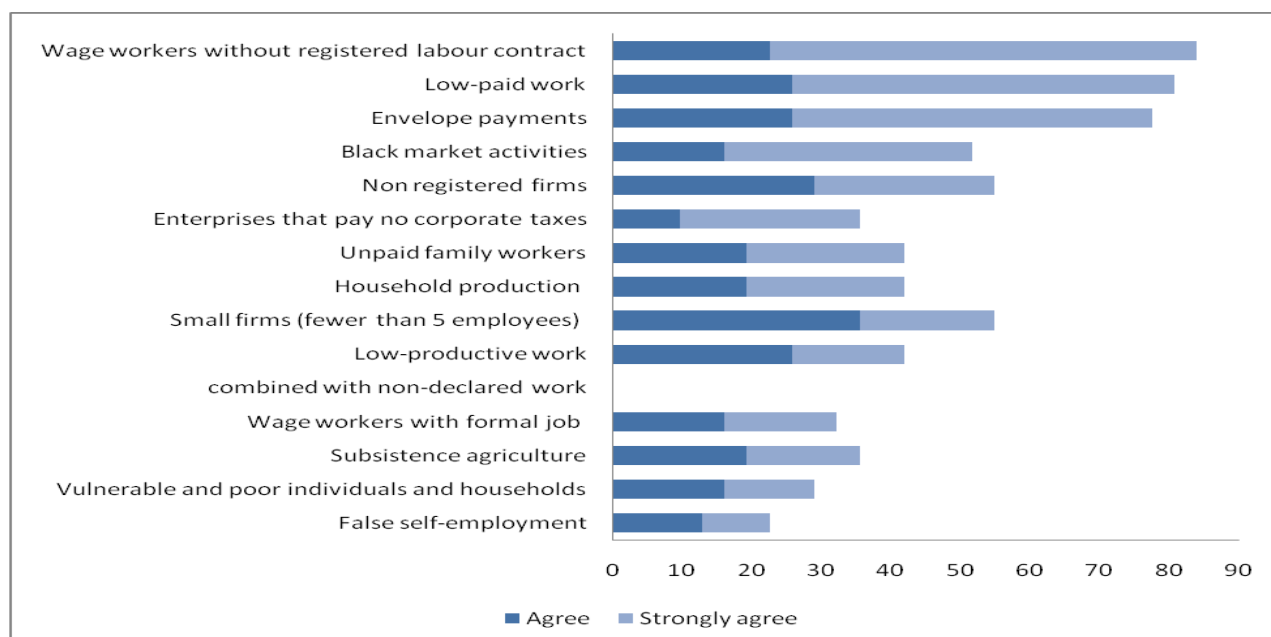
Although agriculture sometimes concerns formal private firms, this is not always the case in Romania, where it often takes place in the non-registered/non-declared economy. Indeed, in developing and transition countries agricultural activities often take place at the household unit and are part of the lower tier of the informal sector. In 1991, the post-communist government decided to return collectivised land to its former owners. This reform changed the average size of firms (Vidican, 2004) and led to a rise in small-scale subsistence farming. The post-transition reduction of jobs and the increase in lay-offs led the unemployed and early retirees to look for alternative livelihood strategies. These were very often in agriculture. Moreover large landowners, and later all landowners, were made ineligible for unemployment benefits, which might also have a link to informal employment.

Currently there is no consensus among experts on Romania on whether agricultural activities are indeed “hidden” and should be part of informal employment (Stănculescu 2007). Some authors (for example, NIS; Daianu *et al.*, 2001; Albu *et al.*, 1998) limit informal activities to legal non-agricultural activities, whereas others (Ciupagea, 2004) include agriculture in their definition of informal employment (Stănculescu, 2006). On the one hand, the plots are registered and authorities are aware of the production (Ghinararu, 2004; 2007). On the other hand, normally no taxes are paid on this type of activities, nor are workers engaged in this type of work offered a registered labour contract and social contributions as other workers in towns are. However, it should be noted that agriculture does form part of the informal sector as employment in this sector is not reported, taxed or in compliance with labour regulations, even though the goods are in some cases sold at the market.

A third distinction which may be important in understanding informal employment, its determinants as well as its consequences, is the unit in which the informal activities take place, i.e. the household or firm level. Activities that take place at the household level often include subsistence agriculture and small production, whereas those performed at the firm level may include some form of unregistered activity such as firms that do not register, workers who are not registered, and/or under-declaration of earnings. Distinguishing among these types of activities and the unit in which they take place is important as they are likely to be driven by different motivations.

Finally, informal employment comprises economic activities that are illegal either because the sale, distribution and possession of the goods and services are forbidden, or because they are carried out by unauthorised producers (UN, 1993). Although this is a non-negligible part of the economy in Romania, we will not consider it in detail here as it is related predominantly to the domain of criminal law rather than the labour market and social protection that are considered in this report.

Figure 5: The Concept of Informal Employment in Romania



Source: Data survey of policy experts (2008).

What do policy makers in Romania actually mean when referring to informal employment? Evidence from a questionnaire survey sent to a small sample of policy experts presents what people usually recognise by the term (more details can be found in the Appendix). It should be noted here that this survey is not representative and hence its results should be treated with caution. They are only indicative and further, more in-depth surveys are needed to present quantitatively robust results. Policy experts in the survey were provided with a list of concepts describing informal employment and were asked to state whether they considered them relevant or not. Figure 5 presents their responses in terms of the “very relevant” and “relevant” concepts of informal employment. The vast majority of respondents stated that informal employment concerns workers without a labour contract, or low-paid work. Envelope payments rank third in the perceptions of policy experts regarding informal employment, followed by black market activities, small firms with fewer than five employees and non-registered firms.

III.2 Size and trends of informal employment

Having discussed the different forms that informal employment takes in Romania and the distinctions that need to be made, we now examine the size and trends of informal employment there. The lack until recently of appropriate data in Romania has constrained the methodologies used to estimate their extent. In this section we rely mostly on indirect sources and the existing literature to discuss the size and trends of informal employment in Romania. We present a variety of indirect indicators based on different methods of estimation and different definitions of informal employment relating to registration, tax evasion, the absence of a labour contract and multiple job-holding. With this we attempt to describe the phenomenon of informal employment in several ways in order to capture its heterogeneity and multidimensional character.

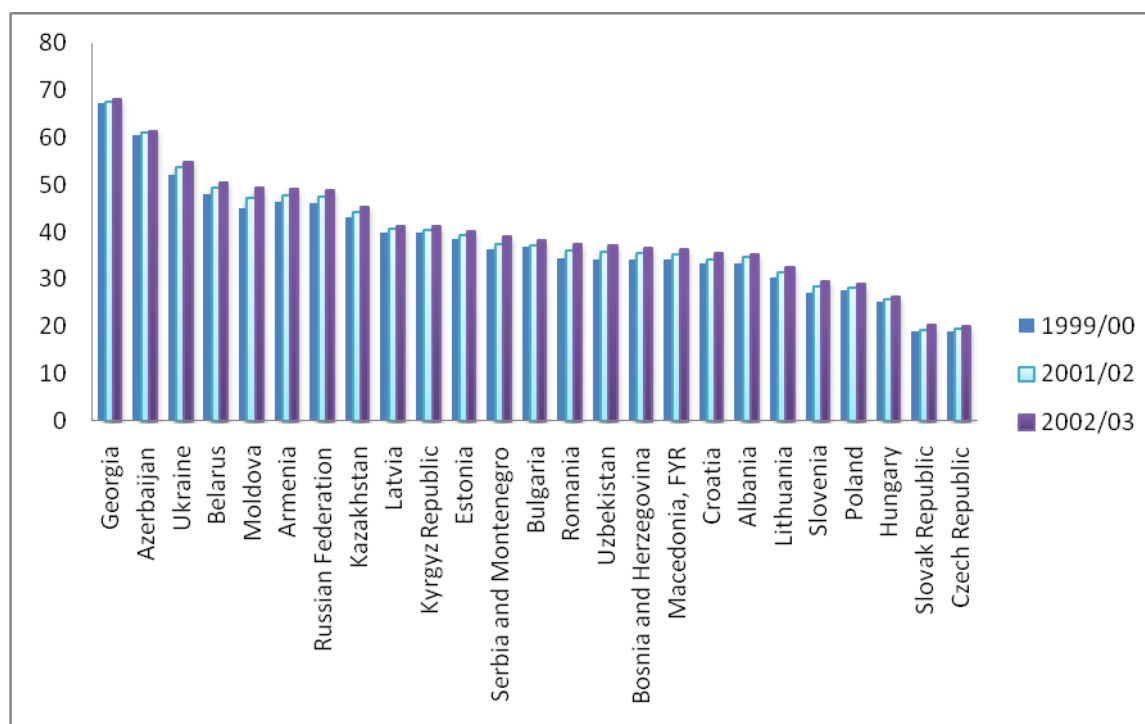
In the course of the last decades, informal employment in Romania, and other transition countries, has changed in size as well as in nature. The transition period and subsequent growth

not only failed to reduce informal employment, but led to an expansion of informal activities operating in a broad range of sectors and taking numerous and quite heterogeneous forms.

In communist times, a “second” economy existed that fulfilled functions the planned economy could not adequately fulfil. It partly consisted of people improving their income with additional sources such as private garden agriculture. In addition, this second economy comprised (semi-) illegal activities, such as people earning additional money either alongside their public jobs during working hours (“left-hand work”), or after working hours (“moonlighting”) (Bernabé, 2002, pp.16-20). In Romania this second economy was not exceptional (Ghinararu, 2007; Stănculescu, 2006; Neef, 2002). Family farming was allowed for very small plots of land, and enterprises used barter and off-the-books payments. More illegal activities such as misappropriation of state-owned enterprises were also pervasive. This second economy flourished especially in the 1980s, reaching up to 20 per cent of the economy according to some estimates (Brezinski and Petersen, 1990).

The informal economy rose further during the period of economic transition. Massive job losses and the explosion in poverty increased the need for people to look for alternative livelihood strategies, but opportunities in the formal private sector were limited because of bureaucracy, corruption and institutional and political uncertainty. The land reform offered a livelihood strategy for many Romanians, and participation in the informal economy also offered families and entrepreneurs a source of revenue in urban areas. Thus, an important share of the population became engaged in informal employment, either as a primary or a secondary job. In the words of Wallace and Haerpfner (2002), informalisation was the consequence of the “failure of the formal market economy to take over from the retreat of the state economy” (in Stănculescu, 2006, p.10). Specific figures on the size of informal employment during transition are rare. It is estimated that informal sector work, i.e. hidden work done to meet basic needs, was highest at the end of the 1990s (Ghinararu, 2004). Figures for the underground economy from the NIS based on the national accounts methodology show a rise from about 5 per cent in 1992, to 18 per cent in 1997 and to 20-21 per cent in 2000-2001 (Albu, 2004, p.3).

Figure 6: Shadow Economy as Percentage of GDP in CEE Countries



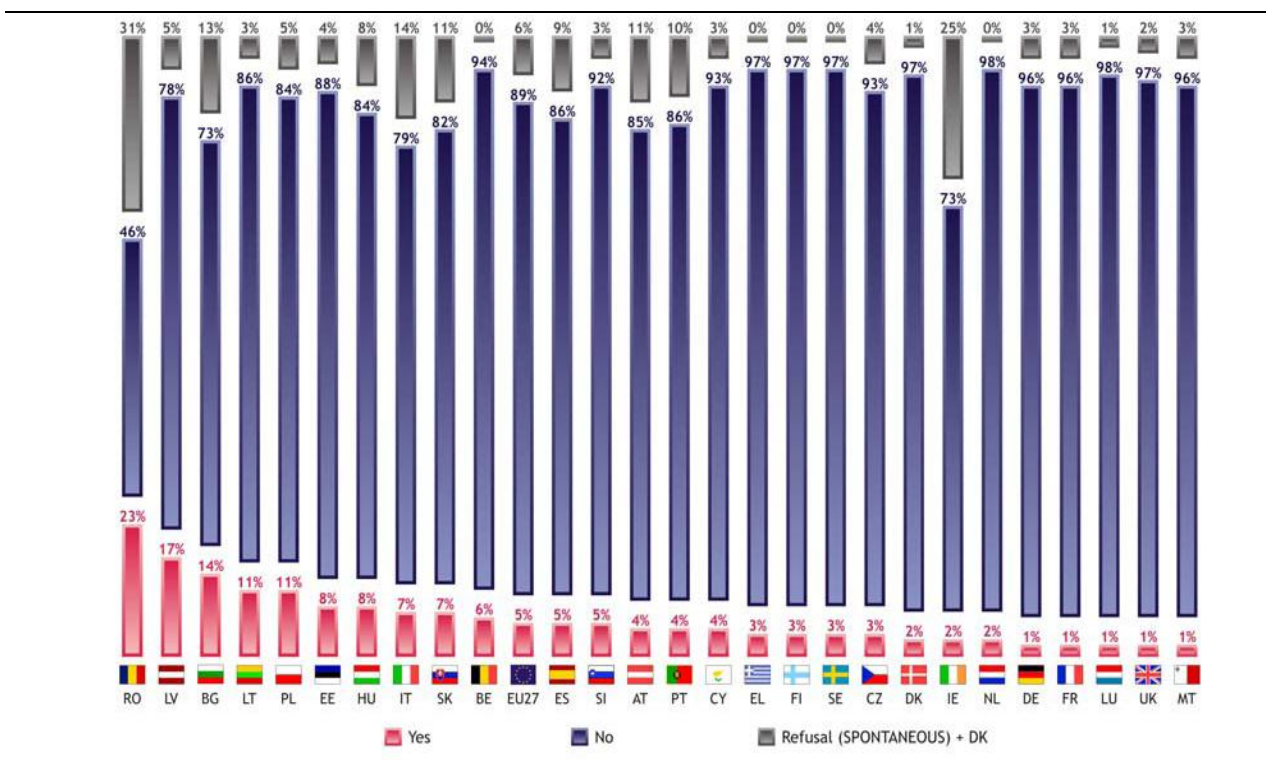
Source: Schneider, 2006, based on DYMIMIC and currency demand method.

Today Romania is at the top of the Central and Eastern European (CEE) countries in terms of incidence of undeclared work, followed by Bulgaria (Renooy *et al.*, 2004; OECD, 2008b). According to the estimates in Schneider (2006)⁷, Romania ranks 14th out of 25 CEE and Former Soviet Union countries in terms of the size of the informal economy as a share of GDP (Figure 6). More specifically, Romania, with a share of 37.4 per cent in 2002/03, appears among the top countries in terms of the shadow economy, well above Croatia, the Czech Republic, Hungary, Lithuania, Poland and the Slovak Republic. Moreover, Romania shows higher shares of people combining informal with formal activities, compared with other countries such as Bulgaria, the Czech Republic, Slovenia and Hungary (Stănculescu, 2006). At the other end, Georgia, Azerbaijan and Ukraine show the highest shares of informal economy, with the Czech and Slovak Republics having the lowest ones. Three main groups of countries can be identified with respect to the size of informal employment. First are Romania and Bulgaria with quite high levels. The second group comprises countries such as Poland, Slovenia, Latvia, and Hungary which present more moderate levels of undeclared work and declining trends. Finally, a third group of countries,

⁷ The dynamic multiple-indicators and multiple-causes model (DYMIMIC) is a method that models the informal economy by connecting indicators for its causes as well as its indicators (more information can be found in Schneider and Enste, 2000; and Schneider, 2002; 2006). Although Schneider's estimates are useful because they allow comparisons across a large set of countries, they should be treated with caution. First, the shadow economy can be quite different from the informal economy and informal employment. Moreover, GDP measures already include a part of the shadow economy but the model cannot provide an estimate for it.

comprising the Czech Republic, Estonia and the Slovak Republic, show low and declining levels of undeclared work (Renooy *et al.*, 2004). It is quite important to note that all countries in Figure 6 show rising trends of the shadow economy as a share of GDP between 1999 and 2003.

Figure 7: Incidence of Envelope-payments (Eurobarometer 2007)



Source: EC, 2007.

Note: The question asked was the following: "Sometimes employers prefer to pay all or part of the regular salary for extra work or over-time hours cash in hand and without declaring it to tax and social security authorities. Did your employer pay you all or part of your incomes in the last 12 months in this way?"

Data from the Eurobarometer (European Commission, 2007), in Figure 7, show that Romania, with 23 per cent, is first among EU countries in terms of the incidence of envelope payments. More worryingly, Romania is also first in terms of the share of people who refused to answer (or did not know). This is indicative not only of the importance of the phenomenon for Romania but also of the attitude with which people approach it.

In the following, different measures and proxies of informal employment are presented in order to provide as comprehensive a picture of the phenomenon as possible. Table 10 presents some of the estimates of informal employment in Romania. It shows the heterogeneity of the estimates, depending on the specific definition adopted and the methodology used. Most importantly, it should be borne in mind that these figures focus on different aspects of informal employment and so are not necessarily comparable.

Table 10: Summary of Estimates Underground Employment, Various Years and Methods

Type	Source	1999-2000	2003	2004-2005
<u>Economy (share of GDP)</u>				
Currency demand and DYMIMIC (shadow economy – per cent)	Schneider (2006)	34.4	37.4	
Undeclared work (per cent) (a)	Ghinararu (2007)	13.0		21.0
Covered wage bill (per cent) (b)	Ghinararu (2007)	10		4.3
Undeclared work (in millions)	Ghinararu (2007)	1.4		1.9
Unregistered workers (including informal sector employment in agriculture and non-agriculture) as share of total employment (per cent)	Stănculescu (2006)	52.3		45.7
Unregistered workers (in millions)	NIS (1999)	1.5-2		
Unregistered workers (in millions)	National Research Institute for Labour and Social Protection (2004)			1.2

Notes: (a) Undeclared work is an estimate of the dimensions of undeclared work expressed as percentage share of the country's GDP, using an estimation with a mix of explanatory variables (Ghinararu, 2007). (b) The figure on the covered wage bill is a proxy for the size of the non-observed/non-registered economy expressed as a share of the country's GDP (Ghinararu, 2007).

Informal employment in Romania has changed in nature since the pick-up of growth from 2000 onwards. Until the beginning of the millennium, most of the informal work within the informal sector was in agriculture. Agriculture was indeed the main sector absorbing people who had lost their jobs following the transition and could not find formal jobs elsewhere (Stănculescu, 2006). Although the importance of agriculture in informal employment has fallen in more recent years it still remains an important activity in the portfolio of income-generating strategies for some households. Table 11 lists the number of unregistered workers in agriculture as the sum of the number of self-employed and unpaid family workers active in agriculture, computed from labour force survey data for the years 1995-2005 by Stănculescu (2006). Figure 8 presents the share of total unregistered work in total employment, and also distinguishing between unregistered work in agriculture and non-agriculture. This type of employment peaked at 4.2 million persons in 2000/2001, and decreased sharply to 2.8 million in 2005, only four years later.

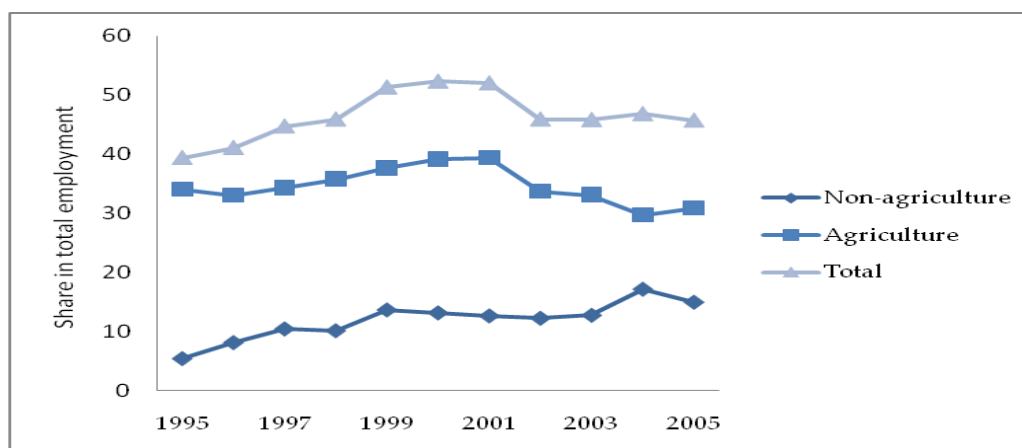
Table 11: Estimates of Unregistered Workers in Agriculture and Non-agriculture, 1995 – 2005

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Number of unregistered workers in agriculture (thousands of persons).	3 792	3 610	3 793	3 883	4 061	4 213	4 218	3 109	3 059	2 722	2 819
Number of unregistered wage-earners in non-agriculture (thousands of persons).	606	881	1 150	1 100	1 467	1 414	1 344	1 129	1 169	1 567	1 362
Unregistered work in agriculture in total employment (per cent)	34	33	34.3	35.8	37.7	39.2	39.4	33.7	33.1	29.7	30.8
Unregistered work in non-agriculture in total employment (per cent)	5.4	8.1	10.4	10.1	13.6	13.1	12.6	12.2	12.7	17.1	14.9
Total unregistered work in total employment (per cent)	39.4	41.1	44.7	45.9	51.3	52.3	52	45.9	45.8	46.8	45.7

Source: Stănculescu, 2006, based on NIS data.

Note: Data computed as difference between the number of employees in LFS and number of employees in LCS, NIS.

Figure 8: Non-registered Work Across Sectors



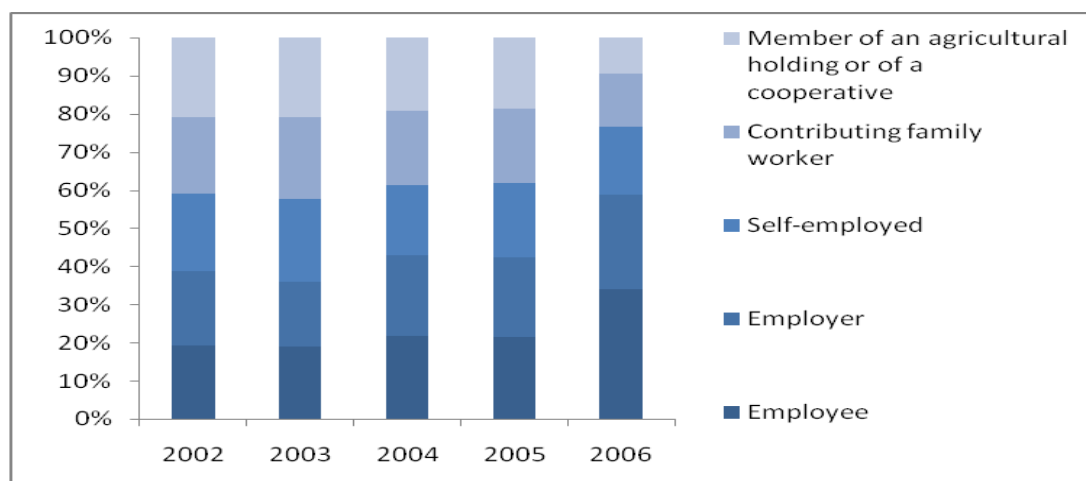
Source: Stănculescu, 2006, based on NIS data.

Looking at the distribution of the workforce across different groups (Figure 9) provides a rough picture of the extent and evolution of some forms of informal employment. Two often-used proxies for informal employment, are the numbers of individuals in self-employment and those of contributing family workers. As shown in Figure 9, the shares of contributing family workers and the self-employed⁸ stood at 13 per cent and 19 per cent respectively in 2006, following a downward trend since 2002. Accordingly the share of waged employees in total employment was around 62 per cent in 2002 and close to 66 per cent in 2006, substantially lower than respective figures in other transition countries (Stănculescu, 2006). According to

⁸ It should be noted here that according to the ILO definition, self-employment comprises all categories of non-wage employment, i.e. own-account workers, contributing family workers, employers and members of co-operatives. However this report presents the data further disaggregated in order to provide a more complete picture of the phenomenon and hence self-employment is defined as a more restrictive term than the ILO definition.

Stănculescu (2006, pp.3), this reflects an important structural problem, especially taking into account that about “90 per cent of the self-employed and over 95 per cent of the unpaid family workers were doing subsistence agriculture” during the entire transition period.

Figure 9: Status of Employed Persons, 2002-06

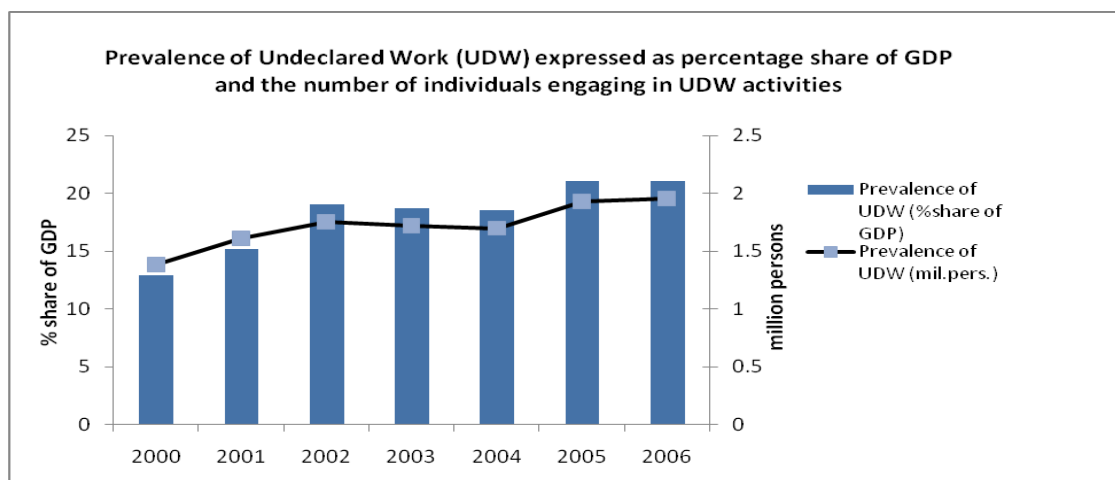


Source: Household Labour Force Surveys 2002-2006, National Institute of Statistics.

An additional, indirect estimate of unregistered work can be derived from the comparison between the number of workers in labour force surveys (LFS) and labour cost surveys (LCS). While the LFS asks workers whether individuals work or not and hence captures registered as well as non-registered individuals, the LCS only captures officially registered firms and their employees. Therefore the difference between the LFS and LCS estimates can be taken as a proxy for workers who are not registered. Stănculescu (2006) has conducted this exercise for Romania for the period 1995-2005. Table 11, based on her findings, clearly shows that there has been a rising trend over time, with a peak in 2004 when over 1.5 million workers were not registered. Between 1995 and 2005, indeed, this number more than doubled. While these estimates in Stănculescu (2006) concern the number of workers, they do not contain information on whether this concerns part-time or full-time work. So we cannot make any inference about the extent of the phenomenon in terms of working hours or output.

Ghinararu (2007) uses a different methodology to estimate undeclared work as a share of GDP and of total employment in full-time equivalents. Figure 10, taken from Ghinararu (2007) displays the trend of undeclared work over the 2000-2006 period. The importance of undeclared work has followed economic growth trends, but at a slower pace. In particular, undeclared work as a share of GDP shows an upward trend until 2005, when it peaks at 22-23 per cent to decline slightly in 2006. The number of persons engaged in this type of work has risen from 1.4 million to around 2 million of the workforce. This aggregate estimate includes both those persons who do not declare their earnings and those who under-declare them.

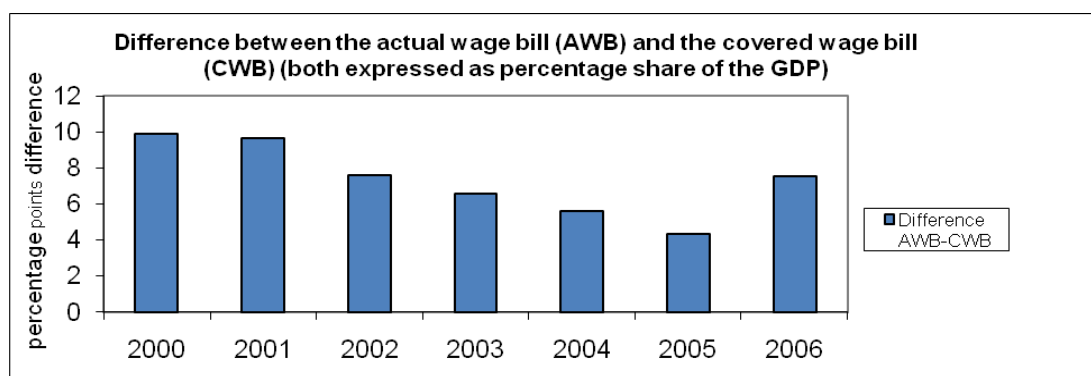
Figure 10: Undeclared Work, 2000-06 as Percentage GDP and Millions of Persons



Source: Calculations by Ghinararu (2007), using NIS data.

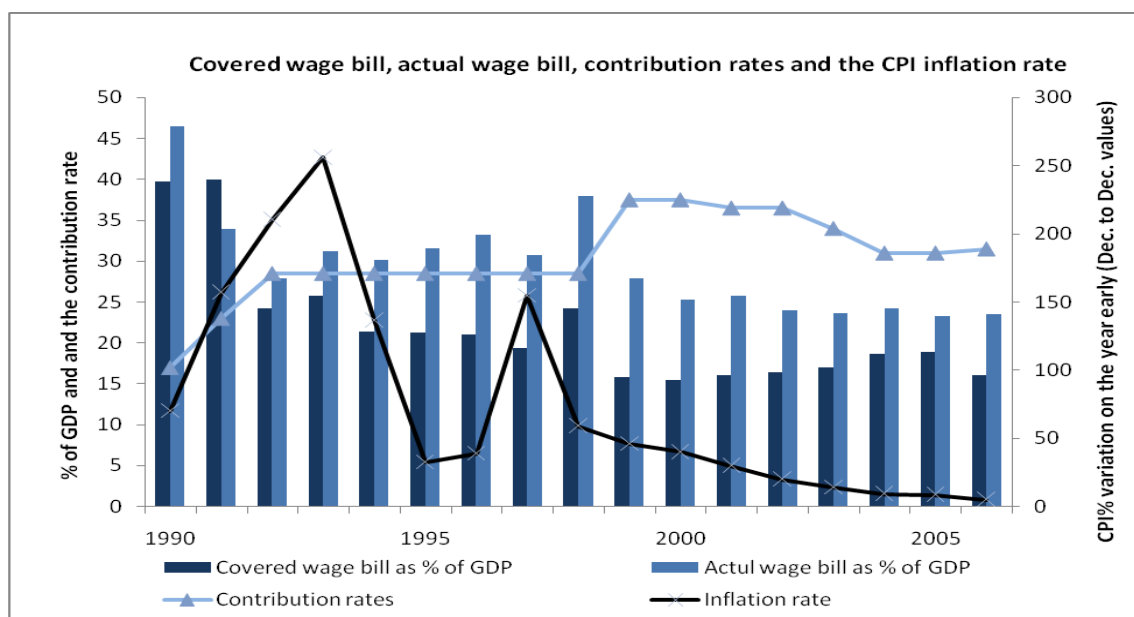
Ghinararu (2007) compares the “covered” and “actual” wage bills to provide very interesting evidence on the incidence of undeclared work in Romania. The “covered wage bill” captures the sum of wages that should have been paid in the economy given the total amount of contributions collected from both employers and employees and the combined contribution rates. The “actual wage bill” is the product from the total number of salaried employees and the average gross wage, as presented previously. A high share of the covered wage bill in GDP would reflect a higher share of wages in GDP but also higher tax and social contributions compliance, and hence lower informality. However, reforms of tax and social security contributions should also be taken into account when interpreting the covered and actual wage bills. According to Ghinararu’s results, the covered wage bill is substantially lower than the actual wage bill for the entire period 1992-2006, which implies that an important share of waged workers lack social security coverage, an indication of the extent of informal employment.

Figure 11: Covered and Actual Wage Bill, 2000-06



Source: Calculations by Ghinararu. (2007), using NIS data.

Figure 12: Covered and Actual Wage Bill, 2000-06



Source: Calculations by Ghinararu. (2007), using NIS data.

This section has provided an overview of different estimates of informal employment, based on various definitions of informality. It has shown that informal employment has been persistent and increasing until recently. However, with the pick-up of growth since 2000, informal activities have decreased as share of employment as a result of the decreased role of subsistence agriculture in households' income. Despite this decrease, informal employment remains an important labour market challenge for the government and it still constitutes an important livelihood strategy for many poor households. In addition, since incomes have increased for some groups of the population tax and social security evasion has become of increasing concern to public authorities.

III.3 Characteristics of informal employment and the profile of individuals

In this section we use data from the Labour Force Surveys (LFS) for the years 2002-2006 (NIS)⁹. The fact that the Romanian LFS do not include a module on informal employment further complicates the study of the phenomenon. However there are questions in those surveys which can help us to provide at least a partial picture of informality in the country. In what follows we have used these data to identify the characteristics of people in informal employment. For the sake of this analysis, we use three proxies for informal employment: first, the absence of a labour contract; second, self-employment; and third, micro-activity. We also provide some data on multiple job holders, in particular their characteristics in terms of gender and geographical location, as well as the sectors in which the second job operates.

⁹ The data were kindly provided by the Romanian National Institute of Statistics. It should be noted that the NIS warns that some questions and groups pose potential problems as calculations for specific cells are based on a small number of observations.

This section provides an overview of the characteristics of the people in some form of informal employment, the sector in which the phenomenon is most prevalent and certain characteristics of informal employment.

III.3.1. Sectors of activity

Table 12 presents the distribution across sectors of workers without a labour contract, but who work instead with different types of labour agreements, based on the LFS data for 2006. The two main sectors in which workers are not hired with a labour contract are those of manufacturing and wholesale and retail trade, with 21 and 22 per cent respectively. Next is construction with 15 per cent, followed by agriculture and public administration with 9 and 8 per cent respectively. These numbers are in line with findings in the literature. According to Stănculescu (2006), most studies agree that informal activities are mostly concentrated in the sectors of retail trade, transportation, construction, repair and maintenance services, agriculture, hotels and restaurants, health and education. Along the same lines, Ghinararu (2004) gives estimates of the share of different sectors in undeclared work. According to his estimates, construction is the sector most pervasively associated with informal economy activities, accounting for around 14 per cent of undeclared work in the non-agricultural sector. Undeclared work is also quite widespread in trade, especially among very small retailers, with around 12 per cent, followed by textiles and leather with 11 per cent. The same sectors are also identified in a recent report by the EC, based on data from the Eurobarometer (EC, 2007). Looking at the types of activities people report they are doing undeclared, construction is highlighted with a substantial 21 per cent, then agriculture (12 per cent), personal services and retail (10 and 9 per cent respectively). The shares of agriculture and construction are indeed higher than the EU average, but close to those in other Central and Eastern European countries.

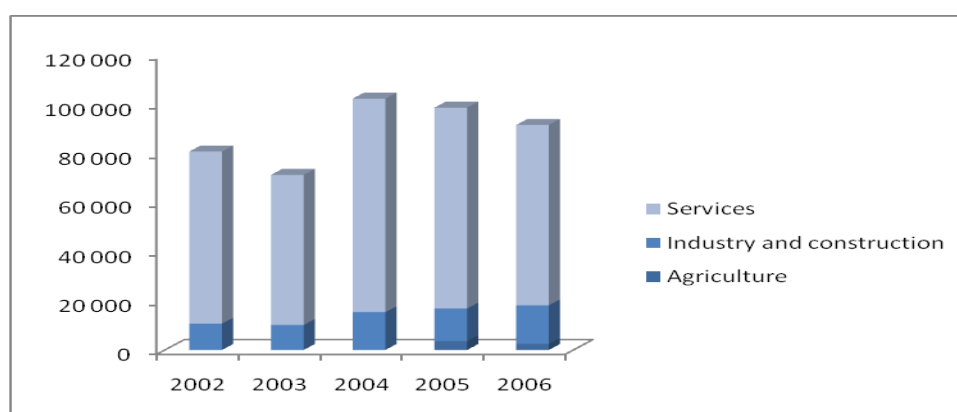
Table 12: Workers With and Without Labour Contracts by Sector of Economic Activity (in Percentages)

	Distribution of workers with labour agreements other than labour contract
Agriculture, hunting and forestry	8.8
Fishing	0.5
Mining and quarrying	0
Manufacturing	21.4
Electricity, gas and water supply	0
Construction	15.1
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	21.7
Hotels and restaurants	3.7
Transport, storage and communications	5
Financial intermediation	1.1
Real estate, renting and business activities	4.8
Public administration and defence; compulsory social security	7.7
Education	0.9
Health and social work	2.1
Others activities of national economy	7.1

Source: Romania, NIS, Labour Force Survey (2006).

In Figure 13, micro-activity with from one to five employees is taken as a proxy for informal employment. Micro-enterprises are found to operate mostly in services.

Figure 13: Micro-enterprises with 1-5 Employees



Source: Romania, NIS, Labour Force Surveys.

Box 2: Informal Employment in the Construction Sector: Evidence from a Focus Group

The construction sector has grown significantly in recent years, and so has the incidence of informal employment in it. "Despite its growth, the sector is facing important challenges especially in attracting and retaining skilled workers", participants in the focus group say. Skills shortages are mainly due to the emigration of construction workers abroad, but also to the delay of the educational system in responding to the increasing demand for skills in construction. Moreover, low pay and job insecurity discourage young Romanians from choosing to work in construction.

Informal employment is most prevalent among small companies and the self-employed. Multiple job-holding combined with informal work is widespread in the construction sector: many workers employed by large companies in the morning choose to work, mostly informally, in private households or small business in the afternoon or at night. In addition false part-time employment is also quite common as many full-time workers are contracted to work part-time and receive additional wages in the form of envelope payments. Also, envelope payments serve to pay overtime work.

High tax wedges as well as complex and time-consuming administrative procedures are the two main reasons why (mainly small) businesses and the self-employed opt for informality. Although registration procedures have been simplified, this is not the case for administrative procedures related to the fiscal, health and unemployment authorities. In addition the efficiency of inspection is particularly low in the construction sector, because of the nature of the work. Workers are very often employed in private properties, where labour inspection and fiscal authorities have limited access.

Source: focus group discussions (March 2008)

III.3.2. Individual characteristics

Identifying the characteristics of people most likely to be in informal employment in some respect is very important for understanding the rationales behind informal employment. Based on LFS data for 2006, Table 13 presents the distribution of the different employment types (employee, employer, etc.) by demographic characteristics such as age, gender, ethnicity and education.

According to a recent EC study (EC, 2007) Romania is among the group of EU countries that show an above-average share of persons who consider that the self-employed are most likely to work undeclared. So taking self-employment as a proxy for informal work is likely to provide a correct picture of at least an important part of those working informally. As shown in Table 13 the self-employed are mostly middle-aged individuals; over half of them (56 per cent) are more than 45 years old. Men are also over-represented in this group with about 71 per cent. The self-employed tend to be less educated than employees and employers, with 58 per cent having low educational attainment and 44 per cent medium levels. In terms of ethnic origin, if we look at the distribution of the different ethnic groups across the different employment statuses (not reported here, available upon request), we see that most of the working population of Romanian, Hungarian and German origin are employees (66, 75 and 80 per cent respectively), while for the Roma working population the percentage is much lower at 28 per cent. In 2006 about 44 per cent of the Roma working population were self-employed. However these observations should be

treated with caution, in view of NIS warnings about inferences based on small samples such as those referring to ethnicity.

Table 13: Employment Status by Age, Gender, Education and Ethnic Origin (Percentages)

	Employee	Employer	Self-employed ¹⁰	Contributing family worker	Member of agricultural holding or co-operative
<u>Age groups</u>					
15-64	99.8	99.6	82.7	89	94.3
15-24	7.8	1.2	4.2	20.1	13.2
25-34	30.4	23	18.7	24.4	27.3
35-44	29.6	36	20.2	15.1	19.3
45-54	25.4	29.2	20.5	14	18.8
55-64	6.6	10.1	19.1	15.4	15.6
65 +	0.2	0.4	17.3	11	5.7
<u>Gender</u>					
Male	53.9	75.3	71	30.9	59.1
Female	46.1	24.7	29	69.1	40.9
<u>Ethnicity</u>					
Romanians	92.3	88.8	90.8	93	83.5
Hungarians	6.2	7	4.5	2.8	14.8
Roma	0.7	1	4.1	3.6	1.7
Germans	0.2	0.4	0.1	0	0
Other nationalities	0.5	2.8	0.6	0.6	0
<u>Educational attainment</u>					
High	18.9	31.8	1.8	0.5	5.6
Medium	72.5	64.5	43.6	33.3	43.2
Low	8.6	3.7	54.7	66.1	51.2

Note: the level of education has been divided into: i) high: PhD (ISCED 6), Long-term university and short-term university (ISCED 5); ii) Medium: Post high-school speciality or technical foremen (ISCED 4), High school, vocational, complementary or apprenticeship and High school first cycle (ISCED 3); iii) Low: Gymnasium (ISCED 2), Primary (ISCED 1) and No education (ISCED 0)

Source: Romania, NIS, Labour Force Survey.

¹⁰ The definition of the term “self-employed” here is used more restrictively than that of the ILO which defines self-employment as all categories of non-waged employment.

Table 14: Workers With and Without Labour Contracts by Age, Gender, Education, Ethnic Origin and Household Characteristics (Percentages)

	Total numbers of individuals with other than labour contract labour agreement	Distribution of workers with other types of labour agreements
<u>Total</u>	47028	
<u>Age groups</u>		
15-24 years	8 437	17.9
25-34 years	17 016	36.2
35-44 years	11 204	23.8
45-54 years	7 442	15.8
55-64 years	1 992	4.2
65 years and over	937	2
<u>Gender</u>		
Male	30 018	63.8
Female	17 010	36.2
<u>Ethnicity</u>		
Romanian	42 100	89.5
Hungarian	3 099	6.6
Rroma	1 153	2.5
German	0	0
Other nationalities	675	1.4
<u>Educational attainment</u>		
High	3 742	8
Medium	31 504	67
Low	11 781	25.1
<u>Household size</u>		
Households with 1 person	2 683	5.7
Households with 2 persons	6 444	13.7
Households with 3 persons	10 655	22.7
Households with 4 persons	14 330	30.5
Households with 5 persons and over	12 915	27.5
<u>Household head's education</u>		
High	2 803	6
Medium	28 474	60.5
Low	15 751	33.5
<u>Household head's labour status</u>		
Employee	35 948	63.2
Non-employee ^{a)}	29 734	13.2
Unemployed	6 214	3.1
Non-economically active	1 443	20.5

Note: the level of education has been divided into: i) high: PhD (ISCED 6), Long-term university and Short-term university (ISCED 5); ii) Medium: Post high-school speciality or technical foremen (ISCED 4), High-school, Vocational, complementary or apprenticeship and High-school first cycle (ISCED 3); iii) Low: Gymnasium (ISCED 2), Primary (ISCED 1) and No education (ISCED 0)

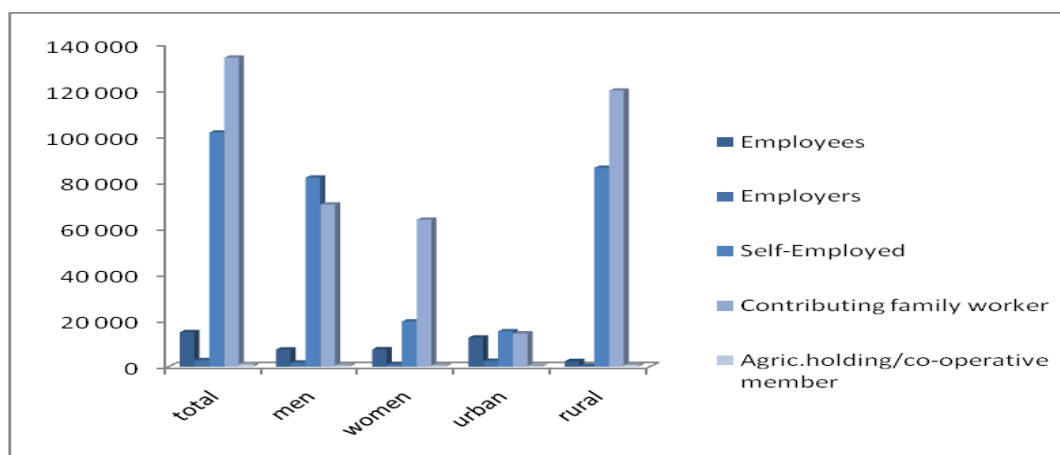
Source: Romania, NIS, Labour Force Survey (2006).

Turning to the group of contributing family workers as another proxy for informal employment, we note that they are mostly women (70 per cent) and young (44 per cent below 34 years old). They have on average lower educational credentials than all other groups. Again, the Roma working population is quite well represented in this group (27 per cent of them are family contributing workers, compared with 13 per cent for individuals of Romanian origin). Nonetheless, the vast majority of contributing family workers are, as expected, Romanian origin (93 per cent).

Overall, taking the self-employed and contributing family workers as proxies for informal employment, we find results similar to those in Ilie (2004). This shows that individuals in informal activities are on average older and less educated than those working formally. According to Stănculescu (2006), the self-employed in Romania are poorly educated, either very young (15-24) or old, and work in agriculture. A large share of those engaging in self-employment are pensioners/farmers or unemployed/farmers.

To complete the picture, we take as a proxy for informal employment the absence of a labour contract. Table 14 presents the characteristics of people working without a labour contract but with some other form of labour agreement. It shows that these are mostly aged 25-44, men, and have low or medium education. They come from big households with 58 per cent of them living in a household with four or more members. About 76 per cent of them come from households where the head is working. This could be in line with the theory that when at least one household member is working (formally), the marginal benefit of a second household member to work formally is relatively low, at least as far as health insurance coverage is concerned. However, this is only a hypothesis, and it is not possible to test it with currently available data. A substantial 20 per cent come from households with non-active heads, a likely indicator of household poverty. This last observation may indicate that informal employment serves as an anti-poverty livelihood strategy for households.

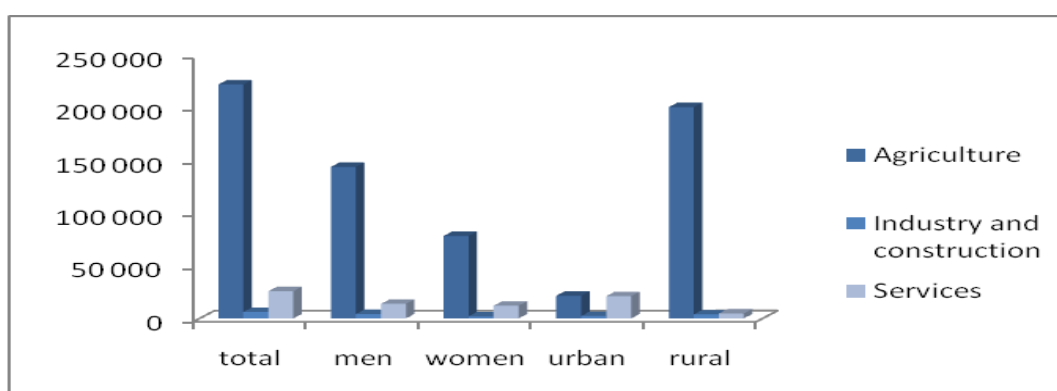
Figure 14: Second Jobs by Type of Employment



Source: Romania, NIS, Labour Force Survey (2006).

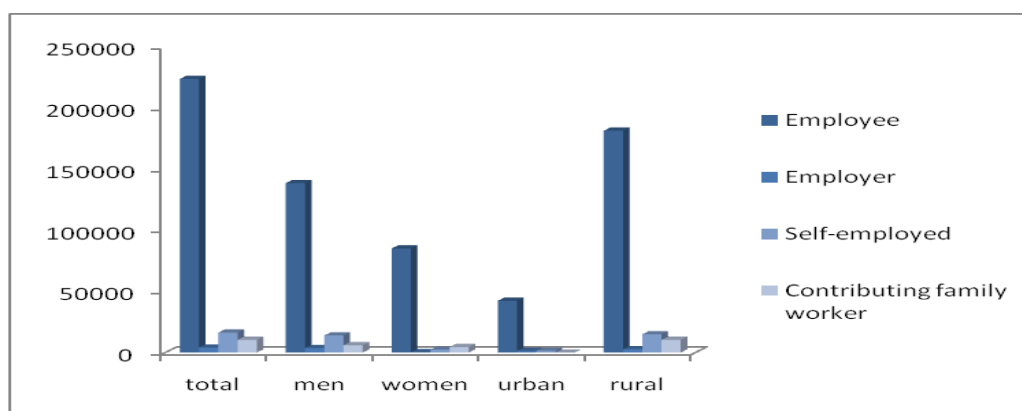
A final, crucial aspect of informal employment concerns people who combine different jobs and activities as a livelihood strategy. Although finding precise data on this is not yet possible for Romania, Figure 14 and Figure 15 show some characteristics of the second job for people with two jobs, whereas Figure 16 shows the type of employment the first job entails. According to Figure 14, the vast majority of people with two jobs are either self-employed or contributing family workers in their secondary activity. This is especially the case in rural areas. In contrast, the distribution among the self-employed, employees and contributing family workers is quite balanced in the cities. Most women with a second job are contributing family workers, whereas for men the numbers are split quite equally between the self-employed and contributing family work. In rural areas, the vast majority of second jobs are in agriculture, followed by the services sector, and this is true for both men and women; whereas in urban areas, they are split equally between agriculture and services (Figure 15). The vast majority of individuals with two jobs, are employees in their first (main) activity, according to Figure 16. In rural areas, a substantial share consists of self-employed or contributing family workers.

Figure 15: Second Jobs by Sector of Economic Activity



Source: Romania, NIS, Labour Force Survey (2006).

Figure 16: First Jobs by Type of Employment (For Multiple Job-holders)



Source: Romania, NIS, Labour Force Survey (2006).

Taking different definitions of informal employment, it has been shown that individuals in informal activities are mostly middle-aged and less educated than those in formal jobs. Women are over-represented among the contributing family workers, and so are the young. When the absence of a labour contract is taken as a proxy for informal employment, the typical individual in informal work is a man with low or medium education, living in a big household. Overall the evidence presented in this section points towards informal work being more of a livelihood strategy for relatively poor households, with few alternatives in the labour market. Yet this does not preclude certain individuals voluntarily choosing informal employment because of the benefits it offers them.

III.3.3. Informal employment and poverty

The relationship between informal employment and poverty is complex. On the one hand, poverty, in association with the lack of formal opportunities, can lead individuals and households to seek alternative livelihood strategies, often in informal employment. On the other hand, informal employment can itself either lead to poverty or contribute to poverty reduction. These opposing results often coexist, depending on the type of informal employment and specific country context and time period. Understanding the causal relationship between informal employment and poverty would require rich data and sophisticated techniques, and so cannot be conducted with the currently available data in Romania. We shall therefore briefly review the relevant literature in order to gain a better understanding of the links between informal work and poverty.

Informal activities in Romania have existed for many years, taking different and quite heterogeneous forms. It is widely acknowledged that during the harsh years of transition, job losses, unemployment and the resulting poverty were the main reasons behind informality for most people (Marc and Kudatgobilik, 2002; Stănculescu and Ilie (2001); Kim, 2005; Albu, 2004). Those job losses, accompanied by limited alternative formal job opportunities and lack of an appropriate system of social benefits, led to informality as an income-generating strategy and a household strategy against poverty.

Analysis of the direct evidence from household surveys has been found to support the assertion that poverty was the basic reason for participation in informal activities (Kim, 2005; Albu, 2004). The evidence in Kim (2005), based on the 1996 household survey, shows that most households engaged in the informal economy are among the poorest. So poverty and the lack of alternatives may lead individuals to take up informal employment, and income from informal employment can in turn serve as an important safety net against poverty. This is confirmed by Stănculescu (2006) who argues that informal employment plays an extremely important role in poverty reduction at the household level in Romania. Looking at the ratio between all benefits (including pensions) provided by the state and household income from some kind of informal activities¹¹, she shows that for low and middle-income deciles informal employment is very important even in comparison to state benefits. Along the same lines, Stănculescu and Ilie (2001) argue that the combination of subsistence farming and informal work is an especially important household livelihood strategy, offering a safety net against poverty. Their calculations show that in 1998 the share of severely poor households was substantially decreased when informal income was taken into account. Combining informal and formal activities is a common household livelihood strategy. According to Stănculescu's findings, in 1998 about 65 per cent of all households derived income from a combination of formal and informal sources, whereas only 26 per cent received income from formal sources only.

Informal employment may be particularly useful for specific groups of the population who are less likely to have access to formal jobs. Marc and Kudatgobilik (2002), argue that informality serves as a coping strategy, especially for the Roma. At the same time, however, not all people in informal employment are poor. Albu (2004) argues that during the transition a small rich segment also engaged in informal work not just to make ends meet, but to avoid paying taxes and contributions.

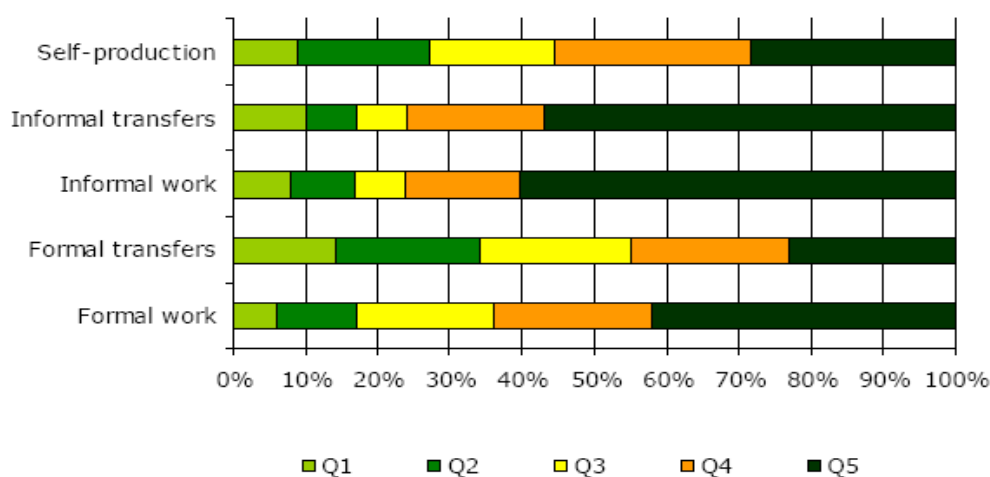
A recent poverty assessment on Romania (World Bank, 2007a) shows that unemployment and informal employment are both associated with a higher incidence of poverty. Taking self-employment as a proxy for informal employment, the report shows that 32 per cent of self-employed adults working in agriculture are poor, against the national average of 14 per cent. The self-employed in non-agriculture and the unemployed are also over-represented among the poor, with 23% and 27% respectively. Moreover, it is found that the incidence of poverty increased in 2006 for the self-employed in agriculture, contrasting with a downward trend observed until 2005.

There is limited evidence available on the share of informal income in total household income. Albu (2004) shows that the share of informal incomes in total real incomes of households increased from 18 per cent in 1995 to 21 per cent in 2002, highlighting the importance of informal employment for the livelihood of many households in Romania. Stănculescu (2007) presents evidence on earnings from various sources along the distribution of total household income. Her findings suggest that formal transfers and informal work are the two main income sources for households in the lowest quintile. This highlights the importance of both social assistance programmes (formal transfers) and informal employment as an income-generating strategy for

¹¹ Defined as income from agriculture, income from non-agricultural self-employment and inter-family transfers in net total household disposable income per adult equivalent.

the poorer households. For people in the second and third quintiles, earnings from formal transfers, formal work and self-production represent the largest share of their total incomes. This might suggest that, for the individuals who have the opportunity to do it, self-production replaces informal work in some way. Finally, earnings from informal employment represent a substantial share of total income of individuals in the highest quintile, along with informal transfers and formal work.

Figure 17: Income Distribution by Source



Source: Stănculescu (2007), based on the data from the Research programme "Social Effects of Informal Economies in Eastern Europe, 1998-2000", Volkswagen Stiftung.

Nonetheless, informal employment does not always serve as a safety net for poor individuals and households. The Eurobarometer (European Commission, 2007) provides interesting information on the consequences of undeclared work. Paid employees in Romania report the following two main consequences: a higher risk of job loss and lack of insurance. Among those who answered that they performed some type of undeclared activity in the last 12 months, 23 per cent said that they had a higher risk of losing their job, a much higher percentage than the EU average. Another 19 per cent said they lacked insurance against accidents.

Overall, informal employment on its own or in combination with other activities appears to be an important livelihood strategy for many households, as it helps to supplement income from other sources. Nevertheless, this is not without potential risks related to the lack of health and pension coverage, unemployment and uncertainty. Getting a better understanding of the causal links between informal employment and poverty requires better data such as panel or appropriate cross-sectional data. In addition, complicated techniques would need to be used and appropriate identification of the counterfactual should be found.

III.4 The determinants of informal employment

As seen in the previous sections, informal employment in Romania takes various forms and dimensions. This section aims at better understanding the determinants of informal employment. Special attention is paid to the reasons leading to informality as a choice and those related to informal employment as a last resort. An additional difficulty is that for Romania there

are no systematic available data that would allow us to test rigorously the determinants of informality at the micro or macro level. So in this section we try to gain some understanding about the motives of groups engaging in different types of informal work, based on a review of the existing literature as well as questionnaires addressed to policy experts and entrepreneurs and interviews held with focus groups¹².

Table 15: Factors Determining Informal Employment Outcomes

Categories	Factors	Informal Employment Outcomes
Socio-economic factors	Economic growth, poverty, unemployment	Subsistence agriculture, under-declaration of earnings, street vendors, contributing family workers, etc.
Institutional factors	Economic restructuring Land market Tax system Social security system Labour market regulations Governance Corruption International developments	Non-registration of firms, firm tax evasion, workers' tax evasion, social security contributions evasion, envelope payments, etc.
Societal/ Behavioural factors	Lack of trust Negative perception of the state Appreciation of public services	Tax and social security evasion, underground and illegal activities, etc.

We follow Renooy *et al.* (2004) to summarise (Table 15) the factors likely to affect the size and extent of informal employment shaping informal work in three groups:

1. Socio-economic factors: economic restructuring and privatisation of state-owned enterprises, economic growth, unemployment, poverty, inequality, demographic changes, and migration.
2. Institutional factors: labour market regulations, land reforms, tax system, social security system, institutional infrastructure, bureaucracy, public administration, corruption, Schengen area.
3. Societal/behavioural factors: lack of trust in public institutions, negative perception of the role of the state, partial understanding or underestimation of the benefits derived from social security.

Economic factors such as growth, the structure of the economy, and poverty and unemployment are among the primary determinants of informal employment. High

¹² Details about the policy experts and entrepreneurs' questionnaires and the focus group interviews can be found in the appendix.

unemployment and the dismantling of state-owned enterprises led to a large number of people looking for jobs outside the formal structures of the economy. Land reform which led to the dismantling of state-owned farms and co-operatives has also contributed to this end. Poverty and inequality are also among the determinants of informal employment. However, we should note that the causal relations are not clear. High poverty levels can lead to informal employment but informal employment can also cause higher poverty.

Along with the above economic factors, emigration has also been blamed as partly responsible for the reported increase of informal employment. An important number of Romanian migrants are temporary, returning to Romania quite often, even within the same year. Because of their short-term stays, they encounter significant difficulties in finding employment in the formal sector when they return to Romania. Instead they find alternatives in the more flexible informal sector for the limited time until their next spell of migration starts. The economic structure, in particular the share of agriculture and services in employment, is found among the determinants of informal employment. The primary and tertiary sectors offer in general more opportunities for informal work given that the production unit is often outside the firm and other formal structures. At the sectoral level, informal employment depends on output growth rate, the share of wage-paid labour in total labour, fiscal burden and the degree of labour mobility, as argued in Ciupagea (2004).

A second set of factors determining informal employment includes those related to institutions. These include labour market institutions and regulations, and the tax and social security systems. Indeed, tax reforms implemented recently in Romania (Schneider, 2002; Stănculescu, 2006; Ciupagea, 2004, etc.), as well as reforms of the social security system and contributions, have directly and indirectly shaped the incentives for informal employment versus work in the formal sector. Increases in the level of the minimum wage and heavy taxation have led many micro and small enterprises to use informal labour (Stănculescu and Ilie, 2001).

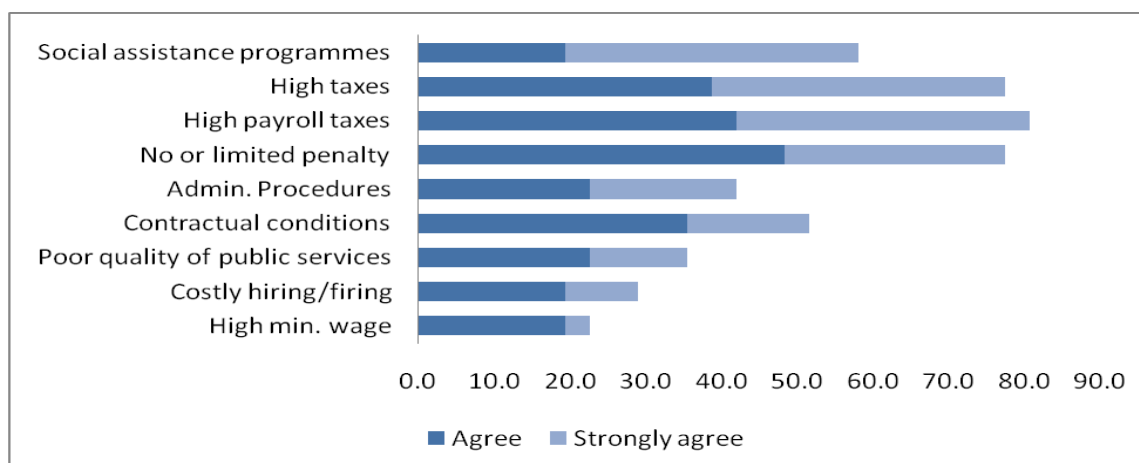
High tax levels are reported as the main reason for employers not registering a business and workers, or for workers not declaring (part of) their earnings. According to the questionnaires sent to a small sample of entrepreneurs in Romania, the burden of administrative procedures also counts in the decision of firms to enter the informal sector in some way. In our sample, an important number of entrepreneurs report that complicated and strict regulations, which can also be costly and time-consuming, often lead them to bypass the formal structures and operate in some informal way. Moreover, lengthy commercial registration procedures are also reported to be one of the factors leading them to informality. In terms of constraints in registering their workers, entrepreneurs mention high payroll taxes and social security contributions. On top of that, strict labour regulations and lengthy administrative procedures do not provide the appropriate incentives for employers to register their workers. Stănculescu and Ilie (2001) argue that labour market regulations may to some degree be responsible for informal employment. The lack of provisions for casual and unregulated day work limits the opportunities for the unskilled to work formally and pushes them to informality. Nonetheless, there are cases in which such arrangements were misused to keep people in flexible contracts.

A survey conducted with a small sample of policy experts gives a good descriptive picture of what this group considers to be the main determinants of informal employment (Figure 18). According to the respondents, the most important reasons leading to informality are

high taxes in general, and more specifically high payroll taxes. In addition, the absence or low level of penalties for being informal is mentioned among the primary determinants of informal employment. An important share of respondents, identify social assistance programmes as factors pushing people into informality by reducing their incentives to become formal. Rigid labour market regulations also figure among the factors responsible for informality: a substantial share of policy experts in our sample believes that strict contractual conditions may be leading to informal employment. Almost half of the respondents consider that too constrictive contractual conditions are leading to informality. Even if progress has been made to simplify as far as possible the administration procedures, bureaucracy remains a possible reason for operating informally.

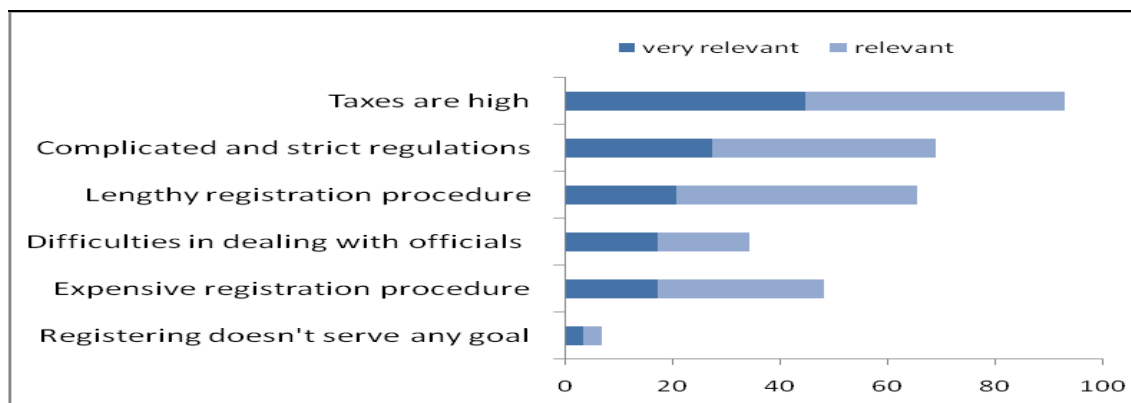
Similarly, Stănculescu and Ilie (2001) argue that early retirement policies and low pensions (since 1990) have pushed pensioners into some form of informal employment or part-time formal work. Moreover, from 1996 many working pensioners have been laid off, which has led them to take up informal work.

Figure 18: What Explains Informal Employment



Source: Data survey of policy experts (2008).

Figure 19: Obstacles to Business Registration



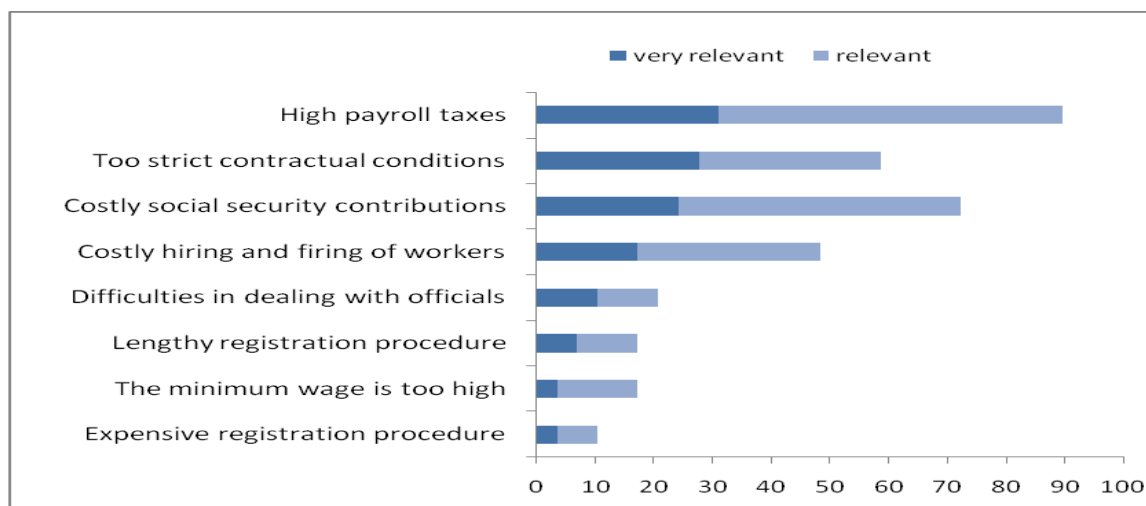
Source: Data survey of entrepreneurs (2008).

However, it is not only the costs associated with formal employment but also the low quality of benefits that are often derived from it which are obstacles. When asked about the benefits that registering their business offers them, entrepreneurs say that it only allows them to avoid trouble with the relevant authorities. In addition, the low quality of public services offered through social security and other schemes is suggested as one of the explanations behind informal employment, according to policy experts answering the questionnaires for this study.

A second set of questionnaires sent to a small group of entrepreneurs provides interesting information on the main reasons why firms do not register or do not register their workers. Figure 18 shows that high taxes as well as complicated and strict regulations are the main obstacles to business registration. Entrepreneurs also highlight the cost and length of the registration procedure among the reasons hindering business registration. It is also worth mentioning that the difficulty in dealing with officials ranks quite high among the obstacles to registering businesses. Similar factors are suggested by entrepreneurs as the chief obstacles for workers' registration (Figure 19).

Economic and institutional factors are not the only determinants of informal employment. Societal and behavioural factors also matter, especially in transition countries that have undergone important changes in the role of the state in economic and social life. Although Romania moved up seven spots between 2007 and 2008 according to the World Bank "Doing Business Indicators", corruption at various levels of economic and social life remains a serious issue.

Figure 20: Obstacles to Workers' Registration



Source: Data survey of entrepreneurs (2008).

The EC 2007 Eurobarometer (European Commission, 2007) provides much interesting information about the determinants of undeclared work in Romania and the other EU countries. Among the chief reasons for doing undeclared work, as given by paid employees, figure the low wages (with 26 per cent), lack of authorities' control (13 per cent) and high taxes and social security contributions as well as lack of formal jobs (with 10 per cent each). Moreover, bureaucracy and red tape figure among the main reasons behind undeclared work (15 per cent), higher than the EU average importance attributed to them.

Ciupagea (2004) mentions rising income inequality, the institutional structure, the level and volatility of the inflation rate and the variability of the tax system among the factors likely to determine the size of the informal economy. He estimates an econometric model of the determinants of informal employment in Romania for the 1989-2002 transition period. Among the factors likely to influence the informal economy as a share of GDP he includes variables such as real GDP, the long-term unemployment rate, investment in machinery and equipment rate in GDP and the share of social security burden tax in GDP. Moreover, he includes the share of wage labour in total labour force and the index of the average real net wage. According to his results, the share of non-wage paid labour, the share of social security burden and real GDP index are the three variables which seem most to affect the share of the informal economy. In the specification in which all variables are expressed in growth rates, long term unemployment and real net wage growth seem also to be among the primary determinants of the share of the informal economy in GDP.

Among people who answered they had carried out some undeclared activity in the last 12 months, about 40 per cent stated that they did so because of the seasonal nature of their specific activity. The second most common reason was the difficulty of finding a regular job (31 per cent); and third that both parties benefited from that undeclared activity. About 13 per cent cited bureaucracy and red tape, and 9 per cent identified high taxes and social security contributions.

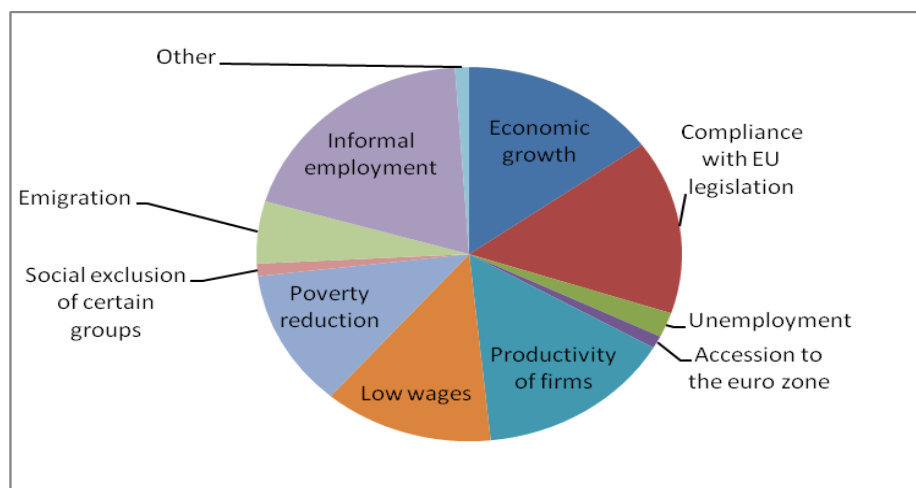
This section has summarised what we know about informal employment in Romania. It started with a discussion of the different forms that it takes there, the concepts of informal employment and the difficulties in measuring it. Then it presented recent trends of informal employment and estimates of its size, using various definitions and measures. From this analysis it has become clear that informal employment in Romania is very heterogeneous, and so it would be misleading to think of the individuals involved as one single group and that treating them in the same way would be appropriate. This is why part three of this section looked at the characteristics of those engaged in informal work, aiming to identify the different groups in informal employment. In addition, the main factors explaining the persistence of informal work in Romania have been identified, and it has been made clear that understanding the characteristics of informal employment and its rationales is extremely important for policies to address effectively the phenomenon of informal work. Informal work in agriculture and poorly paid informal work in cities on the one hand, and false self-employment or intentional tax evasion on the other, are not driven by the same factors and so cannot be addressed by the same policies.

The following section focuses on precisely this: the policies that may affect the extent of informal employment, for different groups of individuals and kinds of informal work. It also discusses the policies implemented by the Romanian government in recent years and their likely impact on informal employment.

IV. TOWARDS MORE POLICY COHERENCE FOR JOB CREATION AND SOCIAL PROTECTION

Informal employment is a major issue in Romania, with implications for workers' lives and the economy as a whole. It is indicative that policy experts, when asked about the main economic policy challenges that Romania faces today, ranked informal employment first in the list, followed by economic growth, compliance with EU legislation and firms' productivity (Figure 21). This section provides a discussion of the policies that affect informal employment. Most importantly, it distinguishes between policies aiming to change people's incentives in favour of formal work and those aiming to improve the conditions of those who are in informal employment because of the lack of alternatives.

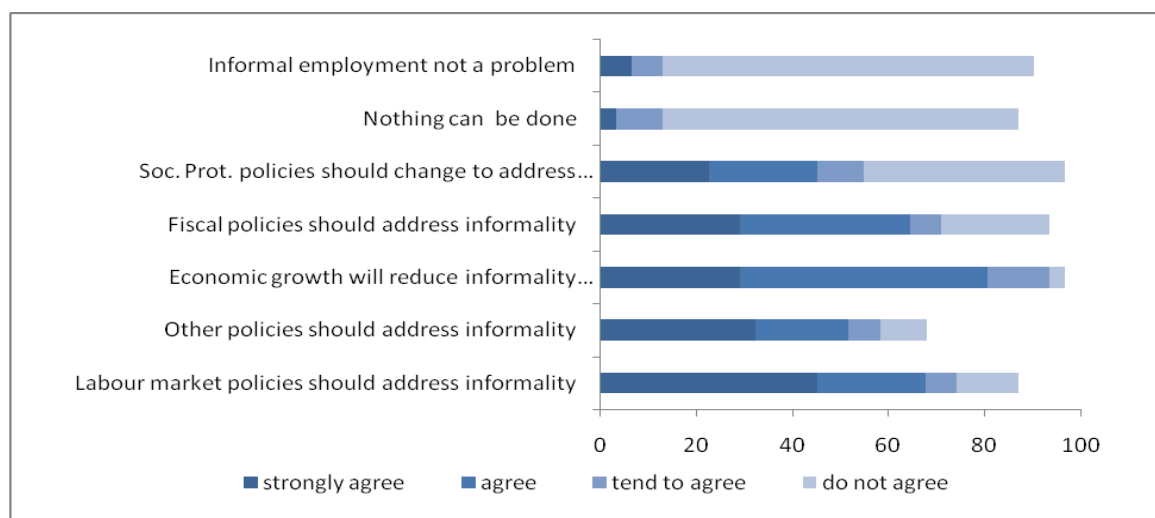
Figure 21: What Main Economic Policy Challenges Does Romania Face Today?



Source: Data survey of policy experts (2008).

In Romania there is the general view that economic growth on its own will automatically reduce informality. This view is also reflected in the questionnaire survey conducted for this report, in which the vast majority of policy experts report that they expect economic growth will be sufficient to reduce informal employment (Figure 22). Most of the experts also agree that fiscal and labour market policies should address informality. Moreover, they argue that social protection policies should change to address informality. Interestingly, the vast majority of policy experts in the survey did not agree that informal employment is not a problem and that nothing can be done about it. The Romanian government has shown some interest in fighting "black work" because of its destructive consequences for taxation (Stănculescu and Ilie 2001). But until recently more emphasis was put on punishment than on prevention or the creation of appropriate incentives for formal versus informal work (Marc and Kudatgobilik 2002).

Figure 22: What Should be Done with Informal Employment?



Source: Data survey of policy experts (2008).

Table 16: Policy Reforms and Scope for Informal Employment

Policy domain	Harder	No change	Easier	Don't know	NA
Tax administration (procedures)	16.1	22.6	48.4	3.2	9.7
Tax rates	9.7	6.5	71.0	3.2	9.7
Labour contract registration procedure	16.1	25.8	41.9	9.7	6.5
Health insurance regulations	29.0	32.3	25.8	6.5	6.5
Social security contributions	6.5	19.4	58.1	6.5	9.7
Social assistance (e.g. Minimum Income Guarantee)	38.7	12.9	19.4	22.6	6.5

Source: Data survey of policy experts (2008).

New and more promising efforts were recently made with a more comprehensive approach to deal with informal employment, some of which are summarised and discussed in this section. Table 16 summarises the responses of policy experts in our survey regarding the areas of recent policy reforms. They were asked whether certain policies in recent years made it “harder or easier for employers to offer workers a formal wage contract, offer them full worker benefits (e.g. pension contributions), or pay taxes over their entire earnings”. The majority agreed that reforms of the tax system (rates and administration), social security contributions and labour contract registration have made it easier for employers to comply with (formal) employment legislation.

In the policy discussion that follows, it should be borne in mind that policies are examined with respect to their impact on informal employment, whether they are designed to address it or they accidentally impact on it while addressing a different issue. It should be noted that there is no single policy that would reduce informal employment and provide the

appropriate incentives to all types of people working informally to get a formal job. While designing an appropriate incentives structure is of primary importance (Ghinararu, 2007; Stănculescu and Ilie, 2001), special attention should also be paid to the group of people who have no other alternative but to work informally. A combination of policies is therefore needed to address the needs of at least the following three different groups of people in informal employment:

1. **The poor and vulnerable who are in informal employment because they have no other choices.** These are also the least likely to move to formal employment because of their lack of skills, assets etc. There is therefore the need to provide them with basic security and assistance and encourage school attendance, for example through subsidies.
2. **Those who are informally employed (either by choice or not) but have the potential to move to formal employment.** It is important to provide these people with the necessary skills and information as well as the opportunities for internal migration for work (Stănculescu and Ilie, 2001). Improving public-private partnerships (PPP) and promoting employment creation through private sector development (Marc and Kudatgobilik, 2002) might prove useful in bringing these people into formal employment.
3. **Those who are informal by choice.** Bringing them back into formal employment necessitates an appropriate incentives structure to increase the relative benefits of formal over informal employment.

For policies to be effective, they should distinguish between the different types of informality and adapt to the specific needs of the different groups of people concerned. This study identifies six main policy domains which may impact on informal work either in a direct or indirect way.

IV.1 Taxes and social security contributions

High labour taxes and social security contributions increase the cost of labour and can thus lead employers to substitute informal workers for formal ones. High taxes on income also increase the incentives for informal work on the side of the workers and may lead to higher incidence of under-declaration of earnings and “false self-employment”. In Romania, labour taxes remain quite high despite certain cuts in recent years and are thought to be connected with the persistence of informal employment. However, special attention should be paid to this point as setting the right level of social contributions is a crucial factor determining the viability of the social protection system and the services provided to workers and pensioners. There is therefore an important challenge in setting social contribution and tax levels so as to achieve a viable social protection system while reducing incentives for informal work, and promoting job creation.

Average effective tax wedge has been relatively high in Romania as in other transition countries such as the Czech Republic, Hungary and Poland. In particular, effective tax rates for people eligible for unemployment benefits and likely to find low-wage employment are above 60 per cent. High average effective tax wedge is likely to increase the incentives of people to work informally.

A flat tax rate introduced in 2005 is considered as a policy reform likely to impact on informal employment. But assessing the impact of the flat tax rate is not straightforward. A report by the National Commission of Prognosis estimates that new formal jobs were created as a result of the introduction of the flat tax. However, it may be too early for a thorough evaluation of the impact of the reform. In addition, the lack of appropriate and detailed data, as well as the short time since the implementation of the reform, further complicate this exercise. In the Czech Republic, the introduction of a flat rate for personal and corporate income in 2004, combined with an increase in the basic tax and child tax allowance, led to significant declines in the tax wedge for families (OECD, 2008a, pp. 29).

In addition to the tax level, the complexity of the tax system can play an important role in incentives for informal employment. A complex tax system may also lead to noncompliance and incentives for tax evasion (OECD, 2008a). However, it should be noted that the impact of tax systems on the incidence of informal (and under-declared) work depends to a large extent on enforcement capacity (Albu, 2004; 2007). According to the data questionnaires to policy experts, simplification of the tax system is a major policy reform likely to have an impact on the extent of informal employment. In Romania, the constitution of a single administrative agency, the National Agency for Fiscal Administration, as the only agency responsible for collecting tax contributions, has been the most important step in that direction.

High social security contributions also increase the incentives for informal work, especially when the quality of services and benefits provided is not deemed appropriate. In 2003 the high social contributions of the public social security system were addressed. The effect of this reform on undeclared work is likely to be positive but difficult to measure. According to the policy experts' questionnaires, although the level of health insurance contributions has decreased in recent years, the administrative procedures remain complicated and so discourage their payments. A further reform of the contribution base for social security took place in the summer of 2007, but it is still too early to ascertain its potential impact on the incidence of non-declaration or under-declaration of earnings. Linking benefits to contributions may play an important role in improving incentives for people to pay their social contributions. Some progress has been made in Romania in that respect with the 2000/01 reform.

Disincentives to formal work can be additionally created by the social protection system. For example, in the case of universal health insurance systems, such as Romania's, there are disincentives for every additional family member to get a formal job. This is because if one family member works and pays contributions, it is sufficient for the dependants to have access to health insurance. Two main issues need to be examined with respect to social protection in Romania. The first concerns the coverage of people in agriculture. Given its importance in the Romanian economy and its informal sector, schemes providing social protection in agriculture should be developed. Second, the issue of social protection for the self-employed should also be considered. One possibility would be to subsidise of social security contributions for the self-employed.

An interesting combination of policies affecting informal employment was implemented by Hungary. Reduced employer social contributions and increased tax credits for low earners were introduced in 2003 (OECD, 2008a), and a further reduction of 50 per cent in social security

contributions for employers hiring from disadvantaged groups is expected to increase formal employment for vulnerable groups.

High non-wage labour costs¹³ can present major obstacles for businesses (Ghinararu, 2004). Providing preferential tax treatment for small and medium companies, for example through start-up tax exemptions, may be one way to address the issue of high non-wage labour costs as well as the cost of registration- related expenses (Stănculescu and Ilie, 2001).

The quality of public services financed through taxation should improve so that workers can see the value of their contributions. Finally, information campaigns should be used to create peer pressure towards tax compliance and inform people about the benefits of formal work and the reasons for paying taxes and contributions.

IV.2 Labour regulation and labour market policies

Minimum wages, the amount and duration of unemployment benefits, employment protection legislation and active labour market policies can all have an important impact on the incidence of informal employment. They create incentives and disincentives for formal versus informal work for different groups of the population. For example, generous benefits and activation policies may induce people to look more actively for formal jobs. Providing lower unemployment benefits to people who do not co-operate with the labour offices (e.g. as in the Czech Republic) has been suggested as one way of dealing with informal employment. Overall it should be noted that the impact of labour regulation may be reduced when enforcement and good governance are in place (OECD, 2008a, p.38).

The minimum wage in Romania has risen and the minimum wage-setting structure has also changed. The statutory minimum wage is set by the government every year, but social partners can negotiate a higher level which will then be applied for all workers. If wage data were available, the distribution would most likely show a spike at the minimum wage level. This is because workers are often contracted at the minimum wage and get additional pay in the form of “envelope” (cash) wages. A recent reform has been introduced to tackle this issue; in 2007 a tiered minimum wage system was introduced linking minimum wages to education levels. For workers with higher education, assuming this matches their job requirements, a higher minimum wage is applied. It has thus been made more difficult for more highly skilled workers to earn incomes with envelope payments. Although promising, the results of this reform are not clear yet, nor is its impact on labour flexibility (Ghinararu, 2007, p.14).

Increasing the minimum wage may reduce the scope for informal employment but could also have an adverse employment effect. According to OECD (2008a) the existence of a binding minimum (and its increase) may lead to lower employment for low-productivity workers or engagement in self-employment to make up for the forgone earnings induced by the increase in social and other contributions in turn resulting from the increase in the minimum wage. Thus getting the level of the minimum wage right is challenging, especially given the concerns regarding its impact on informal employment (Stănculescu and Ilie, 2001) and trade competitiveness (Ghinararu, 2004; 2007).

¹³ Non-wage labour costs have already been reduced; in 2004 they were 8% lower than in 2002.

Along the same lines as in Romania but some years earlier, Hungary increased its minimum wage in 2001 and 2002 and introduced a tiered system in 2006. Declared wages seem to have increased for the group of people who were employed before and after the 2001 increase (Tonin, 2007) but these findings do not take into account potentially adverse effects on employment (OECD, 2008a).

The new labour code established in Romania in 2003 introduced important changes with respect to the types of labour contracts that can be concluded and recognised part-time and fixed-term contracts. In addition, restrictions were put in place to avoid abusive use of these contracts. The opinions of the policy experts in our survey were divided with respect to reforms concerning the labour code. They were aware that the labour law became more restrictive in 2002, equally that procedures for labour contract registration had become easier in 1999. Furthermore, concerns among policy experts remain regarding the misuse of these provisions for flexibility of employment and hence insecurity for workers. In addition, there is scope for improvement in the legal framework for day workers and casual workers which is still not fully covered by the labour code.

Besides, high unemployment benefit provided over a long period of time is usually associated with a higher incidence of informal employment. High unemployment benefits increase informal employment as the unemployed do not take up formal jobs until their unemployment benefit runs out, but work informally instead. Extending payment of part of the unemployment benefit in the first months in a new job might be the way to tackle the issue, although at some cost.

IV.3 Institutions and governance

Culture and tradition may play an important role in the way the public perceives tax payments and social contributions, and more generally the issue of compliance. A culture of non-compliance and poor institutional performance (Stanculescu and Ilie, 2001), as well as poor governance and the lack of trust in public institutions seems to play an important role in tax evasion and the subsequent informality in Romania (Marc and Kudatgobilik, 2002). In addition, people's perception that tax money is not used efficiently encourages evasion (Stanculescu and Ilie, 2001). So there is a great need to inform people about how their tax money is used and, most important, to improve the quality of public services provided through tax income so that individuals see the value of their taxes. Information campaigns about the benefits of formal work and the risks of informality should help towards that goal. In 2003, a national campaign against undeclared work was launched, aiming especially at the major offenders of undeclared work, among which child labour also figures (Ghinararu, 2004; 2007). Such efforts should be repeated and expanded in order to change the current attitudes and perceptions of the Romanian people with respect to tax payments and the state.

In addition to this general cultural environment, the institutional structure, both formal and informal, also discourages the self-employed and small businesses from formal operation (Marc and Kudatgobilik, 2002). So reform of regulatory and legal frameworks to reduce the burden of registration is an important step.

IV.4 Inspection and enforcement

Inspection and enforcement should be natural complements to appropriate labour market policies and tax system reforms. The rules should be clearly set out, and compliance should not mean a high cost in terms of time, effort and money. The Romanian government has made some progress in this respect. In 2000 the Department of Workplace Inspection was created, which includes 3 205 employees (2 966 at county level). Other bodies such as the Economic Police, Office for Consumer Protection and Financial Guard were established for inspection and enforcement (Stănculescu and Ilie, 2001). Informality is often more present in small and medium enterprises, so targeting inspection at these companies may help to detect cases of informality. The Czech Republic has recently intensified inspections in firms with fewer than 100 employees to fight informality in small establishments (OECD, 2008a).

IV.5 Social assistance programmes

Social assistance programmes as well as programmes aiming to extend coverage to those without health insurance (e.g. Seguro Popular in Mexico) may have adverse effects on the incentives to people to work formally (Levy, 2007). As an example, Romania's minimum income guarantee (MIG) scheme¹⁴ has been blamed for creating disincentives for people to join the formal labour market or actively seek a job. The evidence from the policy experts' survey shows that policy makers do indeed perceive social assistance programmes as a source of disincentive to active job-seeking and an incentive for informal employment. Although these considerations might be relevant for schemes offering a substantial basic income, this is less likely to be the case with the specific Romanian scheme, mainly because its level is relatively low. It is believed that only the very marginal groups of the population have access to the minimum income guarantee programme, as these are the groups over-represented among the unemployed and the landless. Nonetheless, a rigorous analysis is needed to evaluate possible incoherence between that and formal employment objectives. Social assistance programmes should therefore be designed in a way that does not distort the incentives of finding a formal job. In addition they should be in some way conditional on working or looking for a job (Stănculescu and Ilie, 2001).

IV.6 Policy Coherence and coordination

Until now, little communication and co-ordination among ministries and governmental agencies have been taking place in Romania. This may have led to certain policy inconsistencies, damaging the objectives of different policy actors. The implication is that there is more scope for dialogue and communication between ministries and institutions as well as social partners. The creation of a task force to discuss these issues and take joint decisions would be an important step in bringing together the various actors.

IV.7 Summing up

The persistence of informal employment has made the implementation of appropriate and effective policies an urgent need for Romania. Although some progress has been made with

¹⁴ At the end of 2002 there were about 1 132 540 beneficiaries of the MIG corresponding to 5.4 percent of the population (Ilie and Vonica Răduțiu, 2004).

respect to taxes and social contributions, there is scope for future reforms in terms of administrative and registration procedures. In addition, special attention is needed to address the issue of informal employment for those vulnerable groups of the population who have no other alternative. In addition, effectively communicating the benefits of formal work and the risks of informality to people can change their views about tax payments and social security contributions. It is extremely important to change cultural perceptions about the role of the state that have been shaped over the years. Improving the quality of public services provided is required to improve the incentives for formal work. For policies to be effective, a better understanding of the situation of people in informal employment and a thorough evaluation of policies are required. Therefore good data on labour market conditions and earnings need to be collected.

On the whole, a comprehensive approach which would take into account the different needs of different groups of people as well as economic sectors and geographic regions is needed to address the challenge of informal employment.

ANNEX 1

Informal employment is undoubtedly one of the main features of the Romanian labour market. Despite this, and the interest of the government in dealing with informal employment, there is a lack of sufficient, good quality data which would allow examination of the phenomenon. For this reason and for the purpose of this study, survey questionnaires were drawn up and sent to two groups: i) policy experts; and ii) entrepreneurs in the construction sector, in which informal employment is especially prevalent.

Both the policy experts' and the entrepreneurs' surveys aimed to identify forms of informal employment and their determinants. In addition, the policy experts' questionnaire aimed to identify policy measures contributing to the increase and/or decrease of formality and/or informality. The issue of informal employment was addressed taking into account its importance on the agenda of the Romanian government and its position among the objectives of socio-economic policies.

Policy experts' survey

The survey among Romanian policy experts was conducted between January and March 2008 and was based on questionnaires sent by post. A total of 100 questionnaires were sent to the main labour market institutions. The low response rate of 32.3 per cent is revealing about the reluctance of the Romanians, including policy experts, to talk about informal employment and reveal any related information. It is highly significant that about 30 per cent of the respondents did not declare either the institutions or the counties they represented, additional evidence of their reticence. The distribution of the final sample of 31 policy experts across policy institutions is presented in Table 17.

Table 17: Sample Description – policy experts

	Frequency	Per cent
Type of institution/organisation		
Labour Inspection	4	12.9
Ministry of Labour	1	3.2
Pension House	12	38.7
Public Employment Services	5	16.1
Missing	9	29.0
Governance level		
Central Government	2	6.5
County level	25	80.6
Other	1	3.2
Missing	3	9.7

Entrepreneurs' survey

The entrepreneurs' survey aimed to identify major forms of informal employment in Romania, as well as to obtain information on the constraints and obstacles entrepreneurs are facing in registering their businesses and offering their workers a formal job. It also tried to identify the benefits of business and workers' registration, as perceived by the entrepreneurs in the sector.

The survey was conducted between January and February 2008 and based on questionnaires sent to a sample of entrepreneurs in the construction industry. The sector was selected because of its high informal employment rate. Twenty-nine questionnaires were returned, corresponding to a response rate of 5 per cent. Large entrepreneurs and entrepreneurs from Bucharest are best represented in the survey, which may cast some doubt about how representative the sample is.

Table 18: Sample Description – Entrepreneurs in Construction

	Frequency	Per cent
Region		
Bucharest	7	24.1
Centre	6	20.7
North-West	4	13.8
West	2	6.9
South-West	4	13.8
South	4	13.8
North-East	2	6.9
Business size		
Micro	3	10.3
Small	8	27.6
Medium	8	27.6
Large	10	34.5

Focus groups on informal employment in construction

(March 2008, Galati, Romania)

The construction sector was chosen for this exercise for two main reasons: first, because it has witnessed constant growth in recent years; and second, because of its particularly high prevalence of informal employment. It is also affected in important ways by emigration abroad of its skilled workers. The county of Galati is situated at the border with the Republic of Moldova. It was selected because of the problems that the sector is facing in the region, including the lack of skilled workers who are often replaced by with migrants from the Republic of Moldova. The participants in the meeting were representatives of trade unions from construction (one person), county labour inspection (two persons), employers from construction (two persons), legal consultants from public employment services (one person) and the National Pension House (one person).

The discussion aimed to shed some light on the prevalence of informal employment in the construction sector and its evolution during past years, as well as the new and old forms that informal employment takes in the sector. In addition, it sought to sketch the profile of those working informally in construction, and highlight specific problems related to the emigration of workers in the sector. Limitations of the regulatory framework of inspection activities were discussed as well as the reasons for and consequences of informal employment for employers. The focus groups aimed to discuss different measures that have been taken in order to combat informal employment and identify possible new measures and policies to address the issue of informal employment in construction.

The focus group involved free collective discussions, aiming to reach an agreement between participants when possible. It was conducted by two interviewers (one principal interviewer and an assistant) experienced in group discussions and in-depth interviews, as well as specialising in issues related to undeclared work.

Focus group with returning migrants

(March 2008, Tecuci, Romania)

In order to understand better the connections between migration and informal employment in Romania, a focus group with Romanian returning migrants was carried out in March 2008. The group consisted of seven persons chosen for being fairly homogeneous in terms of their migration experiences and place of residence, as they all lived in Tecuci. In contrast they were chosen to be heterogeneous in terms of gender (four men and three women), age (28 to 42 years old) and qualification levels (both skilled and unskilled workers).

The focus group involved free collective discussions between participants based on a set of specific questions. These focused mostly on motivations for migration, migration experiences and employment abroad, employment upon return to Romania and future intentions for migration. The focus group was conducted by two interviewers (one principal interviewer and an assistant) experienced in group discussions, as well as in research on migration issues. All discussions were taped and transcribed for a proper and in-depth analysis.

ANNEX 2

Questionnaire form: policy experts

For interviewer only...

Policy expert code:
Date of reception:
Time:

The OECD Development Centre is undertaking a project on informal employment in Romania. For this purpose we would like to learn from you whether this issue is a policy concern at your organisation, how you see the phenomenon, and what the main determinants are in your view. In addition, we would like to know your opinions about the policy environment. The information you give to us is anonymous and will be kept strictly confidential. Results will only be presented in aggregated form.

A. Priority

A1. What are in your opinion the main economic policy challenges that Romania faces nowadays? Select up to 3 of the most important problems.

Concerns	Important
Economic growth	
Compliance with EU legislation	
Accession to the euro zone	
Unemployment	
Productivity of firms	
Low wages	
Poverty reduction	
Social exclusion of certain groups	
Emigration	
Immigration	
Informal employment	
Other concerns:	

A2. If you selected informal employment, why do you think this is a policy concern? Select up to two main reasons.

Concerns	Important
It undermines the tax base	
It is against the law	
Many people are unprotected	
Many people earn low wages and are vulnerable	
Businesses cannot grow	
Other reason:	

B. Definition Informal Employment

B1. We would like to know what you personally think of when you hear the term “informal employment”. Please select 1 if you do not at all associate it with informal employment, up to 4 if you do so strongly. Otherwise, select “don’t know”.

	Examples	1	2	3	4	Don't know
1	Small firms (fewer than 5 employees)					
2	Household of family production that sell their products or services in the market					
3	Subsistence agriculture					
4	Unpaid family workers					
5	People who work for a wage, but do not have a registered labour contract					
6	People previously working with a labour contract, now obliged to work as “service provider” or “independent sub-contractor”					
7	People with a labour contract but with limited pension coverage					
8	Enterprises that pay no corporate taxes					
9	Wage workers who earn part of their income from the same employer informally (e.g. “envelope payments”)					
10	Wage workers who on top of their formal job do independent work that they don't declare					
11	Firms that are not registered with the {relevant authorities}					
12	Black market activities					
13	Low-paid work (e.g. minimum wage or below)					
14	Low-productive work					
15	Vulnerable and poor individuals and households					
16	Other.....					

C. Determinants of informal employment

C1. Please indicate to what extent you agree with the following statements on the reasons leading people to informality or to formality. Please rank 1 where you don't agree at all, up to 4 where you strongly agree. Otherwise, select "don't know".

Statement	1 Don't agree	2	3	4 Strongly agree	Don't know
<i>Reasons leading to informality</i>					
The high payroll taxes are leading entrepreneurs not to declare (part of) their workers' earnings					
The high minimum wage leads to informality					
Administrative procedures take too much time and money					
Taxes are high					
There is no – or too limited – penalty on being informal					
Hiring and firing of workers is too costly					
Too constrictive contractual conditions (e.g. worker rights etc.)					
The quality of public services provided is poor					
Social assistance programmes offer services to anyone, so this reduces the need to become formal					
<i>Reasons why entrepreneurs would opt for formality</i>					
It allows enlarging business opportunities					
Improving access to credit and other services					
Access to new markets					
Avoiding corruption					
Avoiding other problems with government officials					

D. Policy environment

D1. Do you think that in the last five years there have been policy reforms in the areas listed below which have made it harder or easier for employers to offer workers a formal wage contract, offer them full worker benefits (e.g. pension contributions), or pay taxes over their entire earnings?

Policy domain	Please choose 1 option				What year?	How
	Harder	No change	Easier	Don't know		
Tax administration (procedures)						
Rates of taxation						
Labour contract registration procedure						
Health insurance regulations						
Social security contributions						
Social assistance (e.g. Minimum Income Guarantee)						
Other reason:						

D2. What do you think should be done about informal employment? Please rank 1 where you don't agree at all, to 4 where you strongly agree. Otherwise, select "don't know".

Statement	1 Don't agree	2	3	4 Strongly agree	Don't know
Economic growth will reduce informality automatically					
Labour market policies should address informality					
Social protection policies should be changed to address informality					
Fiscal policies should address informality					
Other policies should address informality					
Nothing can be done					
Informal employment not a problem					

D3. Policy co-ordination

	There is no co-ordination			Very well co-ordinated	Don't know
<i>Please rank from 1 (no co-ordination) to 4 (very well co-ordinated).</i>	1	2	3	4	n/a
How well co-ordinated are social protection and employment policies?					

D4. Please list up to 3 mechanisms for co-ordination between social protection and employment policies that you feel are most important. If none, leave blank.

	1 (no effect)	2	3	4 (very useful to co-ordinate policy)
1.				
2.				
3.				

E. Background information

Name institution:	.....
Type of institution:	<input type="checkbox"/> Ministry <input type="checkbox"/> Other public organisation <input type="checkbox"/> Think Tank <input type="checkbox"/> Other
In case government, please indicate level:	<input type="checkbox"/> Central government <input type="checkbox"/> County level <input type="checkbox"/> Other
Location:	.....
Position of respondent in this institution:	.....
Date of completion of survey:	.....

Questionnaire form: entrepreneurs in construction

For interviewer only...

Establishment Code:

Date of reception:

Time:

The OECD Development Centre is undertaking a project on the causes of informal employment in Romania. For this purpose, we would like to learn from you the business views on what is needed to create more and better jobs. In particular we would like to get information on the constraints and obstacles entrepreneurs are facing in offering their workers a formal job. Moreover we are interested in finding out what entrepreneurs like you might consider as benefits of a registered business and registered workers. We are very much interested in your personal view based on your experience as entrepreneur or that of people you may know. The information you give to us is anonymous and will be kept strictly confidential. Results will only be presented in aggregated form.

A. How people perceive informal employment

A1. We would like to know your perception on the extent to which the following labour market phenomena listed in the box below are widespread in your economic sector. Please select 1 when it does not seem very relevant to you, up to 4 in case you find it very relevant. Otherwise, select "don't know".

Examples	1	2	3	4	Don't know
1 Small firms (fewer than 5 employees)					
2 Household of family production that sell their products or services in the market					
3 Unpaid family workers					
4 People helping in the family production but who are not paid a wage					
5 People who work for a wage, but do not have a registered labour contract					
6 People previously working with a labour contract, now obliged to work as "service provider"					
7 People with a labour contract but limited pension coverage					
8 Enterprises that pay no corporate taxes					
9 Waged workers who earn part of their income from the same employer informally (e.g. "envelope payments")					
10 Wage workers who on top of their formal do work that they don't declare					
11 Firms that are not registered with the {relevant authorities}					
12 Illegal, black market activities					
13 Low-paid work (e.g. minimum wage or below)					
14 Low-productive work					
15 Other					

B. Determinants of informal employment

B1. What are in your opinion the main obstacles registering your business with {the relevant authorities}? Please select 1 when the given reason does not seem very relevant to you, up to 4 in case you find it very relevant. Otherwise, select "don't know".

Reasons	1	2	3	4	Don't know
Lengthy commercial registration procedure					
Expensive commercial registration procedure					
Registering doesn't serve any goal					
Taxes are high					
Complicated and strict regulations the business has to comply with					
Difficulties in dealing with government officials and governmental agencies					
Other reasons:					

B2. What are in your opinion the main benefits of registering your business with {the relevant authorities}? Please select 1 when the given reason does not seem very relevant to you, up to 4 in case you find it very relevant. Otherwise, select "don't know".

Reasons	1	2	3	4	Don't know
Avoiding corruption					
Avoiding other problems with government officials					
Enlarging business opportunities					
Improving access to credit and other services					
Growth of firms is facilitated					
Access to new markets					
Other reasons:					

B3. In your opinion, what are the main obstacles for which entrepreneurs would decide not to register their workers, and not to offer them a formal labour contract or worker benefits (pension etc.)? Please select 1 when the given reason does not seem very relevant to you up to 4 in case you find it very relevant. Otherwise, select "don't know".

Reasons	1	2	3	4	Don't know
Lengthy registration procedure					
Expensive registration procedure					
Costly social security contributions					
High payroll taxes					
The minimum wage is too high					
Costly hiring and firing of workers					
Too constrictive contractual conditions (e.g. worker rights etc.)					
Difficulties in dealing with government officials and governmental agencies					
Other reasons:					

B4. In your opinion, what are the main benefits for which entrepreneurs would decide to register their workers, and to offer them a formal labour contract or worker benefits (pension etc.)? Please select 1 when the given reason does not seem very relevant to you and up to 4 in case you find it very relevant. Otherwise, select "don't know".

Reasons	1	2	3	4	Don't know
Avoiding fines					
Avoiding other problems with government officials					
For a good business image					
Attracting good workers					
Taking good care of workers					
Workers are more committed					
Other reasons:					

C. Policy environment

C1. Do you think that in the last five years there have been policy reforms in the areas listed below that have made it harder or easier for employers to offer workers a formal wage contract, offer them full worker benefits (e.g. pension contributions), or pay taxes over their entire earnings? Otherwise, select "no change" or "don't know".

Policy domain	Please choose 1 option				What year?	How
	Harder	No change	Easier	Don't know		
Tax administration (procedures)						
Rates of taxation						
Labour contract registration procedure						
Health insurance regulations						
Social security contributions						
Social assistance (e.g. Minimum Income Guarantee)						
Other reason:						

D. Background information

Date of creation firm:	.....
Business sector:	.....
Location:	.....
Number of workers:	.....
In the last two years, has your firm:	Been growing / remained the same / been shrinking? (choose one option)
Position of respondent in firm:	.....
Highest obtained education:	None / Primary school / Secondary school / Tertiary education (choose one option)
Date of completion of survey:

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