

The Nature and Extent of Informal Economy in Post-Crisis Ukraine

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I. Introduction

The right to decent work for everyone is widely recognized all over the world (European Commission, 2007; UN, 2006; ILO, 2002a). The informal sector is an essential obstacle in terms of its size and vulnerability of its participants (ILO, 2002b). Owing to drain in tax and social security contributions, it directly affects the state (Williams, 2007). The knowledge about informal economy and its implications are rather limited due to its naturally hidden form (Williams, 2009; Pfau-Effinger, 2003).

In recent years, the European Commission has made several attempts to obliterate informal economy (European Commission, 2007; European Commission, 2005). The Commission has established a ‘knowledge bank’ of policies tackling informal employment (European Commission, 2007). The first known empirical survey of the Ukrainian informal sector, using activity-based definition, reveals need for developing an increasingly multilayered understanding of informal economy (Williams and Round, 2007; Round and Kosterina, 2005). This provides an opportunity to examine the informal sector in Ukraine by synthesizing contrasting theories of informal economy.

The present paper investigates the nature and extent of informal economy in post-crisis Ukraine. A better understanding of the diverse nature of the informal sector can assist the development of a more comprehensive policy, while promoting enhanced working conditions and paying in the Ukrainian formal economy. The remainder of this paper is organized as follows: first, a literature review presents an overview of prior researches and theoretical foundations for this paper. Then an overview of the Ukrainian informal sector is provided. Next, the focus will turn to research design and methodology. This is followed by discussion of the results. Finally, an overall summary and conclusions are drawn from the research.

II. Literature review of indicative references

Informal economic practices are extensive in many nations across the world (Williams and Round, 2008; European Commission, 2005; UN, 2006). They have been linked to the drain in tax and social security contributions (Williams, 2009; Pfau-Effinger, 2003). The private sector is the major creator of employment and the state establishes conditions for the productive employment of people (OECD, 2002; European Commission, 1998). Therefore, recent decades have witnessed calls for effective policies to encourage compliance rather than punish non-compliant economic agents (Williams and Round, 2007). However, the informal economy is still considered to be one of the major concerns of the European member states (European Commission, 2007; Stefanov, 2003).

The first cross-national survey of the extent and the nature of undeclared work in EU27 brought a fresh understanding of this phenomenon (Williams, 2008; European Commission, 2007). According to Williams (2008), in Nordic countries and Continental Europe, informal economic activity is practiced on a self-employed basis, while in southern Europe and East-Central Europe it is more likely to be connected to official employment. The motives behind informal employment are not always conducted for the financial benefits of employees or enterprises (Williams and Round, 2008).

A complex geography of informal economy across EU nations has been revealed by Williams (2008). Besides that, the ‘knowledge bank’, combining European states’ experiences, for developing measures to combat informal economy, was created in 2007 (European Commission, 2007). Thus, an important step has already been made by the European Commission in creating a global learning hub for tackling undeclared employment in various contexts.

A significant body of literature suggests three contrasting types of definition: *i)* enterprise-, *ii)* job- and *iii)* activity-based definitions. In studies of developing countries, enterprise- and job-based definitions have predominated until recently (ILO, 2002a, ILO, 2002b). An activity-based definition is commonly used for studies in OECD countries and European states (European Commission, 2007; Williams, 2006).

Informal sector is widely recognized as “involving the production and sale of goods and services that are licit in all respects besides the fact that they are unregistered or hidden from the state” (European Commission, 2007. 47.). As part of what has been called informal sector (ILO, 2002a, OECD, 2002),

employees and businesses seek to participate in both formal and informal operations in market society (Williams, 2004; ILO, 2002b).

1. Informal economy as a residue

Until recently, a widespread belief was that both formal and informal economic practices belong to completely separate spheres (Williams and Round, 2008; Williams and Round, 2007; OECD, 2002). Consequently, a large proportion of hidden earnings have been invisible to state authorities (Williams, 2008). The formalisation thesis depicts formal sector as ‘advancement’ while the informal sector represents a ‘sign of underdevelopment’ (Williams and Round, 2008; Smith and Stenning, 2006).

In spite of the wide acceptance of traditional theory, in recent years a body of literature has contested and rejected various assumptions of this traditional theory (Williams and Round, 2007). Several scholars have indicated that businesses and populations are quite often simultaneously engaged in both formal and informal sectors (UNDP, 2008; Williams and Round, 2008; Smith and Stenning, 2006). In short, it has been widely recognized that shadow sector actively grows in the modern global economy (Williams and Round, 2008; Williams, 2007; ILO, 2002a).

2. Informal economy as a by-product of the formal economy

The second discourse represents the informal sector as a by-product of the formal sector in global economy (Williams and Round, 2008; Williams and Round, 2007; Amin et al, 2002). Economic players of informal economy are forced to participate not by choice, but more likely by necessity (Williams and Round, 2007; Pfau-Effinger, 2003). Moreover, informal economy is displayed “as a new form of work emerging in late capitalism as a direct byproduct of the advent and deregulated open world economy” (Williams and Round, 2008. 370.). In this by-product understanding, informal economy is enormous in marginalised groups of western and developing nations due to weak status of formal economy (Williams and Round, 2007; Amin et al, 2002). Marginalised populations engage in the informal sector in order to survive in this sphere as a last resort (Williams, 2008). Thus, within market economy, informal sector exists as an opposite realm to the formal sector (Williams and Round, 2008; Round et al, 2008).

3. Informal economy as a complement to formal economy

For the third school of thought, the relationship between the formal and informal sector is seen as complementary rather than substitutive (Williams, 2009; Williams and Round, 2008; Williams and Round, 2007). In this perspective, informal sector is read as consolidating disparities produced by the formal sector (Williams and Round, 2007; Williams and Windebank, 2003). Both realms of the economy are seen as intertwined with each other (Williams and Round, 2007).

Williams and Round (2008) posit that affluent households, as main beneficiaries of shadow economy, conduct more informal economic activities than marginalised households. From this view, informal economy tends to possess more positive attributes than residue and by-product theorisations (Williams, 2009; Williams and Round, 2008). Until recently, the complementary approach has been commonly investigated in context of western nations (Williams and Round, 2008; Williams and Round, 2007).

4. Informal economy as an alternative to formal economy

The final approach reads the informal sector as a chosen substitute for the formal sector (Williams and Round, 2008. 372.; Williams and Round, 2007; Williams, 2005). For this group of researchers, the state over-regulation represents the main obstacle to economic growth and sustainability (Williams and Round, 2008; Williams, 2008). Besides that, these authors advocate the deregulation of the labour market from an over-burdensome state as a “resurgence of the free market against state regulation” (Williams and Round, 2008. 372.). This discourse is mainly applied in relation to developing countries (Williams and Round, 2007).

5. An integrative understanding of the nature of informal economy

The evidence suggests that different theories of informal economy are valid when analysing different types of informal economic activities (Williams and Round, 2008; Williams and Round, 2007; Williams, 2008). This is exemplified by the assertion that the range of an informal sector can simultaneously possess positive, as well as negative features and can be relatively separate from the formal sector (Williams and Round, 2008; Williams and Round, 2007). In a study concerning the informal sector’s nature in Ukraine, *Williams and Round* (2008. 384.) argue that “universal theorisations are not possible.” These authors suggest an integrative

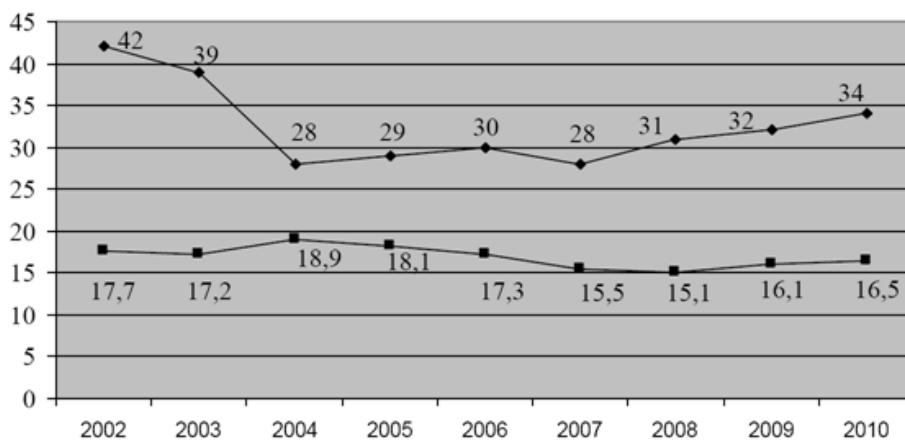
understanding of the theories of informal employment to achieve a more nuanced and multilayered understanding of the phenomenon.

III. Overview of the informal sector in Ukraine

Ukraine is the largest state in Europe by territory and the second most-populated post-Soviet state after Russia (Mykhenko and Swain, 2010). It possesses one of the biggest natural resources in Europe (Tkachuk, 2010a). The Orange Revolution accelerated the state's regional divergence to the highest levels in Europe (Mykhenko and Swain, 2010). Due to the political turmoil, Ukraine has difficulty in capitalizing on its well educated human capital, abundant resources and strategic trade position between two major markets, the European Union (EU) and the Commonwealth of Independent States (CIS).

In Ukraine, the informal economic behaviour is accepted as part of everyday life, as previously identified by researchers in other East-Central European countries (Tkachuk, 2010b; Round and Williams, 2010). The informal sector grows as a consequence of the deteriorating formal sector (Wallace and Latcheva, 2006). It gains economic players forced by the need to survive (Williams, 2009) (see Figure 1).

Figure 1. Size of the Informal Sector in Ukraine 2002-2010 (percentage)



Source: Ministry of Economy of Ukraine, 2011.; State Statistics Committee of Ukraine, 2011.

This figure indicates that there are different estimates of the informal sector among public institutions due to usage of an enterprise-based definition of

employment, or indirect measures using proxy indicators. According to the Ministry of Economy of Ukraine (2011), size of the informal sector in Ukraine was 34% in 2010, while using the estimates of State Statistics Committee of Ukraine, it was 16.5% during the same year. The first known empirical survey of the Ukrainian informal sector by Williams and Round (2008) reveals that around 16% of households in Ukraine are involved in the informal sector. Three main categories of undeclared work complement the informal sector in Ukraine, such as informal waged work, informal own-account work and paid favours for friends, neighbors and kin (Round and Williams, 2010).

Given the relatively low levels of economic development and economic freedom, Ukraine has maintained low rankings regarding its transparency in public life, levels of corruption, barriers of formalisation and tax morality (Transparency International, 2009; UNDP, 2008). Rent-seeking behaviour and bureaucracy became main barriers to both economic growth and the formalisation of economy in Ukraine (Chernyshev, 2006; Hanson, 2006). According to Rose (2005), 73% of Ukrainians indicate that their main income is not sufficient to purchase basic goods. The unemployment rate in Ukraine increased to 9.5% in 2009 due to the global financial crisis of 2008-2009 (The World Bank, 2009). In the category of world countries, Ukraine was referred to as most vulnerable to global crisis effects (Tkachuk 2010b). GDP of Ukraine fell by 14% and national debt increased by 59% during 2009 (Tkachuk 2010a).

Briefly, as a consequence of the stagnant formal economy in post-crisis period, informal economy dramatically grows in Ukraine. There are various estimates of the Ukrainian informal sector due to the usage of direct or indirect proxy indicators. The most prevalent types of undeclared work are informal waged employment, informal self-employment and paid favours for friends, neighbors and kin.

IV. Methodology

Traditionally, the methodology to be adopted has occupied the center stage in scholarly discussions, whether it should be quantitative, qualitative, or mixed-method (Bryman and Bell, 2007; Fabozzi et al, 2005). There is also a question of whether large or narrow data collection is preferable (Baker, 2001). Quantitative research can be defined as a research strategy that focuses on quantification during data collection and analysis involving statistical techniques (Fabozzi et al, 2005). It is founded on numerical

measurements of indicators of unique phenomena (Bryman and Bell, 2007). Qualitative research emphasizes words rather than quantification in data collection and analysis (Eisenhardt and Graebner, 2007). It aims at gathering an in-depth understanding of human behaviour and the reasons behind it (Flyvbjerg, 2006). Mixed-method research can be defined as a strategy that uses qualitative and quantitative approaches (Scandura and Williams, 2000).

1. Research Approach

This study uses a mixed-method research approach to investigate the nature and extent of the informal economy in post-crisis Ukraine. The activity-based definition of the informal sector was used in the present study. Survey appeared as a justifiable research strategy to achieve the purpose of the study. The research process included the following steps: literature review, setting the objective of the study, research design (data collection and limitations), data analysis and discussion of the results, reliability and validity of the study and conclusions.

1. Data Collection

The evidence can be quantitative, qualitative, or both (Bryman and Bell, 2007; Eisenhardt and Graebner, 2007). Quantitative data can be collected from surveys, experiments, questionnaires, official statistics and structured or semi-structured interviews (Eisenhardt and Graebner, 2007). In comparison, qualitative data can be collected from observations, unstructured interviews and documents (Baker, 2001). Primary data collection was conducted from 200 surveys in late 2009 and early 2010. The survey questionnaire has been adopted from previous studies by Williams and Round (2007). Secondary data was obtained from other comparable studies conducted in Ukraine, as well as from literature written on this subject. An extensive literature review was created to identify the contributions and gaps in this field. Detailed information regarding the phenomena was revealed from official sources related to the study (see Appendix 1).

2. Sample

Maximum variation sampling was used for this study due to the evidence that there are essential inequalities in the extent and nature of informal economy between deprived and affluent populations of Europe (European Commission, 2007; Williams and Round, 2007; Williams, 2004). Two contrasting regions were investigated in Ukraine – Donetsk and Sumy regions. 100 surveys were distributed in the affluent area of Donetsk that is

one of the leading industrial, educational and scientific cities in Ukraine. 100 surveys were distributed in the deprived area of Sumy city. Sumy relied heavily on its manufacturing industry that is currently undergoing a reorganization process. Since then it has suffered from a high rate of unemployment and lack of financial support from the government.

V. Findings

First and foremost, we investigate whether participation in the informal or formal sectors represents the main income source of households for their standard of living. Table 1 indicates that some 23% of households in Ukraine rely on the informal sector as the principal source of livelihood. Every sixth household (15%) indicates dependence on other informal form of employment as their income source on a daily basis. Overall, around 38.1% of Ukrainian households identify informal economic activities as either major or secondary income sources to their standard of living. In a previous study by Williams and Round (2008), around 16% was found to heavily rely on the informal sector. This suggests that the amount of informally self-employed people has doubled after the financial downturn of 2008-2009 in Ukraine. In short, the Ukrainian informal economy can not be classified as a residual and underdeveloped sphere under the ‘formalization’ thesis.

Table 1. Major Income Sources for Living Standard (percentage of households)

	Primarily Source	Secondary Source	Total
Self- provisioning	2.8	1.2	4.0
Informal work	23.0	15.1	38.1
Formal work	27.0	23.4	50.4
Pension/benefits	4.1	3.3	7.4

Source: 2009/10 Ukraine survey.

Therefore, our focus turns to the different forms of participation within the informal economy in Ukraine. Some 55.3% of respondents belong to a group of informal employees working for an informal or formal organization (see Table 2). This suggests that the most common type of informal employees is the one that receives primary official wage and secondary informal wage that is called “envelope-wage” from employers. Official wage is used for tax declaration purposes, while informal wage is paid in cash. This finding is

supported by similar studies of undeclared work in Ukraine (Williams, 2009; Williams and Round, 2008). In addition, similar informal practices have been identified by researchers in Bulgaria and Russia (Tkachuk 2010a; Stefanov, 2003). Furthermore, vast amount of gender studies highlighted that women are more likely to be involved in the informal sector (Smith and Stenning, 2006; Losby et al, 2002). This study, confirms the stated-above assumption that women have higher incidence of informal waged work than men. So, women prevail over men in informal waged work in informal or formal enterprises in Ukraine, corresponding to 30.1 and 25.2% (see Table 2). The prevalence of informal waged work shows how formal and informal sectors are intertwined and interdependent within Ukraine. Moreover, it highlights on how modern Ukrainian capitalists avoid meeting certain legal standards such as minimum wages, maximum hours, safety or healthy standards. Waged informal work is mainly common in domestic services (housecleaning, childcare, cooking), trade (salesforce) and tourism-related industries (i.e. regarding waiters and cooks). Briefly, the nature of informal waged work can be considered as complement to the formal economy in Ukraine.

Table 2. Engaging in the Informal Sector (percentage of households)

	Women	Men	Total
Informal waged work	30.1	25.2	55.3
Informal own-account work	20.4	15.7	36.1
Paid favours for kins, neighbours and relatives	3.1	4.5	7.6

Source: 2009/10 Ukraine survey

As Table 2 reveals, 36.1% of households operate their own business as a primary source of income or as the way to supplement their income from formal work. In particular, women prevail over men in own-account work on an informal basis, with corresponding shares of 20.4 and 15.7%. However, Losby et al (2002) argues that in transition economies specifically large percentage of both genders engage on a regular basis in informal economic activities. The most common types of the informal own-account work belong to construction (masonry, painting and carpentry), agricultural (seasonal employees) and IT sectors (mainly consultancy). In short, informal own-account work can be seen as an alternative to the formal economic sector in Ukraine.

In recent years, the factor of social relations has been identified behind informal employment by several researchers and been associated to analogous unpaid community exchange (Round and Costerina, 2005; Williams, 2006; Williams, 2004). From Table 2 we can see that some 7.6% of respondents engage in paid favours for kins, neighbours and relatives on a regular basis. This finding corresponds to similar results that depict paid informal work on the basis of motives other than making financial gain (Williams, 2004). Due to the social relations factor, paid favours are mainly conducted in the service sector. Given the above-mentioned, the 'alternative' discourse describes informal economy as the chosen substitute to the formal one.

This study reveals that the informal sector in post-crisis Ukraine incorporates simultaneously different theories of the informal economy. These results correspond to the similar findings by Williams and Round, 2007; Williams, 2006. The informal economy in Ukraine is not an underdeveloped and residual sphere. In contrast, it is highly intertwined and interdependent within the formal economic sector. Therefore, the formalization thesis does not describe the nature of the Ukrainian informal economy. Analysis of the informal waged work reveals that by-product perspective of the informal economy is the most appropriate that depicts the informal sector as a substitute to the formal economy. The alternative approach, meanwhile, is valid when examining the informal own-account work of the households engaged in informal economic activities by necessity. In the dimension of paid favours, however, complementary discourse of informal economy is relevant as consolidating the disparities produced by formal economy. To sum it up, our results suggest that different theoretical discourses are valid for different kinds of informal economies.

There are some implications and opportunities for researchers and policy-makers to create a collaborative platform on the informal economy in Eastern Europe. Primarily, cross-disciplinary studies could help obtaining an in-depth understanding of the phenomenon in the region. Given the essential inequalities in the extent and nature of informal economy between the deprived and affluent populations of European states, development of specific context-based scenarios of tackling informal sector might be more appropriate rather than the common usage of best policy practices borrowed from advanced economies. Finally, in terms of future policy directions, it appears that instead of struggling with an informal economy it would be more efficient to remove barriers to formalize informal economic activities (i.e. informal taxes, bureaucracy and bribes).

VI. Conclusions

By using data from two regions in a single country, we were able to investigate the nature and extent of the informal economy in post-crisis Ukraine. This study finds that the informal sector incorporates simultaneously different theoretical discourses of the informal economy in Ukraine. Our results go in line with previous researches in the field suggesting that different theories are valid for different kinds of informal economy (for example, Williams and Round, 2007; Williams, 2006).

Informal economy in Ukraine is not an underdeveloped and residual sphere. In contrast, it is highly intertwined and interdependent within the formal economic sector. We find that the amount of informally self-employed people has doubled after financial downturn of 2008-2009 in Ukraine. The present study confirms the assumption that women have higher incidence of the informal waged work corresponding to the prior literature on gender studies.

This study makes several contributions to the existing literature on informal economy. Firstly, it adds to the limited knowledge about informal sector due to its naturally hidden form. Then, it investigates empirically the phenomena of informal economy using an activity-based definition in post-Soviet states, such as Ukraine. Finally, it extends the growing body of literature based on a better understanding of the diverse nature of the informal sector by synthesizing the contrasting theories of informal economy.

It would be interesting to carry out a survey of households on the nature and extent of informal economy using a larger sample size in Ukraine. It could help to obtain an in-depth understanding of the diverse nature of the informal economy in the region and to develop specific context-based scenarios of tackling the informal sector. Furthermore, it would be interesting to carry out similar studies in other regions of the Eastern European states to compare with the present study. This could assist in the development of a more comprehensive public policy, while promoting enhanced working conditions in the Eastern European region.

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