

INFORMAL EMPLOYMENT: Fiscal Implications for Municipalities (Assessment of Revenue Losses and Growth Potential)



This report presents the findings of the project “Study on Enhancing the Capacity of Municipalities to Mobilise Personal Income Tax (PIT) Revenues”, carried out by the Ukrainian Center for Social Reforms with the support of U-LEAD with Europe. The experts assessed the level and structure of informal employment across different types of municipalities, the volume of foregone revenues from PIT and the single tax due to informal employment, as well as the potential for their increase. The report also analyses domestic experience in engaging local self-government bodies in monitoring compliance with labour legislation, reviews best European practices of such cooperation, and examines the prospects for their application in Ukraine.

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This publication has been prepared with the support of the U-LEAD with Europe Programme, the European Union and its Member States Germany, Denmark, France, Austria, Poland and Slovenia. The content of this publication is the sole responsibility of its authors and cannot in any way be taken to reflect the views of the U-LEAD with Europe Programme, the European Union or its Member States Germany, Denmark, France, Austria, Poland, and Slovenia.

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INTRODUCTION

Decentralisation is one of the most important and successful reforms in Ukraine. The transfer of powers and resources to the level of municipalities has created the conditions for the development of local self-government capable of responding to people's needs and supporting local development. During the full-scale Russian invasion, municipalities demonstrated their ability to act swiftly and effectively: they mobilised resources in a bottom-up manner, organised territorial defence, accommodated large numbers of internally displaced persons, and ensured the continuity of essential public services.

However, the prolonged hostilities have had a negative impact on the local financial base, exacerbated fiscal imbalances, and intensified disparities among municipalities in terms of fiscal capacity. As a result, more than 70% of municipalities are currently dependent on fiscal transfers. In this context, the European Commission, in its enlargement reports, has recommended that Ukraine “make progress in ensuring a fair allocation of personal income tax (PIT) among municipalities where taxpayers actually reside and expand the sources of local taxation”.

In the study “Modelling the Impact of Changes in the Personal Income Tax Allocation Mechanism on the Budgets of Municipalities”¹, carried out in 2024 at the request of U-LEAD with Europe, the potential effects of transitioning to allocating PIT based on taxpayers' place of residence were modelled and analysed. The results indicated that, for the vast majority of small and medium-sized municipalities where a significant proportion of residents work outside their place of residence, tax revenues would increase. At the same time, disparities in fiscal capacity between municipalities would decrease: the gap in per capita PIT revenues between the richest 10% and the poorest 10% of municipalities would be reduced by more than half.

However, such a reform may create risks to the financial sustainability of municipalities that currently benefit from substantial tax revenues due to the concentration of employers within their territories. According to the modelling results, two-thirds of cities with populations exceeding 100,000 would experience losses in PIT revenues of varying magnitude. For these municipalities, identifying additional sources to strengthen financial capacity becomes particularly important.

This study represents a further step towards establishing a systematic approach to strengthening the financial capacity of local self-government in Ukraine. Alongside improvements to the PIT allocation mechanism, a significant reserve for increasing budget revenues lies in reducing the scale of informal employment and expanding participation in formal economic activity.

Addressing this issue is not only a matter of increasing budget revenues, but also of eliminating unfair competitive practices and fostering an effective business environment. A situation in which business entities gain competitive advantages by reducing production costs through the minimisation of social contributions and labour costs is unacceptable; it hampers the development of entrepreneurship and reduces the investment attractiveness of territories. In the European Union, such practices are regarded as manifestations of so-called “social dumping”, the prevention of which is identified as a key priority of regulatory policy both for EU Member States and for candidate countries. In this context, the European Commission's 2025 Enlargement Report emphasises the need for Ukraine to intensify efforts to reduce informal employment, noting that

¹[Modelling the Impact of Changes in the Personal Income Tax \(PIT\) Allocation Mechanism on the Budgets of Municipalities. U-LEAD with Europe, 2024.](#)

labour inspection legislation has not yet been aligned with the EU acquis and that the capacity of public institutions remains limited.

The development of effective policy in this area is further complicated by the fact that, following the onset of the full-scale war, the regular collection of statistical data on informal employment has been suspended. According to expert estimates, its scale has increased during this period, further narrowing the tax base. At the same time, no systematic assessment of the level and structure of informal employment has previously been conducted at the level of municipalities. This limits the ability to develop evidence-based policies that take into account the socio-economic heterogeneity of municipalities.

The purpose of this study is to assess the potential for strengthening the financial capacity of municipalities through the proper formalisation of employment and to formulate evidence-based recommendations for involving local self-government bodies in the implementation of policies aimed at preventing informal employment at the local level.

The study applies a methodological approach based on a combination of official statistical data and data from a representative sample survey of residents of municipalities. The survey results have been processed in accordance with the methodological requirements of the International Labour Organization (ILO), ensuring comparability of the obtained estimates of informal employment with retrospective official statistical data.

To provide a comprehensive overview of the issue, the report is structured into three main chapters:

Chapter 1 provides an overview of approaches to defining informal employment, analyses its impact on socio-economic development and municipality revenues and outlines the methodology for assessing this impact.

Chapter 2 assesses the level and structure of informal employment across different types of municipalities, as well as the volume of foregone revenues from personal income tax (PIT) and the single tax at different budget levels, and the potential for their increase.

Chapter 3 analyses the current system for monitoring compliance with labour legislation, the Ukrainian experience of involving local self-government bodies, and best European practices of such cooperation.

The report concludes with **recommendations** for further policy decisions. They outline opportunities for coordinated action by national authorities, local self-government bodies and other stakeholders to reduce informal employment and strengthen the financial capacity of municipalities.

CHAPTER 1. WHAT IS INFORMAL EMPLOYMENT AND WHY IT MATTERS

1.1. Approaches to Definition

One of the key factors for the sustainable development of municipalities is the reduction of informal employment and the expansion of participation in formal economic activity. Formal employment provides workers with legal and social protection, contributes to increased labour productivity, supports the development of a competitive economic environment and expands the fiscal base, thereby increasing revenues across different levels of government. This has led to increased attention from international organisations and national governments to the study of various forms of employment that are not covered, or only partially covered by existing labour and tax reporting and oversight frameworks.

In international practice, approaches to analysing this phenomenon have gradually evolved from a focus on the **informal sector of the economy** to a broader conceptual framework of **informal employment**, which encompasses both employment in the informal sector and informal jobs within formally registered enterprises.

The ILO defines the informal sector as any economic activity carried out by workers or production units that, in law or in practice, is not covered or is insufficiently covered by formal regulatory frameworks. It typically includes unregistered private business entities without legal personality. Such activities are generally small in scale and characterised by a low level of organisation, while employment relationships are often based on casual work arrangements, family or personal ties, rather than on formal contractual relationships with official guarantees. At the same time, it is emphasised that the informal sector should be distinguished from criminal or illegal activities (such as drug production or smuggling), which are governed by criminal law and fall outside the scope of labour or economic relations.

In order to expand the analytical scope for studying different forms of undesirable employment, in 2002, the ILO proposed a shift from analysing the characteristics of enterprises to examining the **formal or informal nature of jobs**.² For example, an individual may be employed by an enterprise that operates in compliance with legal requirements regarding registration, accounting and taxation, while their employment relationship remains undeclared or only partially formalised. Within this framework, employment can be categorised into three main segments:

- formal employment in the formal sector, where both enterprises and jobs comply with legal requirements;
- informal employment in the formal sector, where undeclared jobs exist within registered enterprises;
- employment in the informal sector, where economic activity is carried out by unregistered enterprises or individual producers.

This conceptual framework is considerably broader than approaches limited solely to the analysis of the informal sector. Research shows that in most developed countries the share of employment

²[International Labour Organization. \(2002\). Decent work and the informal economy: Resolution and conclusions adopted by the International Labour Conference at its 90th session. Geneva: ILO.](#)

in the informal sector is relatively small, whereas informal employment within the formal sector may be quite widespread.

At the 17th International Conference of Labour Statisticians (2003), the Guidelines concerning a statistical definition of informal employment were adopted.³ In accordance with these guidelines, **informal employment** is defined as the total number of informal jobs within enterprises in both the formal and informal sectors, as well as in households. The key characteristic of an informal job is the absence of official registration of the employment relationship with public authorities or non-compliance with requirements governing its formalisation. This approach is widely applied in contemporary international research and serves as the methodological basis for analysing the scale and implications of informal employment.

Taking into account the ILO recommendations and national specificities, the following categories of the employed population are used in Ukraine to measure informal employment:

- **self-employed persons**⁴ and **employers** operating their own enterprises within the informal sector;
- **individuals working in unregistered partnerships**, i.e. members of informal production cooperatives (due to their small number, this category is typically included among the self-employed);
- **unpaid family workers** engaged in enterprises in either the formal or informal sector;
- **employees in the formal and informal sectors**, provided they meet any two of the following criteria:
 - the employer does not pay the unified mandatory state social insurance contribution on their behalf;
 - they are not entitled to annual leave;
 - they are not entitled to paid sick leave.⁵

Table 1.1. **Structure of Employment by Type of Unit and Job Status**

Type of unit	Employment status						
	self-employed (including partnerships)		employers		unpaid family workers	employees	
	informal employment	formal employment	informal employment	Formal employment	informally employed	informal employment	formal employment
Formal sector enterprises					1	2	
Informal sector enterprises	3		4		5	6	

Note: informal sector: 3+4+5+6; informal employment: 1+2+ 3+4+5+6; informal employment outside the informal sector: 1+2.

Source: [Methodological Guidelines on Defining Informal Employment approved by Order of the State Statistics Service of Ukraine No. 16 dated 23 February 2013.](#)

³International Labour Organization. (2003). [Guidelines concerning a statistical definition of informal employment](#). Geneva: ILO.

⁴*Self-employed persons* are individuals engaged in independent economic activity carried out on their own account, i.e. without the regular engagement of hired employees. *Employers* are individuals who operate their own enterprises and employ hired workers on a regular basis. *Employees* are individuals who have entered into a written (or oral) employment contract (agreement) with the administration of an enterprise, institution, organisation or with a natural person, defining the terms and remuneration of their work.

⁵[Methodological Guidelines on Defining Informal Employment approved by Order of the State Statistics Service of Ukraine No. 16 dated 23 February 2013.](#)

It should be noted that, in accordance with the provisions of the 17th International Conference of Labour Statisticians, a separate category within informal employment may include self-employed individuals producing goods exclusively for own final household consumption. In Ukraine, such persons are not classified as part of the employed population. Only those individuals who, while working in personal subsidiary farming, sell at least part of their output on the market are considered informally employed. In research, this category of self-employed persons is often analysed separately due to its specific social significance, as such activities play an important role in sustaining household livelihoods in rural municipalities, as well as in the context of ongoing debates regarding the appropriateness of their taxation. This is particularly relevant for the analysis of informal employment at the level of municipalities, as in many rural settlements this type of activity represents a traditional form of economic engagement and is often perceived by the population as an inherent private right, into which the state should not intervene.

Ukraine is among the European countries with relatively high levels of informal employment. European Commission enlargement reports emphasise the need to take measures to reduce its scale and increase labour force participation.⁶ At the same time, the concealment of employment is not limited to employment without formal registration. Significant volumes of economic activity are associated with the underreporting of actually paid wages, the concealment of income by self-employed persons and the use of various legal arrangements (such as contracts with sole proprietors, internship agreements, or outsourcing contracts) to disguise what are, in substance, employment relationships.

To ensure a more precise distinction between non-compliant forms of employment, EU countries widely use, alongside the concept of informal employment, the concept of **undeclared work**.⁷ Unlike the ILO approach, which focuses on the formal or informal nature of jobs, research on undeclared work primarily addresses the tax and regulatory aspects of employment.

In European Commission documents, undeclared work is defined as any paid activity that is lawful in nature but not declared to public authorities in accordance with the applicable regulatory requirements of EU Member States.⁸ This definition does not include criminal activities, nor work that is not subject to state regulation or does not require notification to public authorities (for example, certain forms of household activity for own use in some countries). Research typically distinguishes the following main types of undeclared work:

- **undeclared employment**, encompassing both work in unregistered enterprises and undeclared employment in formally registered enterprises;
- **undeclared self-employment**, where individuals carry out business activities without official registration or conceal part of their income;
- **undeclared family work**, arising when family members are engaged in economic activity without proper formalisation of employment relationships;
- **under-declared work**, where the employer or employee declares only part of the actual work performed.

Despite differing conceptual approaches, in practice the notions of informal employment and undeclared work overlap, particularly in countries with well-developed labour market regulation systems, where legislative requirements cover most forms of economic and employment activity.

⁶[European Commission. \(2025\). Ukraine 2025 Report](#) (SWD(2025) 759 final).

⁷[European Platform tackling undeclared work \(EU\)](#).

⁸[European Commission. \(2007\). Stepping up the fight against undeclared work](#) (COM(2007) 628 final).

In fact, the first three categories listed above correspond to those classified as informal employment under the ILO methodology.

At the same time, the concept of undeclared work draws attention to additional forms of concealed economic activity that have direct implications for tax revenues and, consequently, the financial capacity of municipalities. The most common example of under-declared work is so-called “envelope wages”, whereby an official employer pays part of an employee’s remuneration outside the formally declared salary in order to reduce tax liabilities and social security contributions. Such practices may also include underreporting working hours, concealing actual bonuses or other forms of remuneration.

In research, a distinct form of undeclared work is identified as **bogus self-employment**. In such cases, a worker is formally registered as self-employed but is, in reality, engaged in an employment relationship. This practice is used by employers to reduce tax and social contribution costs and to circumvent compliance with labour law requirements.

Attention is also drawn to new and more complex forms of undeclared work emerging within non-standard employment arrangements, particularly those associated with digital platform work and temporary work agencies. In such cases, the concealment of employment relationships may occur through complex contractual arrangements between workers, intermediaries and user companies.

Measuring these forms of undeclared work presents a significant challenge. In European Union countries, one of the methods used to estimate its scale is the Labour Input Method (LIM), which involves comparing labour input with officially declared employment and output indicators. Direct measurement approaches are also widely used, including periodic EU-wide surveys of the population on participation in undeclared work (e.g., Special Eurobarometer surveys)⁹. However, such approaches do not always provide a detailed understanding of the socio-economic characteristics of undeclared work or its manifestations at the local level. In this context, even a partial assessment of the forms of undeclared work described above can significantly complement statistical measurements of informal employment and enhance understanding of potential tax revenue losses and the reserves available for strengthening the financial capacity of municipalities.

1.2. Impact on Socio-Economic Development and Revenues

The scale and structure of informal employment have a direct impact on the socio-economic development of municipalities. They affect the quality of life of the population, the functioning of local labour markets, the conditions of competition among business entities, as well as the formation of the revenue base of local budgets, thereby determining the capacity of local self-government bodies to provide an adequate level of public services.

Social Implications. Despite the diversity of its forms, a common “core” feature of informal employment is the heightened vulnerability of workers. Individuals employed in the informal sector or in informal jobs often lack access to comprehensive social protection, including pension provision, unemployment insurance and temporary disability benefits. The absence of such guarantees increases the risks of social insecurity, limits opportunities to accumulate contributory service (insurance record), and may lead to the formation of population groups with limited prospects for integration into the formal economy.

⁹[European Commission. \(2020\). Undeclared work in the European Union](#) (Special Eurobarometer 498).

The prevalence of informal employment may also negatively affect public attitudes towards local authorities and levels of civic participation. Unstable working conditions, the lack of social guarantees and limited opportunities to improve living standards contribute to a sense of social insecurity and reinforce the marginalisation of certain population groups. In this context, reducing the scale of informal employment should be viewed not only as an economic priority but also as an important social objective.

Implications for Local Labour Markets and the Competitive Environment. The emergence of a segment of employment operating outside formal labour regulation alters the structure of labour supply and demand and creates a parallel labour market segment characterised by different hiring conditions and wage levels. Formal enterprises are required to compete for labour with the informal sector, where labour costs and compliance with regulatory requirements are lower.

The use of informal employment creates unfair competitive advantages. Enterprises that fail to comply with labour and tax legislation are able to reduce costs and offer lower prices for goods and services. In the long term, this may hinder the development of entrepreneurship, reduce the investment attractiveness of a territory, and deteriorate the overall quality of the economic environment. Within the European Union, such practices are regarded as manifestations of so-called “social dumping”, counteracting which has been identified as a priority of regulatory policy for both EU Member States and candidate countries.

The significant scale of informal employment reduces the transparency of local labour markets and complicates decision-making processes for public authorities. A proportion of jobs and labour income is not reflected in official statistics, which limits the ability to develop local strategic and programme documents, forecast labour demand within municipalities, and carry out effective budget planning.

Impact on the Financial Capacity of Municipalities. The use of informal and improperly declared labour, as well as informal business activity, reduces the tax potential of municipalities and negatively affects the formation of local budget revenues, thereby weakening their capacity to finance local infrastructure, social services and development programmes. The nature and scale of such budgetary losses are determined by the specific features of the tax system and the structure of local budget revenues in Ukraine.

First and foremost, there is a shortfall in **PIT** revenues, which constitute the key source of income for local budgets. In recent years, the share of PIT has consistently accounted for around 60% of the general fund revenues of municipality budgets. Losses arise from the use of undeclared wage labour, the payment of part of wages informally (“envelope wages”), and the application of various schemes to conceal employment relationships, including bogus self-employment. In such cases, PIT is either not paid at all or is replaced by the single tax or other payments, the amounts of which are significantly lower than the tax liabilities that would arise if employment relationships were properly formalised as wage labour.

The second channel of tax revenue losses is the **single tax** paid by sole proprietors and other business entities operating under the simplified taxation system. A proportion of self-employed individuals who are in fact engaged in economic activity do not register as sole proprietors, in particular in order to avoid paying tax liabilities and the unified social contribution, or they partially conceal their income in tax reporting. According to certain estimates, the share of such “shadow self-employed” may account for at least 25–30% of the economically active population in relevant sectors, including small-scale retail trade, personal services, transport services and certain segments of the freelance economy.

In addition, concealed economic activity leads to shortfalls in **other local taxes and charges**, including the tourist tax, land lease payments and property tax. Such losses are particularly characteristic of activities in the rental housing sector, short-term accommodation services and certain types of small-scale entrepreneurship.

The manifestations of informal employment and undeclared work presented in Table 1.2 reflect the most common mechanisms of revenue losses in local budgets.

Table 1.2. Main Forms of Informal and Improperly Declared Economic Activity and Channels of Revenue Losses in Municipal Budgets

	Type of violation	Mechanism	Typical sectors	Potential revenue losses
1.	Use of undeclared wage labour	Workers are employed without formal employment contracts and without officially declared wages	Construction, retail, hospitality, personal services	Loss of PIT revenues
2.	Unregistered business activity	Economic activity carried out without state registration	Small-scale retail trade in markets, personal services	Loss of single tax revenues from potential first-group taxpayers
			Hospitality, retail, personal services	Loss of single tax revenues from potential second- and third-group taxpayers; losses of tourist tax, property tax and land lease payments
3.	Undeclared family labour	Family members engaged in economic activity without formalisation	Agriculture, retail, personal services	Loss of PIT or single tax revenues
4.	“Envelope wages”	Part of wages is paid informally, outside official accounting	Almost all types of business activity	Partial loss of PIT revenues
5.	Bogus self-employment	Employment relationships are disguised through contracts with sole proprietors	IT, services, retail, hospitality	Replacement of PIT with lower tax payments under the simplified taxation system
6.	Business fragmentation among sole proprietors	A single business is formally divided among several sole proprietors to benefit from the simplified taxation system	Retail, hospitality, services	Under-collection of PIT and single tax revenues due to misuse of the simplified system
7.	Underreporting of turnover by sole proprietors	Part of revenues is not recorded in accounting systems or fiscal registers	Retail trade, services	Loss of part of single tax revenues and local taxes and charges
8.	Overstatement of expenses by entities under the general taxation system	Artificial inflation of expenses and/or concealment of part of income	Various types of business activity	Reduction of PIT revenues from net income

Compiled on the basis of a desk review of regulatory acts and existing research.

It should be noted that the impact of informal employment is not unequivocal. In certain cases, it may serve an adaptive function, providing employment and income for the population where opportunities in the formal labour market are limited. In particular, self-employment within personal subsidiary farming or small-scale entrepreneurial activity based on the use of privately owned land

may play an important role in sustaining household incomes and reducing poverty in rural municipalities. The ILO emphasises that employment in the informal sector may sometimes represent the only available alternative for many socially vulnerable groups. In EU research literature, the concept of socially embedded own-account undeclared work is also used. In particular, Birgit Pfau-Effinger¹⁰ distinguishes types of undeclared work based on individual motivation — such as “escape from poverty”, “supplementary income” and “solidarity-oriented work” — each of which requires different policy approaches.

At the same time, there may be situations in which the costs of combating certain forms of informal employment significantly exceed the expected benefits of their formalisation.

In this regard, the assessment of tax revenue losses associated with informal employment and undeclared work requires a differentiated approach. When developing the calculation methodology, it is important to take into account their various forms and socio-economic roles. This makes it possible to more accurately assess the potential for increasing tax revenues of municipality budgets as a result of employment formalisation, while avoiding both overestimation of potential fiscal effects and underestimation of the associated socio-economic risks.

1.3. Assessment Methodology

The ILO identifies the Labour Force Survey (LFS) or similar household surveys as the primary source of national data on informal employment, provided that they include relevant questions necessary to obtain such information. Although such surveys may produce somewhat underestimated estimates of the scale of informal employment due to limited respondent candour (a common limitation of all direct measurement methods), they remain the only instruments that allow for the identification of informal employment in accordance with established criteria. They also make it possible to determine the socio-demographic and socio-economic characteristics of population groups engaged in informal employment, which is essential for evidence-based policymaking.

In Ukraine, these purposes are served by the Labour Force Survey (LFS) conducted by the State Statistics Service of Ukraine on a regular basis since 1995, with the inclusion of informal sector employment modules since 1997. The survey questionnaire contains a dedicated set of questions enabling the identification of different categories of informally employed persons in accordance with the applicable methodological provisions. However, during the period of the full-scale war, the conduct of the LFS was suspended. In addition, even under conditions of regular implementation, the data obtained can only be presented for major socio-demographic groups, types of economic activity and regions of Ukraine. Data at the level of municipalities are not representative, which makes it impossible to use them for analysing local labour markets and assessing the impact of informal employment on local budget revenues.

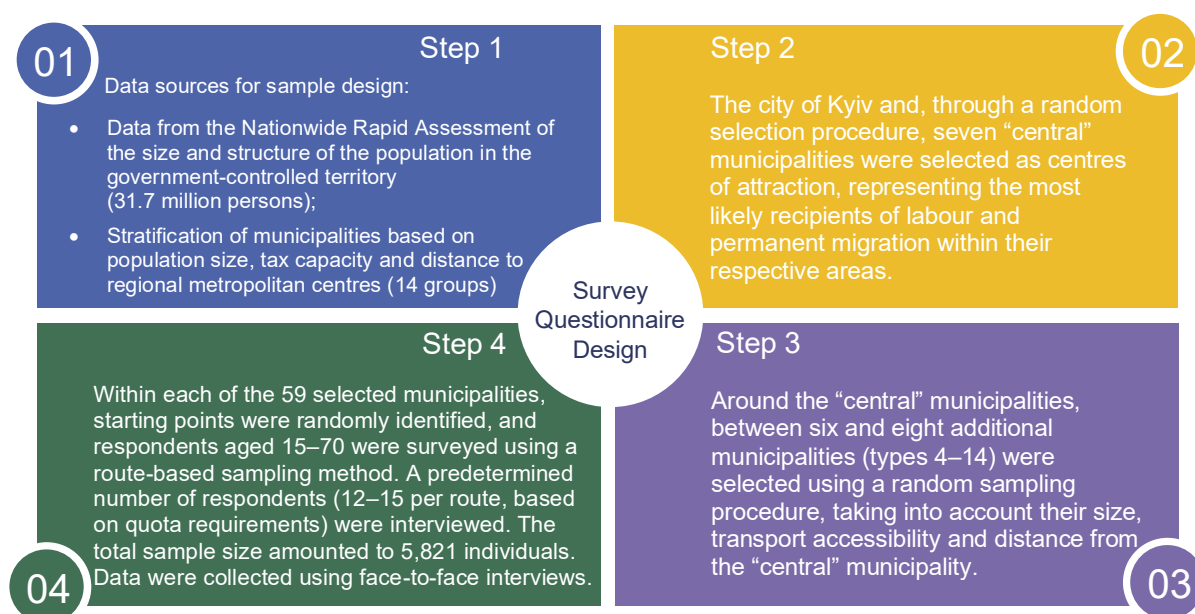
In this context, in 2024, as part of the project “Modelling the Impact of Changes to the PIT Allocation Mechanism on the Budgets of Municipalities”¹¹, supported by the U-LEAD Programme, a dedicated national sample statistical survey was conducted at the level of municipalities in Ukraine. This made it possible to ensure comparability across different types of municipalities throughout the territory of Ukraine under government control.

¹⁰Pfau-Effinger, B. (2009) Varieties of undeclared work in European societies. *British Journal of Industrial Relations*. Vol. 47, No. 1, pp. 79-99.

¹¹[Modelling the Impact of Changes in the Personal Income Tax \(PIT\) Allocation Mechanism on the Budgets of Municipalities, U-LEAD with Europe, 2024.](#)

The survey is representative of the population of typical municipalities in Ukraine. At the first stage of sample design, municipalities were grouped, and the required number of municipalities from each group was selected. As a result, 14 strata of municipalities were identified. Within the first three strata (those with the largest population), eight municipalities were selected using systematic random sampling with probability proportional to size; these were treated as notional “centres of attraction” for analysing labour mobility (Figure 1.1).

Figure 1.1. **Methodology of the Sample Statistical Survey of Residents of Municipalities**



Around these “centres of attraction” (hereinafter referred to as central municipalities), between six and eight additional municipalities were selected, taking into account their distance from the central municipality (up to 30 km; 30–65 km; 65–100 km), as well as transport connectivity (national and regional highways, territorial roads and railway links). This approach made it possible, already at the sampling stage, to capture the functional linkages between settlements that predominantly act as labour supply areas and those that predominantly serve as labour demand centres.

As a result of the stratified random sampling procedure, a total of 59 municipalities were selected for the survey, ensuring representativeness for the entire population of municipalities in Ukraine. Data were collected between 28 August and 29 September 2024. In total, 5,821 individuals were interviewed using face-to-face interviews.

The **survey questionnaire** included a block of filter questions analogous to those used in the LFS, in particular regarding employment status, type of enterprise, working conditions and the availability of social guarantees. This enabled the identification of different categories of informally employed individuals. In addition, questions concerning the formalisation of employment relationships, the level of wages received and taxes paid made it possible to partially assess the prevalence of certain forms of undeclared work, including bogus self-employment, which are otherwise difficult to detect and measure.

The questionnaire also included questions on the location of the workplace, the place of registration of the employed person and their actual place of residence. The availability of such information allows for modelling potential changes in the distribution of tax revenues resulting from the formalisation of informal employment across local budgets under different taxation scenarios. In particular, it enables a comparison between the current model of PIT allocation based on the

location of the tax agent and an alternative model under which the tax is allocated based on the taxpayer's place of residence.

Tax revenue losses to budgets and the **potential increase in revenues** resulting from the formalisation of informal employment were estimated separately for PIT and the single tax.

PIT. The primary focus was on estimating tax losses arising from undeclared wage employment. To ensure an appropriate level of detail, the calculations were performed for different types of municipalities, as well as across economic sectors, taking into account variations in average wage levels.

The results obtained were supplemented by estimates of PIT losses associated with bogus self-employment schemes. These estimates are based on the assumption that bogus self-employment occurs where an individual works for a registered enterprise, but their relationship with the employer is formalised not through an employment contract, but through alternative arrangements — such as service contracts (for example, under the status of a sole proprietor). It should be noted that such estimates are indicative. Some respondents may not fully understand the legal nature of their employment relationships or may provide incomplete information regarding their remuneration, which limits the precision of the results.

Single tax. Single tax losses were estimated taking into account categories of self-employed individuals and their distribution across types of economic activity. This made it possible to identify informally employed persons as potential taxpayers under the first, second or third groups of the simplified taxation system. The calculations were based on applying the maximum fixed rates of the single tax applicable to the respective taxpayer groups.

Losses associated with the partial concealment of income by registered sole proprietors, as well as with inconsistencies between the selected single tax group and the actual scale or nature of business activities, were not taken into account due to the lack of relevant data. Accordingly, the estimates obtained should be regarded as conservative (underestimated), as they do not capture certain forms of undeclared work and are therefore lower than the potential full scale of losses.

In calculating the total budgetary losses from PIT and the single tax, it was taken into account that, in cases of bogus self-employment, losses in PIT are partially offset by revenues from the single tax. Therefore, net losses were calculated as the difference between the amount of unpaid PIT and the single tax actually paid.

The potential increase in revenues of municipality budgets reflects the expected growth in PIT and single tax receipts, estimated on the basis of assumptions regarding a possible reduction in the level of informal employment as a result of implementing relevant policy measures. These assumptions are based on a differentiated analysis of the socio-economic nature and role of various forms of informal employment, a review of regulatory approaches applied in EU countries, and consideration of institutional features and current socio-economic conditions in Ukraine.

At the same time, in formulating these assumptions, the complete eradication of informal employment and other forms of improper labour declaration was not considered a realistic objective. On the one hand, a segment of socially vulnerable, low-productivity or occasional economic activity is identified, for which strict formalisation may not be appropriate. In particular, in the medium term, the formalisation of self-employment within personal subsidiary farming — and the corresponding increase in tax revenues — is not considered a viable source of budgetary growth and is therefore excluded from the calculations. On the other hand, informal employment within the formal sector is, in European practice, subject to the most stringent regulatory

intervention, and its level under such conditions may be reduced to minimal values. To reflect these differences, a system of coefficients was applied, forming a matrix of assumptions regarding the potential level of formalisation of specific forms and manifestations of informal employment under different scenarios. This approach allows for the derivation of interval estimates of the potential increase in tax revenues, depending on variations in the parameters of the calculation model.

Some studies suggest that strengthening measures aimed at reducing informal employment may lead to a decline in the number of business entities. However, an analysis of the relationship between trends in informal employment and business demography in Ukraine does not confirm this assumption at the macro level. At the same time, the opposite effect is possible: a reduction in informal employment may enhance fair competition and improve the efficiency of enterprises that comply with legal requirements. Thus, the contraction of the informal segment of the economy may be offset by the development of formal entrepreneurship. Nevertheless, it cannot be ruled out that, in certain local markets characterised by a limited number of economic actors and objective constraints on economic activity, negative effects may arise. To avoid overestimating potential revenue gains, additional adjustment coefficients were applied in the calculations for such types of municipalities.

Informal employment also serves as a source of income and, accordingly, indirectly contributes to the formation of effective demand, thereby stimulating the development of certain segments of the local economy, including the real estate market, services and retail trade. A quantitative assessment of such effects would require a significantly broader data base. Within the framework of the proposed methodology, these impacts were not taken into account; however, they should be considered a promising direction for further refinement of methodological approaches to assessing the socio-economic consequences of informal employment.

The following chapter presents the results of calculations of the level of informal employment, the scale of revenue losses and the potential reserves for increasing revenues across different types of municipalities and in aggregate.

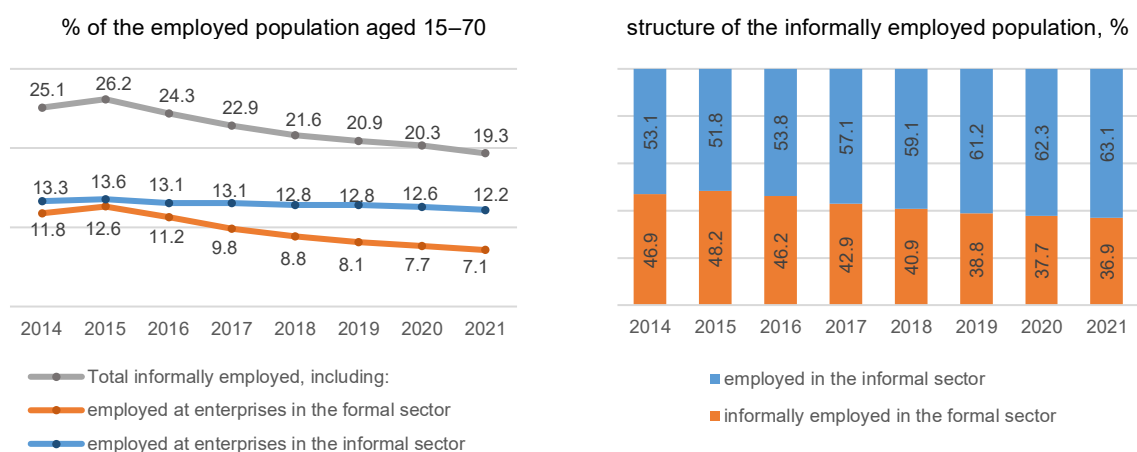
CHAPTER 2. INFORMAL EMPLOYMENT AND ITS FISCAL IMPLICATIONS FOR MUNICIPALITIES

2.1. Scale and Characteristics of Informal Employment in Ukraine: Implications for Further Research

Available official statistical data on informal employment make it possible to assess key trends and patterns in its prevalence, as well as to formulate, on this basis, hypotheses regarding the potential for employment formalisation. The analysis covers the period 2014–2021. Since 2014, indicators have been calculated on a unified methodological basis¹², ensuring their comparability. Following the onset of the full-scale war, the Labour Force Survey was suspended; therefore, data for 2022–2025 are not available.

The problem of informal employment in Ukraine is long-standing and large-scale. In certain years, it has accounted for than a quarter of the employed population. The analysis shows that the **level of informal employment can be significantly reduced through the implementation of consistent and effective public policy**. In particular, against the backdrop of active government measures — including strengthened labour inspections — this indicator steadily declined from 26.2% in 2015 to 19.3% in 2021 (Figure 2.1). Even labour market disruptions caused by the COVID-19 pandemic did not alter this trend. At the same time, international comparisons indicate that the potential for further reductions in informal employment in Ukraine remains substantial and far from exhausted.

Figure 2.1. Informally Employed Population



* Source: The State Statistics Service of Ukraine

A clear indication of the importance of situational and subjective factors in informal employment is provided by its regional disparities, which show striking differences. In 2021, the level of informal employment ranged from over 44% in Rivne and Chernivtsi regions to less than 10% in the city of Kyiv, as well as in Lviv, Kharkiv, and Kyiv regions. These differences are partly explained by objective factors, including the structure of the economy. However, the scale of variation further confirms the significant role of systemic governance decisions in addressing informal employment. For example, it is difficult to explain — other than by differences in the quality of interaction between

¹²On Approval of the Methodological Guidelines on Defining Informal Employment: Order of the State Statistics Service of Ukraine No. 16 dated 23 February 2013.

regional and local authorities and the business sector — the twofold difference in informal employment levels between economically similar regions such as Kherson (37.3%) and Kirovohrad (14.3%).

Policies aimed at the formalisation of employment require a differentiated and localised approach. The largest share of informally employed individuals in Ukraine consists of workers engaged in the informal sector — namely unregistered entrepreneurs, self-employed persons and individuals working for unregistered business entities (Figure 2.1). In 2021, this segment accounted for 12.2% of the total employed population aged 15–70 and, compared with 2015 (13.6%), did not decline significantly. By contrast, the share of informally employed individuals at registered enterprises decreased between 2015 and 2021 from 12.6% to 7.1% of total employment.

The identification of undeclared employment relationships within registered enterprises is a relatively more straightforward task for supervisory authorities. In contrast, the informal sector — due to the absence of official registration of business entities — is significantly less accessible to control through traditional inspection mechanisms. This increases the importance of local self-government bodies, which, owing to their proximity to local economies and a better understanding of local labour markets, can play a key role in the formalisation of employment in segments that remain beyond the scope of official monitoring.

The highest levels of informal employment are observed in agriculture, forestry and fisheries. Between 2014 and 2021, the rate consistently exceeded 60%, reflecting the seasonal nature of work, the high share of low-skilled labour, limited employment opportunities in other sectors, and the difficulty of enforcing labour legislation in conditions of dispersed economic activity. The second most affected sector is construction. The share of informally employed workers in this sector decreased from 62.0% to 46.7%, but remains high, largely due to the widespread practice of work being carried out by small, unregistered groups of workers.

The most significant reductions in informal employment were observed in the accommodation and food service sector (from 34.9% to 19.3%) and in wholesale and retail trade, including the repair of motor vehicles and motorcycles (from 32.3% to 16.3%). However, the potential for further formalisation of employment relationships in these sectors remains substantial. Existing research suggests that progress in employment formalisation in these areas is partly associated with the spread of practices such as the fictitious registration of workers as sole proprietors and other forms of undeclared work.

When designing policy measures, it is important to take into account age and gender-specific patterns in the prevalence of informal employment. This applies in particular to young people, individuals aged over 55 and women with childcare or other caregiving responsibilities. Social stereotypes, insufficiently adapted job search infrastructure and workplaces, as well as the need to balance employment with other aspects of personal life, often compel these vulnerable population groups to accept various forms of informal and undeclared employment in order to meet their economic needs. Efforts by national and local authorities aimed at ensuring accessibility and inclusiveness, as well as developing family-friendly and flexible employment policies, may be no less effective in reducing budget losses from under-collected PIT due to improper forms of employment than administrative and regulatory measures directly focused on enforcing compliance with tax, social, and labour legislation.

The greatest fiscal gains from the formalisation of informal employment are likely to be realised by urban municipalities. Although the level of informal employment in rural areas is significantly higher than in urban areas (in 2021: 35.5% versus 12.1%, respectively), its structure differs substantially. In rural areas, the overwhelming majority (81.3%) of informally employed

individuals are self-employed or unregistered entrepreneurs, primarily engaged in basic and irregular forms of agricultural production. In contrast, in urban areas, informal employment is predominantly concentrated within the formal sector, accounting for 60.7% of all informal workers. In absolute terms, this difference is even more pronounced: according to the State Statistics Service of Ukraine, in 2021, there were 321.4 thousand informally employed persons working at registered enterprises in rural areas, compared to 791.6 thousand in urban settlements (Figure 2.2). Given that facilitating the transition to formal employment for workers in registered enterprises is generally easier than encouraging the formal registration of self-employed activities, the most rapid progress in reducing informality can be achieved in large urban municipalities.

Figure 2.2. Number of Informally Employed Population by Type of Area, thousand persons



* Source: The State Statistics Service of Ukraine

The study “Modelling the Impact of Changes to the PIT Allocation Mechanism on the Budgets of Municipalities” concludes that, if PIT were allocated to local budgets based on the taxpayer’s place of residence, the vast majority of small and medium-sized municipalities — where a significant share of residents work outside their place of residence — would experience an increase in tax revenues. At the same time, approximately two-thirds of cities with populations exceeding 100,000 would incur tax revenue losses of varying magnitude.¹³ This report approaches the issue of strengthening the fiscal base of municipalities in a comprehensive manner. While changes to the PIT allocation mechanism may ensure a more equitable distribution of resources and reduce disparities in fiscal capacity across municipalities, an effective policy of employment formalisation can serve as a complementary instrument to partially offset potential revenue losses in urban municipalities.

The following subsections analyse the impact of the full-scale war on the scale of informal employment, assess its level across different types of municipalities and provide estimates of budgetary losses and the potential increase in revenues resulting from the formalisation of informal employment.

¹³ [Modelling the Impact of Changes in the Personal Income Tax \(PIT\) Allocation Mechanism on the Budgets of Municipalities, U-LEAD with Europe, 2024.](#)

2.2. Impact of the Full-Scale War on Informal Employment in Municipalities

According to available estimates, progress in reducing informal employment came to a halt following the outbreak of the full-scale war. In the context of large-scale population displacement, growing territorial and occupational imbalances in the labour market, the introduction of a moratorium on business inspections, and insufficient regulation of mobilisation and employee reservation procedures, the risks associated with the spread of informal forms of employment have increased. According to information published by the Ministry of Economy of Ukraine, the level of informal employment may currently exceed 23% of the employed population, while approximately 2.7–3 million individuals receive “envelope wages”.¹⁴

Within the framework of the sample statistical survey of residents of municipalities, respondents were asked a set of questions designed to identify informal employment, aligned with the methodology of the Labour Force Survey. The results obtained generally confirm the trends outlined above and allow for a more detailed analysis of changes in the structure of informal employment and its characteristics across different types of municipalities.

According to the survey, the **level of informal employment amounted to 26.2%**. This figure is likely somewhat higher than the annual average, as the survey was conducted in August–September — a period characterised by the peak of seasonal employment.

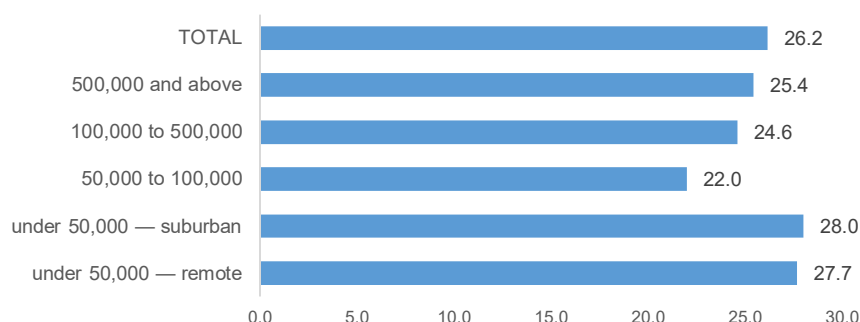
The structure of informal employment has also changed. During 2015–2021, there was a downward trend in informal employment within registered enterprises as a result of strengthened state policies aimed at reducing informality (see Figure 2.1). However, survey data indicate a reversal of this trend: the share of informally employed persons working in registered enterprises increased from 37% (based on Labour Force Survey data for 2021) to nearly 45% of the total number of informally employed individuals. Such changes may be linked to the suspension of state supervision (control) measures under martial law. Another significant factor is likely the use of informal employment by some workers as a means of avoiding military registration requirements. As indicated by interviews with employers, male job applicants often refuse formal employment arrangements at enterprises where employee reservation (exemption from mobilisation) is not available.

Traditionally, the highest level of informal employment has remained in agriculture, forestry and fisheries (over 60%). This indicator has also increased significantly in construction (up to 57%). Whereas in the pre-war period it showed a steady downward trend, it has now approached the peak level recorded in 2015. According to estimates by the World Bank, mobilisation and migration have substantially reduced the supply of labour, particularly in construction, transport and logistics. The labour shortage in construction exceeds 30%, which has led to more intensive use of temporary construction crews, the engagement of workers without sufficient qualifications, and the widespread use of employment without proper formalisation of labour relations.

Accordingly, the most significant increase in informal employment in recent years has been observed in large urban municipalities that have become centres of attraction for internally displaced persons and simultaneously face a considerable shortage of skilled labour — especially in construction and transport — which is partially compensated through informal employment (Figure 2.3).

¹⁴[Ministry of Economy of Ukraine. Scientific Platform meeting \(February 2026\).](#)

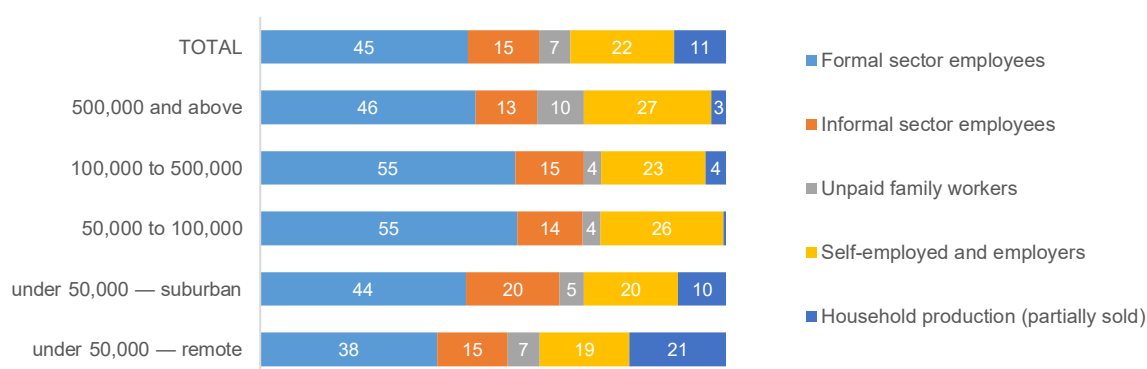
Figure 2.3. **Share of Informally Employed Population Aged 15–70 in Different Types of Municipalities, % of the Employed Population of the Corresponding Age Group**



Calculated based on data from the sample survey of residents of municipalities.

In municipalities with populations of 500,000 or more, nearly half of informally employed individuals worked in enterprises within the formal sector. The share of self-employed persons is also relatively high—27% (Figure 2.4). Large cities are characterised by strong demand for a wide range of services from both businesses and households (including construction and repair works, transport services, delivery, etc.), which stimulates the development of small-scale entrepreneurship and, under conditions of weakened state oversight, its informal forms. Accordingly, the largest share of informally employed persons is concentrated in construction, transport and logistics, as well as in trade.

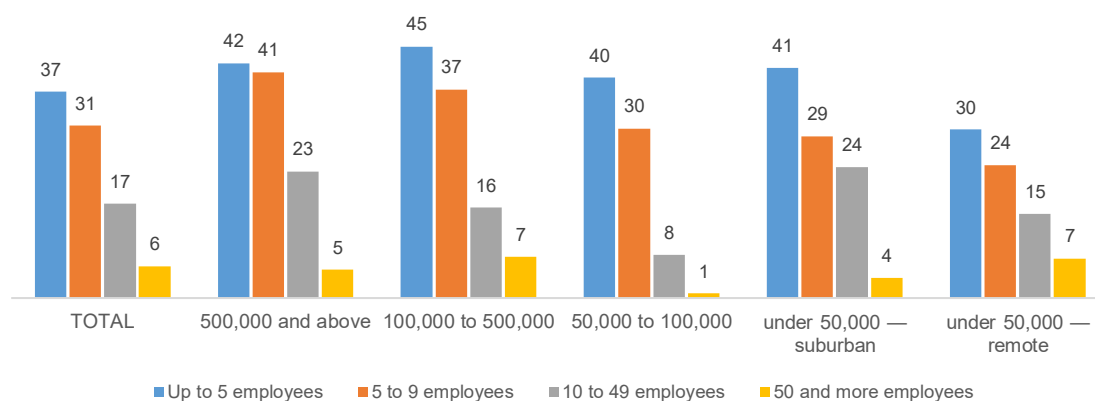
Figure 2.4. **Structure of Informal Employment, % of the Total Informally Employed Population**



Calculated based on data from the sample survey of residents of municipalities.

Regardless of the type of municipality, a clear relationship can be observed between the level of informal employment among wage employees and enterprise size: as the size of the enterprise decreases, the share of informally employed workers increases (Figure 2.5). This pattern is important to consider when designing differentiated policies and programmes for the formalisation of employment.

Figure 2.5. **Rate of Informal Employment among Employees by Enterprise Size, %**



Calculated based on data from the sample survey of residents of municipalities.

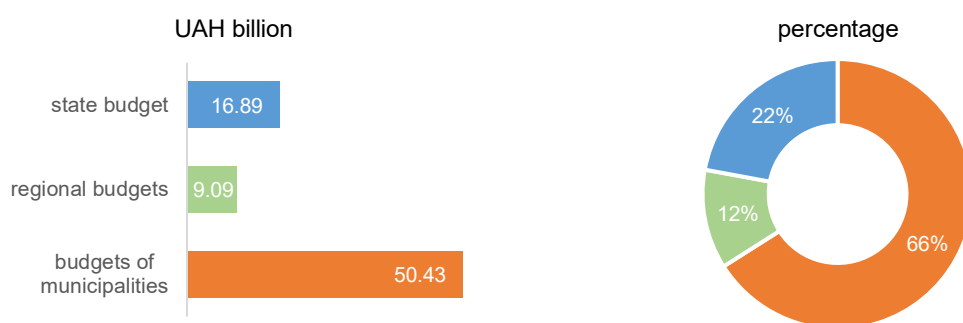
For **small municipalities with populations of up to 50,000**, the structure of informal employment is characterised by a relatively lower share of both informally employed wage workers and self-employed persons. At the same time, there is a high proportion of individuals working within their own households and selling part of their output on the market — exceeding 21% of all informally employed persons in municipalities remote from large cities (see Figure 2.4). In practice, in many such municipalities, opportunities for both formal and informal employment are limited, and household production becomes one of the primary sources of income for the population.

2.3. Assessment of Budget Losses from Informal Employment

Budget losses arising from informal employment represent the volume of tax revenues that could have been collected under conditions of its full formalisation. In estimating losses from PIT, differences in average wage levels across sectors of economic activity and enterprise size were taken into account. Losses from the single tax were estimated with regard to categories of self-employed persons, their distribution by type of economic activity and the income levels reported during the survey, which made it possible to identify informally self-employed individuals as potential taxpayers within the respective single tax groups. To illustrate the scale of losses, the estimated figures are compared with actual budget revenues for 2024.

According to the calculations, total budget losses from informal employment in 2024 exceeded **UAH 76.4 billion**, of which **UAH 67.5 billion** relates to uncollected PIT and **UAH 8.9 billion** to the single tax. In relation to actual revenues, this corresponds to 3.8% of total tax revenues to the general fund of the consolidated budget of Ukraine, 21.0% of PIT revenues from wages, and 16.1% of single tax revenues from individuals.

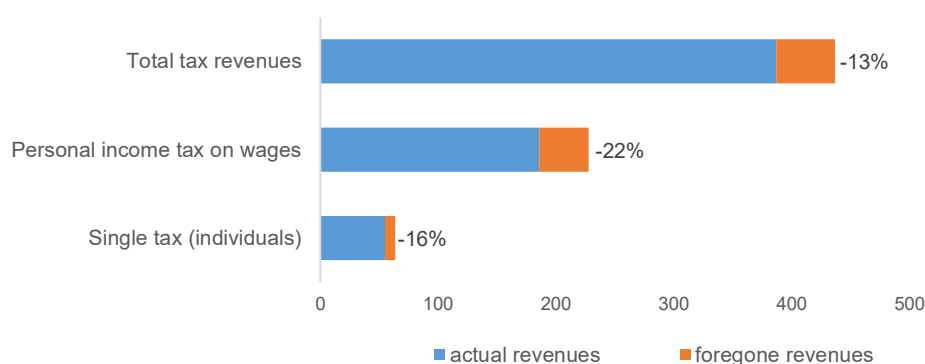
The largest losses from informal employment are borne by the **budgets of municipalities**, which account for **66% of the total volume of losses** (Figure 2.6). This is due to the structure of tax revenue distribution within the budget system: 64% of PIT paid by tax agents within the territory of a given municipality (and 40% in the case of the city of Kyiv) is credited to its budget, while the single tax is a local tax and is fully allocated to the budget at the taxpayer's tax address.

Figure 2.6. **Structure of Losses from Informal Employment by Budget Level**

Calculated based on data from the sample survey of residents of municipalities.

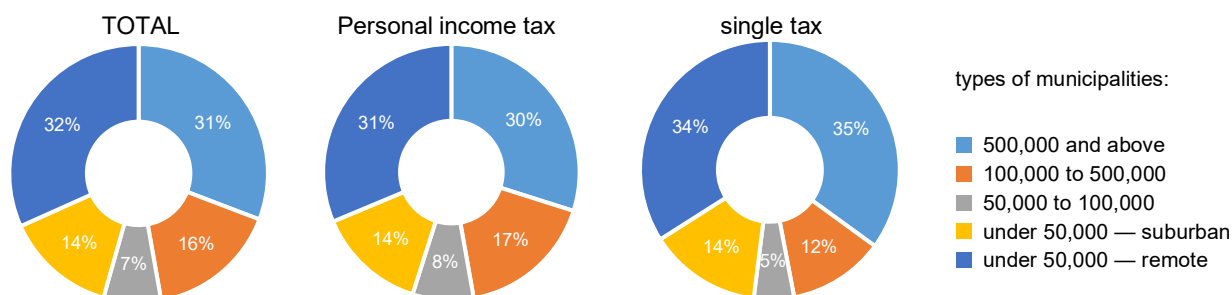
Overall, the budgets of municipalities fell short by more than **UAH 50.4 billion**. For comparison, this amounts to approximately 13% of the actual volume of tax revenues to their budgets. In the absence of informal employment, PIT revenues could have been at least 22% higher, and single tax revenues at least 16% higher (Figure 2.7).

In this study, informal employment is considered, firstly, as a potential source of increased tax revenues, and secondly, within a broader framework of a systemic approach to strengthening the financial sustainability of municipalities. One of the key directions of such strengthening is the reform of the PIT allocation mechanism, which provides for its distribution based on the taxpayer's place of residence. The implementation of this reform is expected to promote a more equitable distribution of tax revenues across municipalities and reduce disparities in their fiscal capacity. From this perspective, the formalisation of informal employment is regarded as an additional compensatory mechanism for municipalities that may incur losses as a result of changes to the PIT allocation system. Accordingly, the subsequent analysis of differences between types of municipalities in terms of budget revenue losses from informal employment, as well as the assessment of their growth potential, is carried out under the assumption that PIT is allocated based on the place of residence of the individual from whose income it is paid.

Figure 2.7 **Actual and Foregone Revenues of Municipal Budgets, UAH billion**

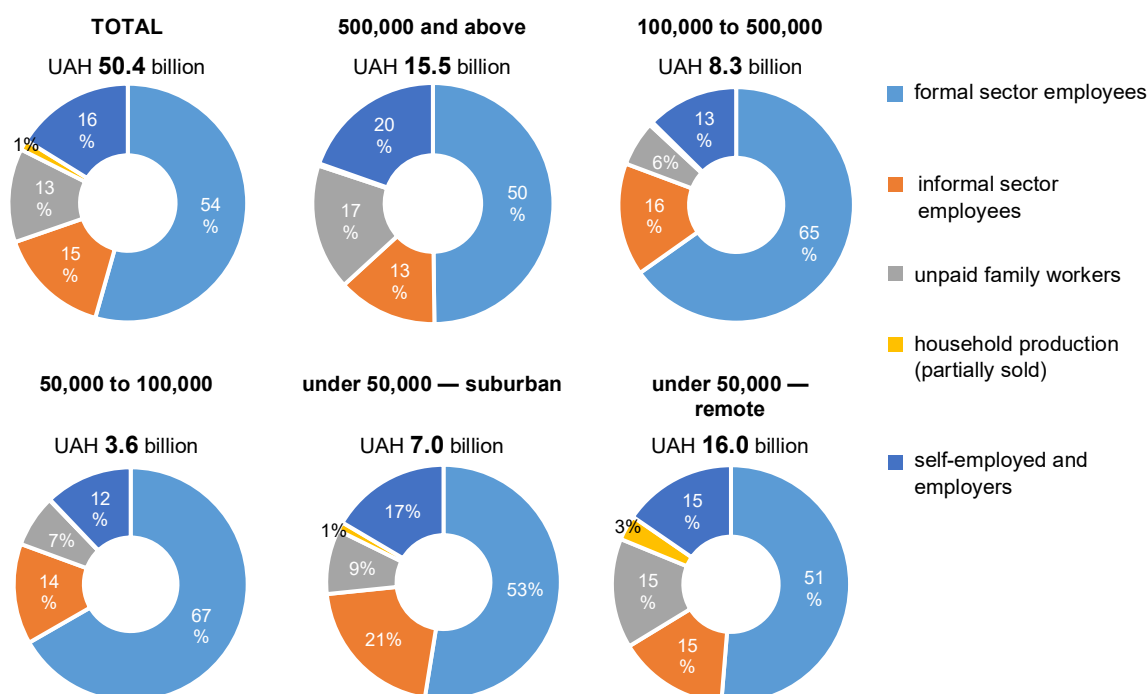
Calculated based on data from the sample survey of residents of municipalities.

Figure 2.8 presents the distribution of total losses of municipality budgets from informal employment by type of municipality.

Figure 2.8. **Distribution of Budget Losses from Informal Employment by Type of Municipality, %**

Calculated based on data from the sample survey of residents of municipalities.

The structure of budget revenue losses by categories of informally employed persons varies depending on the type of municipality. As shown in the previous subsection, during the period of the full-scale war there has been an increase in the share of informally employed persons working at registered enterprises. This share is highest in municipalities with populations ranging from 50,000 to 500,000. Accordingly, in such municipalities, losses of PIT attributable to this category of informally employed persons exceed 65% of the total volume of tax losses (Figure 2.9). At the same time, in large metropolitan areas a noticeably higher share of losses is associated with informal activity of self-employed persons. This is likely due to more favourable conditions for the development of small businesses and the widespread use of tax optimisation practices in the context of weakened state oversight.

Figure 2.9 **Structure of Budget Losses of Municipalities by Category of Informally Employed Population, %**

Calculated based on data from the sample survey of residents of municipalities.

Despite the fact that in small municipalities — particularly those remote from large cities — the structure of informal employment includes a notable share of individuals working within their own households and selling part of their output on the market (over 20%), the fiscal losses associated

with this category remain relatively insignificant. They account for just over 1% of the total losses in suburban municipalities with populations below 50,000 and around 3% in small remote municipalities. This is explained by the low income levels generated by such activities and their predominantly seasonal nature. At the same time, this highlights the need for a differentiated approach to assessing the prospects for employment formalisation, particularly taking into account its social functions and the expected fiscal impact.

Policy efforts should be directed towards stimulating the socio-economic development of small municipalities and creating employment opportunities for their residents. This will establish the conditions for increasing budget revenues and strengthening the financial base of local self-government. However, under current conditions, this is a long-term objective. In the short term, improving the financial position of such municipalities will be supported by the transition to allocating PIT based on the taxpayer's place of residence. The analysis of the scale and structure of losses from informal employment confirms the initial research hypothesis that large urban municipalities stand to gain the most from employment formalisation. It is precisely in these municipalities that a significant number of informally employed wage workers are concentrated, with earnings above the national average. The legalisation of their employment represents a significant source of additional tax revenues to local budgets and may partially offset losses arising from changes to the PIT allocation mechanism. The next subsection presents the results of the assessment of such opportunities.

2.4. Potential for Increasing Budget Revenues through the Formalisation of Informal Employment

In this study, the potential for formalising informal employment is understood not as the likelihood of immediate formalisation of informally employed workers, but as the share of informal employment that could be transitioned into the formal sector under conditions of normalised labour market functioning, including strengthened enforcement and the creation of incentives for legalisation. Thus, this does not refer to a guaranteed outcome, but rather to the potential for transition to formal employment and, accordingly, to an increase in tax revenues to budgets resulting from such a transition.

To assess this potential, a multi-scenario approach was applied, within which different scenarios were considered depending on assumptions regarding the feasibility of formalisation across various categories of informally employed persons, sectors of the economy, enterprise sizes, types of settlements and other factors. The analysis of survey data, domestic experience from 2014–2021, and European practices in employment formalisation made it possible to identify a number of key patterns and trends, which were taken into account in the calculations. In particular:

- the potential for formalisation increases with enterprise size: the lowest potential is observed in micro-enterprises with up to 5 employees, whereas in enterprises with more than 50 employees formalisation is most achievable due to higher levels of organisational structuring, institutional visibility, and economic resilience;
- for self-employed persons and wage workers in the informal sector, the scope for formalisation is more limited due to employment instability, low institutional visibility, and economic risks;

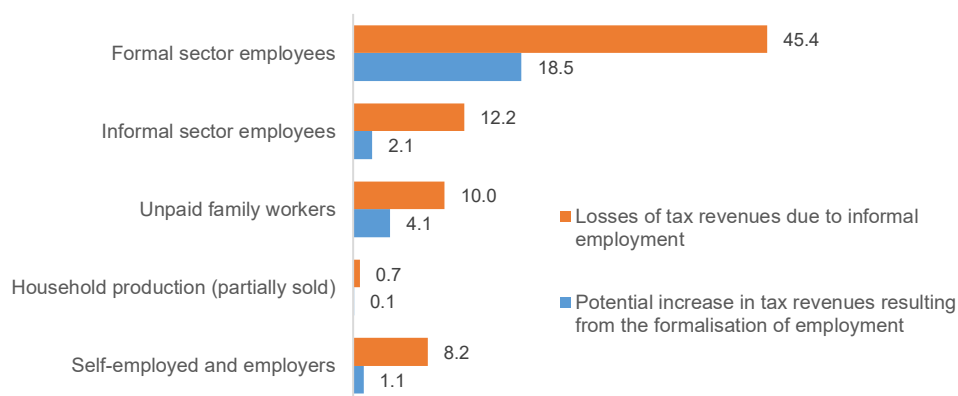
- on average, the potential for formalisation is higher in large urban and suburban municipalities, where higher levels of economic activity, labour demand, and institutional capacity are combined; in remote rural municipalities, formalisation is constrained by low profitability and the risk of employment reduction resulting from excessive regulatory pressure;
- not all informal employment is amenable to formalisation: a portion is episodic or low-income in nature and may disappear if formalisation is attempted, thereby limiting the realistic potential for increased tax revenues.

According to the results of the scenario-based calculations, the potential increase in tax revenues resulting from the formalisation of informal employment ranges from UAH 19.5 billion to UAH 30.1 billion. In the subsequent analysis, the median scenario is used, as it is considered the most realistic for Ukraine. Under this scenario, the potential increase in tax revenues is estimated at **UAH 25.9 billion**, or 34% of the total losses from informal employment, including UAH 24.6 billion from PIT (36%) and UAH 1.2 billion from the single tax (14%).

Of the total potential additional revenues, **UAH 6.2 billion would accrue to the state budget, UAH 3.3 billion to regional budgets and UAH 16.4 billion to the budgets of municipalities.**

The greatest opportunities for the formalisation of labour relations are associated with informally employed wage workers at enterprises in the formal sector. The formalisation potential within this group is estimated at approximately 40%. It should be noted that this indicator varies significantly depending on enterprise size and type of economic activity: in enterprises with more than 50 employees, it exceeds 70%, whereas in small enterprises with fewer than 5 employees it is below 20%. Overall, this segment of informal employment could generate approximately UAH 18.5 billion in additional revenues (Figure 2.10).

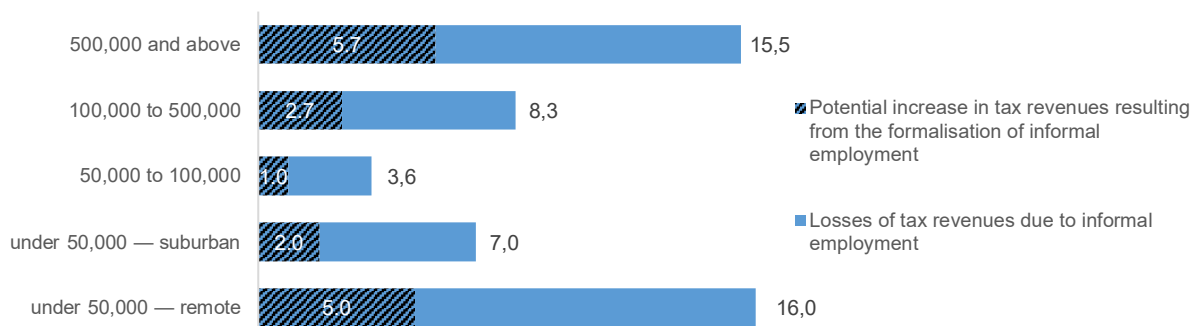
Figure 2.10: **Potential Increase in Tax Revenues by Categories of Informally Employed Persons, UAH billion**



Calculated based on data from the sample survey of residents of municipalities.

The specific configuration of local labour markets, as well as the influence of institutional, social and other factors determine differences in the potential for employment formalisation and the opportunities for increasing tax revenues to the budgets of municipalities depending on their type (Figure 2.11).

Figure 2.11. **Potential Increase in Tax Revenues to the Budgets of Municipalities, UAH billion**

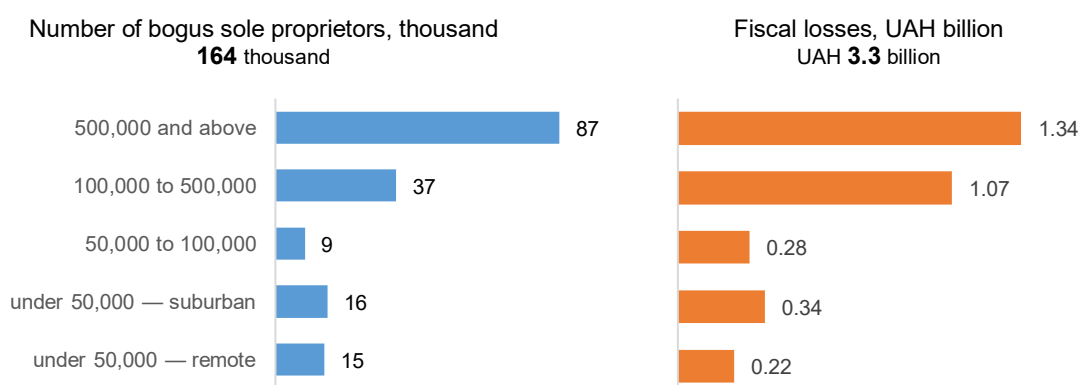


Calculated based on data from the sample survey of residents of municipalities.

Tax revenues to budgets may also increase significantly as a result of reducing various forms of undeclared work (see § 1.3). This study includes an attempt to estimate the fiscal losses associated with so-called **bogus self-employment**, where an individual is formally registered as a sole proprietor but is in fact engaged in an employment relationship. Such practices are used by employers to reduce tax and social contribution costs, as well as to avoid compliance with labour legislation requirements.

According to the estimates, approximately 164,000 bogus self-employed individuals operate in Ukraine, more than half of whom are concentrated in municipalities with populations of 500,000 or more. These individuals typically pay the single tax, the amount of which is significantly lower than the PIT that would be payable if their labour relations were formalised as employment. Taking into account the difference between the uncollected PIT and the single tax actually paid, the losses resulting from the spread of bogus self-employment are estimated at approximately **UAH 7.4 billion**, of which UAH 3.2 billion represents losses to the state budget, UAH 0.9 billion to regional budgets and UAH 3.3 billion to the budgets of municipalities (Figure 2.12).

Figure 2.12. **Scale and Fiscal Losses to Municipal Budgets Resulting from Bogus Self-Employment**



Calculated based on data from the sample survey of residents of municipalities.

The obtained estimates of bogus self-employment are indicative in nature. Some respondents may not fully understand the legal nature of their labour relations or may provide incomplete information regarding the terms and level of remuneration, which limits the accuracy of the results. Within the scope of this study, no assessment is made of the feasibility of transitioning such individuals into the status of wage employees, as Ukraine currently lacks both systematic experience in

implementing such measures and sufficient empirical data to reliably evaluate their effectiveness. At the same time, these findings may be considered as a first step, highlighting the relevance of further research on this issue.

The ability to realise the identified potential and the timeframe for achieving it largely depend on the effectiveness of public policy in the area of employment formalisation. The following section examines the current system of control over compliance with labour legislation, Ukraine's experience in engaging local self-government bodies, and best European practices of such cooperation.

CHAPTER 3. HOW THE CENTRAL GOVERNMENT AND MUNICIPALITIES CAN INFLUENCE INFORMAL EMPLOYMENT

3.1. How the Current System of Labour Law Enforcement Operates

A key role in monitoring compliance with labour legislation in Ukraine is played by the State Labour Service of Ukraine (SLS) and its territorial bodies with regard to the use of hired labour, as well as by the tax authorities in the area of business activity and self-employment. The SLS's activities are directed and coordinated by the Cabinet of Ministers of Ukraine through the Minister of Economy, Environment and Agriculture.¹⁵

Central executive authorities monitor compliance with labour legislation at enterprises, institutions and organisations within their scope of management, while local self-government bodies oversee such compliance at municipally owned entities of municipalities. The SLS exercises state supervision over the implementation of these powers by central executive authorities.

The procedures for state control over compliance with labour legislation are defined by the Procedure approved by Resolution No. 823 of the Cabinet of Ministers of Ukraine dated 21 August 2019.¹⁶ In 2020, amendments were introduced to this Procedure, according to which all labour-related control measures — except those aimed at detecting undeclared labour relations — must be carried out in accordance with the requirements of the Law of Ukraine “On the Basic Principles of State Supervision (Control) in the Sphere of Economic Activity” No. 877-V of 5 April 2007.¹⁷ As a result, two types of inspections were effectively distinguished:

- **control measures concerning compliance with labour legislation** (including adherence to employee rights and guarantees, working conditions and occupational safety, working time arrangements, etc.), which are carried out in accordance with the requirements of Law No. 877-V;
- **control measures aimed at identifying undeclared labour relations**, which are conducted in the form of labour inspections (inspection visits) by labour inspectors in compliance with the requirements of Procedure No. 823.

Labour inspectors are officials of the SLS and its territorial bodies who have successfully passed a knowledge assessment and have been issued official identification certificates. Resolution No. 823 establishes the grounds for conducting inspection visits, including, inter alia, complaints from employees and individuals, court decisions, instructions from public authorities, information from other state bodies (the tax authorities and the Pension Fund), trade union organisations regarding identified violations, as well as failure to comply with orders issued by labour inspectors.

De jure, the powers of labour inspectors and inspection procedures generally comply with the provisions of International Labour Organization Conventions No. 81 and No. 129, which define internationally recognised standards for labour inspection. In particular, labour inspectors are entitled to:

¹⁵[On Approval of the Regulation on the State Labour Service of Ukraine: Resolution of the Cabinet of Ministers of Ukraine dated 11 February 2015 No. 96.](#)

¹⁶[Certain Issues of State Supervision and Control over Compliance with Labour Legislation: Resolution of the Cabinet of Ministers of Ukraine dated 21 August 2019 No. 823.](#)

¹⁷[On Amendments to Certain Acts of the Cabinet of Ministers of Ukraine: Resolution of the Cabinet of Ministers of Ukraine dated 8 July 2020 No. 617.](#)

- enter, without prior notice and at any time of day, any premises where hired labour is used during inspection visits;
- examine books, registers and documents required to be maintained under labour legislation that contain relevant information;
- interview, in private or in the presence of witnesses, the employer and/or employees of the inspected entity, as well as other persons possessing relevant information on compliance with labour legislation;
- obtain from public authorities and inspected entities the information and documents necessary for conducting inspection visits.

Where violations are identified, the labour inspector issues a compliance order and takes measures to hold the responsible persons liable. The mechanism for imposing financial penalties is defined by the Procedure for Imposing Fines for Violations of Labour and Employment Legislation, approved by Resolution No. 509 of the Cabinet of Ministers of Ukraine dated 17 July 2013 (as amended).¹⁸

At the same time, a number of concerns have been raised in the academic and policy literature. The Law of Ukraine “On the Basic Principles of State Supervision (Control) in the Sphere of Economic Activity” establishes strict procedural limitations on control measures, including restrictions on the ability to conduct inspections without prior notification. Although these provisions do not formally apply to measures aimed at identifying undeclared labour relations, they indirectly affect the overall effectiveness of the labour inspection system. In particular, current legislation lacks a clear definition of the term “undeclared labour relations”. Its commonly applied interpretation as admission to work without a formal employment contract narrows the scope of policies aimed at preventing informal employment and undeclared work, which also encompass the concealment of actual working hours, disguised employment (including bogus self-employment), and other forms of non-compliance. As a result, different manifestations of undeclared work fall under different control procedures, which complicates the development of a coherent and comprehensive policy in this area.

The ILO also draws attention to the fragmented organisation of labour inspection in Ukraine, which suggests the existence of three separate categories of inspectors (labour, occupational safety and occupational health), each responsible for a distinct area of activity.¹⁹ Given the shortage of inspection staff, such a model reduces the effectiveness of enforcement and requires several separate inspection visits to conduct a comprehensive assessment of a single entity. The literature substantiates the expediency of transitioning to a more integrated model of labour inspection; however, the legally established procedures governing different types of control measures effectively prevent the implementation of such an approach.

In practice, attempts to apply a comprehensive approach to detecting informal employment are further constrained by judicial practice. As its analysis shows, the imposition of financial penalties is often deemed unlawful by courts where violations were identified during inspections conducted for other purposes (in particular, occupational safety inspections), and the supervisory authority failed to demonstrate that the inspection visit was carried out specifically within the framework of the special procedure for detecting undeclared labour relations. Courts consistently take the position that the mere identification of signs of a violation is not sufficient grounds for imposing sanctions without compliance with due procedure and a clearly defined scope of inspection.

¹⁸[On Approval of the Procedure for Imposing Fines for Violations of Labour Legislation and Employment Regulations: Resolution of the Cabinet of Ministers of Ukraine dated 17 July 2013 No. 509.](#)

¹⁹[Labour Inspection Legal Framework in Ukraine: Analysis and Recommendations. International Labour Organization, 2018.](#)

The ILO emphasises that the effectiveness of the labour administration system depends not only on the scope of functions assigned to it, but also on the level of organisation and coordination among its components — between internal structural units, central and territorial bodies, as well as among specialised agencies. Labour inspection functions should be assigned to logically distinct specialised units, with each functional area organised in a way that strengthens accountability for the performance of tasks while ensuring the overall coherence of the governance system.²⁰

Territorial units of the SLS play a key role in the implementation of control powers, as they directly carry out inspection visits and interact with employers. Accordingly, the organisation of their activities and the level at which managerial decisions are taken are of fundamental importance for the effectiveness of detecting informal employment.

In 2022, a reorganisation of the regional structure of the SLS took place: territorial bodies at the regional level were abolished and replaced by seven interregional territorial bodies, whose jurisdiction extends across several regions.²¹ According to the Government's rationale, reducing the number of territorial administrations and introducing an interregional model is intended to optimise administrative staffing and release resources to improve operational efficiency. It also provides for the possibility of flexible reallocation of inspection staff depending on needs. For example, in the event of a shortage of inspectors in one region, specialists from other regions may be promptly deployed within the jurisdiction of the relevant interregional office.²²

Under the new organisational structure, inspection activity units at the regional level function as structural subdivisions of the respective interregional offices and report to their management. Their authority extends to the territory of the respective region; however, by decision of the management of the interregional office, these units may be assigned tasks in other areas within its jurisdiction, thereby creating a mechanism for the mobility of inspection personnel.

At present, it is difficult to assess the effectiveness of this reorganisation. By Resolution No. 303 of the Cabinet of Ministers of Ukraine dated 12 March 2022, the conduct of scheduled and unscheduled state supervision (control) measures in respect of legal entities and individuals — including measures aimed at detecting undeclared labour relations — was suspended for the duration of martial law.

From the perspective of this study, the key issue is the extent to which the current organisational model of the SLS is capable of effectively addressing informal employment at the local level and contributing to strengthening the financial capacity of municipalities. This issue should be considered in a broader context of the decentralisation reform and the modernisation of approaches to state supervision, which highlights the need to align competences and coordination mechanisms between state authorities and local self-government bodies, particularly in the field of labour law enforcement.

First, in 2025 legislative amendments were adopted aimed at establishing a system of state supervision over the legality of acts of local self-government bodies.²³ According to expert assessments, these changes do not provide a comprehensive answer regarding the future model of state oversight or the distribution of powers between different levels of government. At the same time, both their adoption and the public debate surrounding them confirm the relevance of developing a clear and coherent framework for interaction between state authorities and local self-

²⁰Ibid.

²¹[Certain Issues of Territorial Bodies of the State Labour Service: Resolution of the Cabinet of Ministers of Ukraine dated 12 January 2022 No. 14.](#)

²²<https://me.gov.ua/News/Detail?fbclid=IwAR0EjrkPxxrIhuPWDsOh5d8QgfkigOUH0qcXnP9soQO78mENbPg2ukH0yac&id=ce8df1b2-33b6-4e9d-86f0-eb248aa764ba&lang=uk-UA&title=UriadUdoskonalivRegionalnuStrukturuDerzhpratsi>

²³[On Amendments to Certain Legislative Acts of Ukraine on Ensuring Legality and Transparency in the Activities of Local Self-Government Bodies: Law of Ukraine dated 5 November 2025 No. 4677-IX.](#)

government bodies. In the field of labour, this is directly related to aligning competences and procedures of cooperation between the SLS and local self-government bodies, particularly with regard to monitoring compliance with labour legislation at municipally owned enterprises.

Second, the key source of own revenues for local budgets is PIT. The formalisation of employment directly translates into increased PIT revenues for municipalities and strengthens their incentives to engage more actively in combating informal employment. In turn, this enhances the practical importance of cooperation with the SLS. At present, however, there are concerns regarding the effectiveness of existing instruments of such cooperation. In particular, the introduction of interregional territorial bodies of the SLS — while offering potential advantages in terms of resource concentration and mobility — may also create risks of “detachment” of decision-making centres from municipalities. In this context, the development of stable channels of interaction becomes particularly important, including information-sharing protocols, mechanisms for routing signals, as well as joint preventive and awareness-raising activities.

The list of grounds for conducting inspection visits, as defined by the Procedure for State Control over Compliance with Labour Legislation, is indicative in this regard. Notably, it does not include submissions from local self-government bodies containing information on violations related to the formalisation of employment relationships. The system of state control is primarily oriented towards individual complaints and vertical information flows, particularly from supervisory and fiscal authorities. By contrast, the role of local self-government bodies as a source of systematic information on local labour market conditions and employment practices remains limited. Such a configuration complicates the detection of violations that are structural rather than episodic in nature and do not necessarily manifest themselves through individual complaints.

In this context, analysing practical models of interaction between labour inspectorates and local self-government bodies — both in Ukraine and in other countries — becomes particularly relevant. Generalising such experience makes it possible to identify effective models for involving municipalities in combating informal employment and undeclared work, as well as to outline directions for their adaptation in Ukraine.

3.2. Ukrainian Experience of Involving Municipalities in Tackling Informal Employment

Within the framework of the decentralisation reform, in 2016–2021 Ukraine undertook an attempt to partially decentralise state control over compliance with labour legislation by delegating certain powers of SLS to local self-government bodies. By Law of Ukraine No. 1774-VIII of 6 December 2016, amendments were introduced to Article 34 of the Law of Ukraine “On Local Self-Government in Ukraine”, under which executive bodies of city councils of cities of regional significance and councils of amalgamated municipalities were granted powers to monitor compliance with labour and employment legislation within their respective territories. These powers included, in particular, oversight of the timely and full payment of wages, compliance with minimum state guarantees in remuneration, and the formalisation of employment relationships. In addition, local self-government bodies were granted the right to impose fines for violations of labour legislation in accordance with the Labour Code of Ukraine and subordinate regulatory acts.

The legislation did not provide for a unified model for implementing these powers at the local level, leaving local self-government bodies with discretion in choosing organisational arrangements. To exercise the delegated powers, municipalities could establish dedicated structural units within executive bodies, introduce labour inspector positions within existing units or assign the relevant

functions to current officials. Decisions on establishing structural units or introducing dedicated positions were adopted by councils taking into account the financial capacity and administrative capability of the municipality. An example of regulations governing a body responsible for monitoring compliance with labour and employment legislation is provided in Annex 1.

The possibility of granting labour inspector powers to starostas of municipalities is also envisaged. As an official operating directly at the level of the starosta district, the starosta maintains constant contact with municipality residents, entrepreneurs, and employers and is typically well informed about actual employment conditions and labour practices within the relevant territory.

Labour inspectors of local self-government bodies held the status of local government officials and were subject to legislation governing service in local self-government. For the purpose of exercising control powers, they were issued official certificates by the SLS upon submission by the head of the respective municipality and were registered in a centralised register. In terms of the scope of authority, such inspectors were practically equivalent to inspectors of the SLS: they were entitled to conduct inspection visits and desk-based inspections, draw up reports, issue compliance orders and initiate the application of financial sanctions. Examples of selected provisions from a model job description for a labour inspector of a relevant executive body are provided in Annex 2.

Thus, at the local level, two parallel labour inspection systems effectively operated, which, according to the legislator's intent, were to be integrated into a unified system of state control over compliance with labour legislation through supervisory mechanisms exercised by the SLS. Local self-government bodies performed inspection functions under its oversight, while the SLS provided methodological guidance, information support and training for inspectors. At the same time, the SLS retained the authority to revoke the appointment of local labour inspectors in cases of systematic improper performance of their duties.

An important element of this model was the empowerment of local self-government bodies to impose fines for violations of labour legislation. The list of such violations included, in particular, the actual admission of employees to work without a formal employment contract, violations of wage payment deadlines, payment of wages not in full, failure to comply with minimum state guarantees in remuneration, as well as obstruction of inspection activities. Amendments to the Budget Code of Ukraine adopted in 2018 provided that **administrative fines** and other financial sanctions imposed by executive bodies of local councils would be credited to the **respective local budgets**. This created a direct financial incentive for municipalities to engage more actively in combating informal employment and formalising labour relations.

The introduction of this model generated mixed reactions among different groups of stakeholders. Representatives of local self-government bodies generally viewed positively the opportunity to directly influence the processes of employment formalisation within their territories. During in-depth interviews with heads of municipalities conducted as part of a number of research projects, it was noted that proximity to local labour markets, knowledge of employers and awareness of prevalent informal practices enabled more flexible and targeted action. This often took the form of informal negotiations with employers aimed at the gradual formalisation of employment, including through the official registration of employees at the minimum wage level.

Local labour inspectors and authorised officials of local self-government bodies, including starostas (village and settlement heads), are typically well informed about the socio-economic situation in their respective territories, the nature of business activities, and prevailing forms of employment. In small municipalities, such awareness is often informal in nature and is based on personal contacts, day-to-day communication with residents and employers, as well as an understanding of local

social norms. In this context, they could serve as an important source of information on hidden forms of employment that remain beyond the reach of formal state control mechanisms.

At the same time, this model generated institutional risks. Where the formalisation of employment was achieved through individual arrangements with employers, there were risks of selective enforcement of legislation, unequal treatment of economic operators and the development of practices vulnerable to corruption. Research highlights that reliance on informal arrangements between representatives of local self-government bodies and employers runs counter to the principles of legal certainty and equal application of the law, and may create conditions conducive to corruption risks. Although in certain cases such approaches contributed to reducing the level of informal employment, in systemic terms they could undermine trust in state control institutions and create unequal conditions for economic actors.

Among the negative aspects of decentralising state control, the **issue of territorial fragmentation is particularly notable**. The establishment of labour inspection functions by local self-government bodies was a right rather than an obligation of municipalities, which resulted in uneven coverage of Ukraine's territory by such structures. In some municipalities, the relevant positions were not created or operated only formally, without adequate staffing or material and technical resources. This complicated the consistent application of labour legislation and the implementation of national labour policy.

A further challenge was the **limited human resource capacity of many municipalities**, particularly smaller and grant-dependent ones. The SLS recommended a staffing benchmark of one labour inspector per 20,000 inhabitants.²⁴ However, decisions on staffing levels were taken by local self-government bodies based on their own budgetary capacities, which were often constrained. As a result, the recommended ratio was frequently not met, adversely affecting the quality and regularity of inspection activities.

The absence of uniform standards for the recruitment, training and professional development of labour inspectors employed by local self-government bodies led to significant disparities in professional competence and working conditions. Selection criteria were determined at the local level, without centralised requirements from the SLS. In conditions of staff shortages, labour inspector certificates were sometimes issued without mandatory initial training or prior assessment of knowledge in labour legislation and inspection practices.²⁵

In this context, attention should also be drawn to the position of the ILO, which critically assessed Ukraine's experience with the decentralisation of labour inspection. The ILO noted that this model did not fully comply with the requirements of Conventions No. 81 and No. 129, particularly with regard to ensuring the independence of labour inspectors and the stability of their employment. Labour inspectors employed by local self-government bodies did not have the status of civil servants, which increased their vulnerability to local political and economic influences. In this regard, Ukrainian authorities were recommended to "terminate the current decentralisation process and initiate an alternative approach, developed within the supervisory powers of the central

²⁴[Implementation of Labour Law Compliance Monitoring by Local Self-Government Bodies: Methodological Guidelines \(second edition\). Association of Ukrainian Cities, 2019.](#)

²⁵By comparison, in a number of EU countries (for example, France, Portugal and Spain), access to the position of labour inspector depends on successfully completing a comprehensive, demanding and relatively lengthy initial training programme (typically lasting around one year). During this period, candidates undergo both theoretical training (including role-playing exercises) and practical training covering all key aspects of labour regulation and the relevant national and international legal frameworks (such as labour relations, labour inspection and occupational safety and health). At each stage of the training programme, candidates' knowledge is assessed through multiple evaluation methods. Failure to meet the required standards results in disqualification from appointment as a labour inspector.

apparatus of the SLS, based on the organic and sustainable development of its territorial bodies, taking into account the needs of local labour markets and the broader socio-economic context".²⁶

Finally, a significant factor in scaling back the reform was the negative reaction of some employers and business associations, which viewed the expansion of local self-government powers in the field of labour law enforcement as a source of excessive administrative pressure. In 2021, Law of Ukraine No. 1320-IX was adopted, stripping local self-government bodies of control powers and the authority to impose fines in the field of labour, thereby effectively bringing the decentralisation phase of labour inspection in Ukraine to an end.

In summary, the domestic experience suggests that a return to a model of full or partial decentralisation of state control over compliance with labour legislation in its previous form appears inadvisable. At the same time, this experience has demonstrated significant potential for more active involvement of local self-government bodies in the formalisation of employment and the prevention of undeclared work. This points to the need to develop effective mechanisms of cooperation and coordination between the SLS and local self-government bodies.

3.3. Best European Practices of Cooperation Between the State Authorities and Local Self-Government Bodies

Comparative analysis shows that in European countries, the practice of fully transferring inspection powers in the field of combating informal employment to local self-government bodies is virtually absent. Instead, various models of cooperation with inspection authorities have become widespread, under which local self-government bodies may act as:

- a source of information and signals regarding potential violations;
- an initiator of inspection activities;
- a partner in joint inspections or inter-agency operations;
- a participant in, or implementer of, preventive measures.

In this context, the experience of **Poland** is particularly relevant for Ukraine. First, Ukraine has partly drawn on the Polish model in the process of implementing decentralisation reform. Second, Poland has undergone a similar institutional evolution — from delegating certain functions related to monitoring the legality of employment to local self-government bodies to establishing a centralised state labour inspectorate with an extensive network of territorial offices.

Over recent decades, the system for monitoring the legality of employment in Poland has undergone significant institutional changes.²⁷ In the 1990s, these functions were performed by voivodeship labour offices (wojewódzkie urzędy pracy, WUP) and, under their authority, district labour offices. Voivodeship offices operated as regional branches of the National Labour Office (Krajowy Urząd Pracy), a central government body subordinated to the Minister of Labour. As part of the 1999 administrative reform, voivodeship and district labour offices were transformed into organisational units of voivodeship and powiat (county) self-government (a similar approach was applied in Ukraine in 2016–2021). Accordingly, their heads were appointed by the marshal of the voivodeship and the starosta. In 2002–2007, control functions were re-centralised at the state level and exercised by voivodes (government representatives in the regions) through specialised units within voivodeship administrations (Urząd Wojewódzki).

²⁶ [Labour Inspection Legal Framework in Ukraine: Analysis and Recommendations. International Labour Organization, 2018.](#)

²⁷ [Factsheet on Undeclared Work – Poland.](#)

Since 1 July 2007, control over the legality of employment and other paid work in Poland has been carried out by the National Labour Inspectorate (Państwowa Inspekcja Pracy, PIP). Its structure includes the Chief Labour Inspectorate and a network of Regional Labour Inspectorates (Okręgowe Inspektoraty Pracy), which generally operate at the level of voivodeships and may have local branches. Parliamentary oversight of the Inspectorate's activities is exercised by the Labour Protection Council (Rada Ochrony Pracy).²⁸

The National Labour Inspectorate cooperates with a range of institutions involved in combating undeclared work, including the police, the Border Guard, tax authorities, social insurance institutions, and local self-government bodies. The principles of such cooperation are defined by legislation and further specified through **bilateral agreements** between the respective institutions.

Particular attention should be given to cooperation with powiat labour offices (powiatowe urzędy pracy), which are organisational units of powiat self-government and perform the functions of the public employment service. These offices hold administrative data relevant for identifying risks of illegal employment. Within the framework of cooperation with the labour inspectorate, they facilitate information exchange, verify data within their competences, and participate in joint information and preventive activities.

At the same time, there is a reverse direction of interaction. Inspection activities carried out by the National Labour Inspectorate in Poland are based on an annual work programme and an approved action plan. In addition, intervention inspections are conducted in response to complaints and reports, as well as inspections initiated at the request of other institutions. One such institution is the powiat labour office, which, within the framework of inter-agency cooperation, may initiate inspection activities by submitting relevant requests. In response, the inspectorate conducts inspections within its competence and informs the powiat level (the starosta) of the results. In certain years, inspections initiated by powiat labour offices accounted for around one-fifth of the total number of inspections carried out at the request of partner institutions.²⁹

For Ukraine, such practices may be useful in complementing the current model — which is primarily oriented towards individual complaints and vertical information flows — with instruments for systematic “bottom-up” signalling from municipalities. In practical terms, the introduction of such mechanisms of interaction between the SLS and local self-government bodies could ensure regular data exchange, standardise formats for submissions and feedback on results, and enhance the capacity to detect not only episodic but also structural violations in local labour markets.

It should also be noted that the practice of concluding inter-agency agreements is widespread across EU countries. In particular, in the **Netherlands**, cooperation between the labour inspectorate (Nederlandse Arbeidsinspectie) and municipalities is often formalised through agreements (convenant), which define the framework for interaction between the parties, including data sharing, joint inspections, and coordination of preventive measures in high-risk sectors (such as construction, renovation, and redevelopment projects). A notable example is an agreement between the labour inspectorate and the municipality of Lelystad, concluded with the aim of strengthening oversight of “fair work” and combating illegal employment practices that distort competition in the construction sector.³⁰ Such cooperation places emphasis on preventive

²⁸ The Labour Protection Council under the Sejm of the Republic of Poland serves as a supervisory body on issues related to compliance with labour legislation, including occupational safety and health, the legality of employment, and the activities of the National Labour Inspectorate. The Council's term of office is four years, and its members are appointed and dismissed by the Speaker of the Sejm. Its composition includes members of parliament, representatives of the government, employers' and workers' organisations, as well as experts and academics specialising in occupational safety and health (<http://rop.sejm.gov.pl>).

²⁹ [Factsheet on Undeclared Work – Poland](#).

³⁰ [Uitvoerings- en Handhavingstrategie Lelystad 2024-2028](#).

measures and the implementation of joint inspections on large construction projects or at sites with a high risk of illegal employment or labour exploitation.

In European practices of organising control over compliance with labour legislation, particular importance is attached to the establishment of **effective channels for information exchange** — both at the inter-agency level and vertically between central, regional and local authorities. A notable example of such a model is the system of coordination and information exchange in **Belgium**.

The key labour inspection units in Belgium operate within the Federal Public Service Employment, Labour and Social Dialogue. In particular, the Directorate for the Supervision of Social Legislation is responsible for ensuring compliance with labour and social security legislation, including issues related to working time, remuneration, leave, and rest periods. Its competences also cover employment matters, the application of collective agreements, and the regulation of labour relations. The main functions of the inspectorate include monitoring compliance with legislation, providing information to employers and employees, offering advisory services, and conducting conciliation procedures.

The Directorate for the Supervision of Social Legislation has a well-developed territorial structure, with external units operating in the Flemish and Walloon Regions, the German-speaking municipality, and the Brussels-Capital Region. In total, 36 units operate within 22 regional entities, carrying out inspection activities within defined territorial jurisdictions. Key regional competences include issues related to labour migration, employment support, and the accreditation of temporary employment agencies.³¹

To coordinate the activities of multiple inspection services involved in combating social fraud and illegal work, the Social Information and Investigation Service (Sociale Inlichtingen- en Opsporingsdienst — SIOD)³² has been established in Belgium. It performs strategic coordination of policy, facilitates information exchange between inspection bodies, and administers centralised reporting tools. One such tool is the information platform “Contact Point for Fair Competition” (Meldpunt voor Eerlijke Concurrentie), which serves as an official channel for reporting suspected cases of social fraud, including undeclared work and unfair competition (social dumping). Submitted reports are processed and forwarded to the competent inspection services.³³

A specific status is granted to authorised professional users, including selected public authorities, employers’ and workers’ organisations, social services, and municipalities. These actors are provided with a secure channel for accessing the reporting system and are subject to defined response procedures. As a result, **municipalities** are equipped with an effective mechanism for signalling potential violations that may trigger inspection activities. At the same time, risk assessment and decisions regarding the necessity of inspections remain within the competence of specialised inspection authorities. Relevant information for risk assessment may also be obtained through the OASIS system, which centralises administrative data from various federal services to detect indicators of social fraud.³⁴

Overall, the Ukrainian experience of delegating inspection powers to local self-government bodies demonstrates that such a model can ensure responsiveness and leverage local incentives. However, it also creates risks of uneven law enforcement, limited administrative capacity in some

³¹ [Labour inspection profile – Belgium](#).

³² <https://www.siod.belgie.be/nl>

³³ <https://www.meldpuntsocialefraude.belgie.be/en/general-information.html>

³⁴ [Optimisation of the OASIS data warehouse \(OASIS\)](#).

municipalities, and heightened vulnerability to local political and economic influences. By contrast, European practice places emphasis on institutionalised cooperation between labour inspectorates and local authorities. Within this framework, municipalities are integrated into the system through structured mechanisms of information exchange, reporting, participation in joint operations, and implementation of preventive measures. The effectiveness of these approaches is ensured by centralised coordination, joint strategic planning, and the application of risk-based approaches to the selection of inspection targets. Accordingly, **further development of the Ukrainian model should be based on combining centralised inspection authority with institutionalised participation of the local level within clearly defined procedures for cooperation.**

CONCLUSIONS AND RECOMMENDATIONS

Strengthening the financial resilience of municipalities requires a systemic approach that combines reform of the PIT allocation mechanism, compensatory measures for municipalities that may incur financial losses, as well as policies aimed at formalising employment and combating undeclared work. The findings of this study indicate that the greatest potential for increasing budget revenues through employment formalisation lies in large urban municipalities, which may simultaneously experience the largest losses following a transition to allocating PIT based on taxpayers' place of residence.

Informal employment has a complex and heterogeneous impact on the socio-economic development of municipalities. In large urban municipalities, it is more often associated with the use of undeclared work within formally registered enterprises and creates risks of unfair competition and loss of budget revenues. In contrast, in small and rural municipalities it frequently forms part of household survival strategies and serves as an important source of income for the population. Accordingly, policies aimed at formalising employment should be differentiated and combine enforcement measures with instruments to support entrepreneurship and expand opportunities for formal employment, in order to avoid negative effects on local economic activity and the incomes of vulnerable population groups.

Local self-government bodies should play an important role in implementing policies to prevent informal employment, given their proximity to local economies and better understanding of local labour market dynamics. The effectiveness of such involvement requires the development of cooperation mechanisms with the State Labour Service, tax authorities, and other public institutions, as well as the establishment of systemic instruments for coordination at both national and local levels. Taking this into account, the following **recommendations** are proposed:

Introduce formalised procedures for information exchange between the State Labour Service and local self-government bodies. In the medium term, it is advisable to establish a regular information and analytical system for monitoring the financial and socio-economic development of municipalities, based on the integration of administrative registers and other data sources. Within the project “Development of Information Support for the PIT Reform” implemented in 2023 under the U-LEAD with Europe Programme, key objectives and approaches for building such a system were substantiated. Following the example of the OASIS system in Belgium, it could be used to identify risks related to the spread of informal employment and to support preventive measures at the local level.

Establish a clear legal framework for cooperation between the State Labour Service and local self-government bodies. In particular, it is advisable to define procedures for submitting information by local authorities regarding suspected violations of labour legislation, including timelines for its consideration and response procedures by the labour inspectorate. It is also important to introduce an obligation for the State Labour Service to inform local self-government bodies about the outcomes of such submissions. This would contribute to the development of systematic cooperation and improve the effective use of information received from municipalities.

Enhance mechanisms for joint planning of preventive measures. The Action Plan for the implementation of the Employment Strategy of Ukraine up to 2030 provides for the introduction of pilot programmes aimed at formalising informal self-employment in selected sectors of the economy. In this context, local self-government bodies could contribute to identifying priority sectors and territories with a high risk of informal employment, as well as participate in information

campaigns promoting labour formalisation. Such an approach would ensure alignment between national policy priorities and the specific characteristics of local labour markets.

Consider introducing financial incentives for local self-government bodies to participate in combating informal employment. One possible mechanism could involve allocating a share of fines imposed for violations of labour legislation to local budgets. Previous experience with this approach in 2019–2021 indicates that it increased the incentives of local authorities to detect and address informal employment.

Establish permanent coordination mechanisms between the State Labour Service and local self-government bodies at the interregional level. These may take the form of joint working groups or coordination platforms involving territorial offices of the State Labour Service, tax authorities, local self-government bodies, employment services and other relevant stakeholders.

A separate set of recommendations relates to **integrating mechanisms for preventing informal employment into Ukraine’s post-war reconstruction plans.** Given the substantial demand for labour during the reconstruction phase and the large-scale use of public and donor funding, it is essential to introduce specific requirements for contractors implementing reconstruction projects. International practice demonstrates that effective prevention of informal employment relies on a combination of qualification requirements for tender participants, requirements regarding sufficient staffing capacity, regular reporting on the workforce engaged, and monitoring mechanisms during project implementation. To this end, the following measures are proposed:

Include in tender documentation and contracts a mandatory requirement to employ only formally registered workers for tasks that inherently involve employment relationships. This requirement should apply to both contractors and subcontractors and be supported by monitoring mechanisms and enforcement measures. Similar approaches are applied in the European Union in line with Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement, which allows for the inclusion of social and labour requirements in procurement procedures and contract performance conditions (Articles 18(2) and 70). The implementation of this Directive forms part of the EU acquis in the field of public procurement and is assessed within the European Union enlargement process.

Strengthen requirements for verifying the staffing capacity of tender participants. In particular, bidders should be required to provide information on their average annual number of employees, a list of key personnel, a workforce mobilisation plan aligned with the scope and timeline of the project, and details on the use of subcontractors. This approach is consistent with EU practices for assessing the technical and professional capacity of tenderers (Directive 2014/24/EU, Article 58).

To ensure an effective assessment of staffing capacity, it is necessary to develop appropriate methodological approaches. These should include indicative labour productivity benchmarks, typical ratios between the volume of work and the number of employees, reference wage levels, and other indicators that enable the realism of the proposed work plan to be assessed. Such benchmarks should be used by contracting authorities to identify abnormally low tenders, particularly in cases where the declared number of workers does not correspond to the scale of work or the proposed implementation timeline.

Introduce regular reporting by contractors on workforce utilisation during contract performance. Such reporting may include information on the number of workers engaged, their employment status, hours worked, and remuneration paid. Similar mechanisms are widely applied

in projects financed by World Bank and European Bank for Reconstruction and Development, requiring the maintenance of employment records and periodic reporting by contractors.

Ensure systematic monitoring of contractors' compliance with labour legislation and working conditions throughout the entire contract period. An example of such an approach is the DURC system in Italy, which provides for regular verification of contractors' compliance with employment and social contribution requirements in the fulfilment of public contracts. In Ukraine, such monitoring should involve, alongside the State Labour Service and tax authorities, local self-government bodies in the locations where reconstruction projects are implemented.

ANNEXES

Annex 1. Example of the Powers of a Labour Legislation Compliance Authority (Labour Department) as defined in a Model Regulation

- 1.1. The Labour Department shall be an executive body of the village/settlement/city council.
- 1.2. The Department shall be accountable to and under the supervision of the village/settlement/city council and shall be subordinated to the village/settlement/city mayor.

- 2.1. The purpose and main task of the Department shall be to implement state and local policies on compliance with labour legislation and employment regulation within the territory of the village/settlement/city within the powers established by applicable law, including:
 - 2.1.1. Exercising state control over compliance with legislation concerning the timely and full payment of wages.
 - 2.1.2. Exercising state control over compliance with minimum wage guarantees.
 - 2.1.3. Exercising state control over the formalisation of employment relationships.
 - 2.1.4. Organising activities to ensure compliance with labour legislation, occupational safety regulations and the functioning of social dialogue mechanisms.

- 3.1. In accordance with its purpose and assigned tasks, the Department shall:
 - 3.1.1. Exercise control over compliance with labour legislation by legal entities, including their structural and separate subdivisions that do not have legal entity status, as well as by natural persons employing hired labour, through labour inspectors conducting inspection visits and desk-based inspections.
 - 3.1.2. Conduct information and awareness-raising activities among employers and employees regarding the necessity of compliance with labour legislation.
 - 3.1.3. Carry out, without hindrance and in accordance with applicable legal acts, inspections of administrative premises of legal entities (including their structural and separate subdivisions) and natural persons employing hired labour, without prior notice and at any working hour of the day; record any identified violations of labour and employment legislation.
 - 3.1.4. Impose fines for violations of labour legislation in accordance with procedures established by law.

- 4.1. The Department shall be headed by a Chief, who is appointed to and dismissed from the position by the village/settlement/city mayor.

Source: Exercise of Control over Compliance with Labour Legislation by Local Self-Government Bodies. Methodological Recommendations (2nd edition). Kyiv: Association of Ukrainian Cities, 2019.
<https://auc.org.ua/sites/default/files/library/metodychka2.pdf>

Annex 2. Example of the Powers and Status of a Labour Inspector of a Local Self-Government Body as Defined in a Model Job Description

1.1. The Chief Specialist (or other official) — Labour Inspector of the Labour Department (or another executive body) (hereinafter referred to as the “Labour Inspector”) — shall be appointed to and dismissed from the position by the village/settlement/city mayor. Appointment to the position of Labour Inspector shall be carried out on the basis of a competitive selection procedure through career advancement of a local self-government official following an internship or from the personnel reserve of local self-government bodies.

1.2. The Labour Inspector shall report directly to the Head of the Department (or other executive body).

For the purpose of ensuring the implementation of state policy in the field of social and labour relations, remuneration and decent working conditions, the Labour Inspector shall:

2.1. Ensure, within the scope of his/her powers, the protection of the rights and legitimate interests of natural and legal persons.

2.2. Exercise state control over compliance with labour legislation by legal entities, including their structural and separate subdivisions that do not have legal entity status, as well as by natural persons employing hired labour.

2.3. Exercise state control over compliance with employment legislation, including: safeguarding citizens' rights during recruitment and employees' rights upon dismissal; monitoring the employment of foreign nationals and stateless persons; overseeing the hiring of employees for the purpose of performing work for another employer in Ukraine; ensuring compliance with rights and guarantees for categories of citizens entitled to additional employment support; regulating activities related to employment intermediation and placement services.

The Labour Inspector shall have the right to:

3.1. Conduct inspection visits without hindrance and without prior notification.

3.2. When conducting inspection visits aimed at detecting undeclared employment, and where there are grounds provided by applicable law, independently and at any time of day — subject to occupational safety requirements — enter any production, service or administrative premises of the entity being inspected where hired labour is used.

Source: Exercise of Control over Compliance with Labour Legislation by Local Self-Government Bodies. Methodological Recommendations (2nd edition). Kyiv: Association of Ukrainian Cities, 2019.

<https://auc.org.ua/sites/default/files/library/metodychka2.pdf>