

The Hidden Economy in Bulgaria 2002 - 2011 Policy Implications

Policy Briefing

Sofia, 18/01/2012

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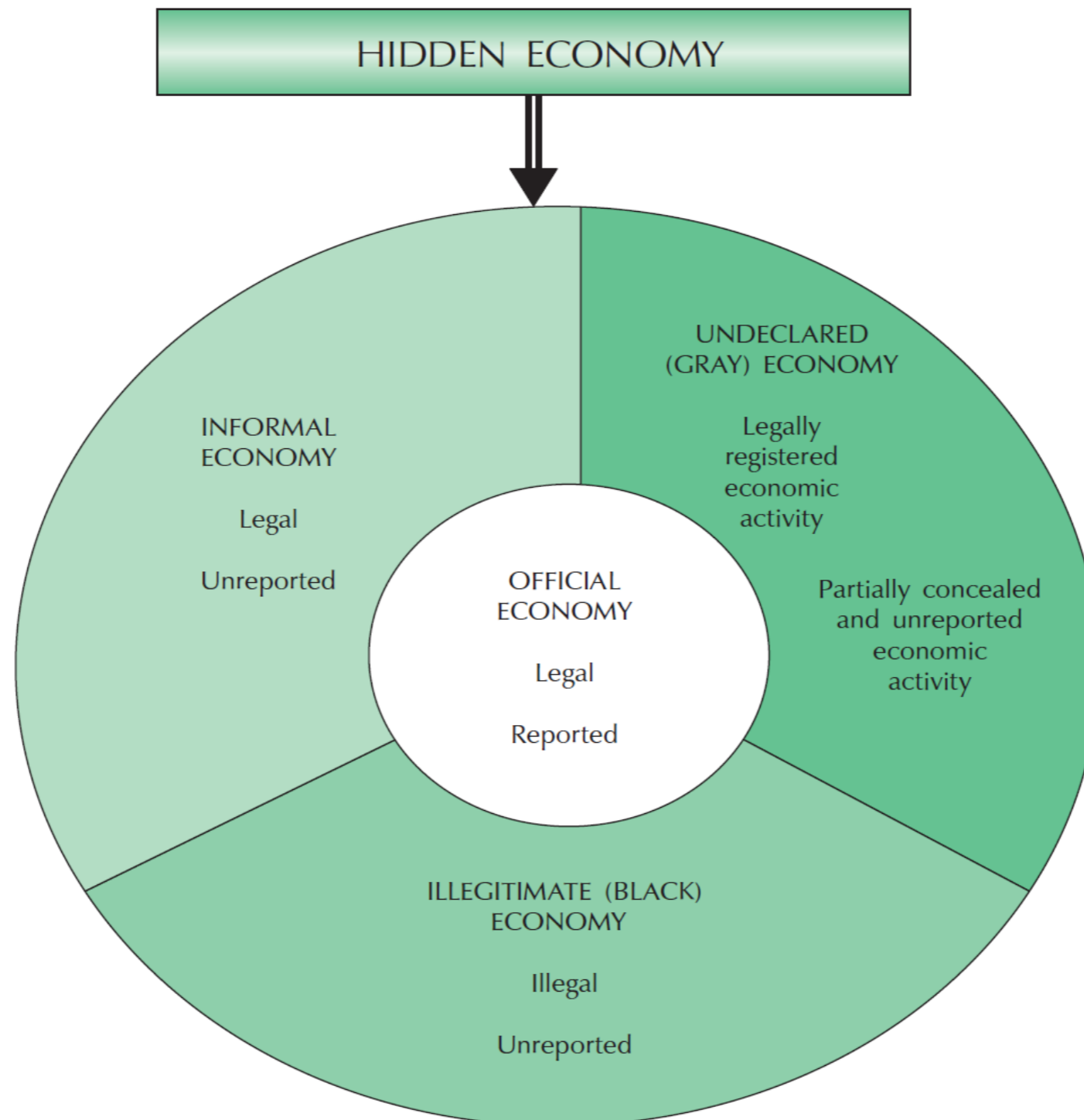
Contents

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- The Hidden Economy Index: 2002 - 2010
 - Business
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Why is it important?

- The Greek (or Euro) crisis
- Aggregate indicator of the quality of policies and institutions
- A sexy topic
- Is hidden economy better than none at all?

Definition



Methods for Measurement

- Direct
- Indirect / models

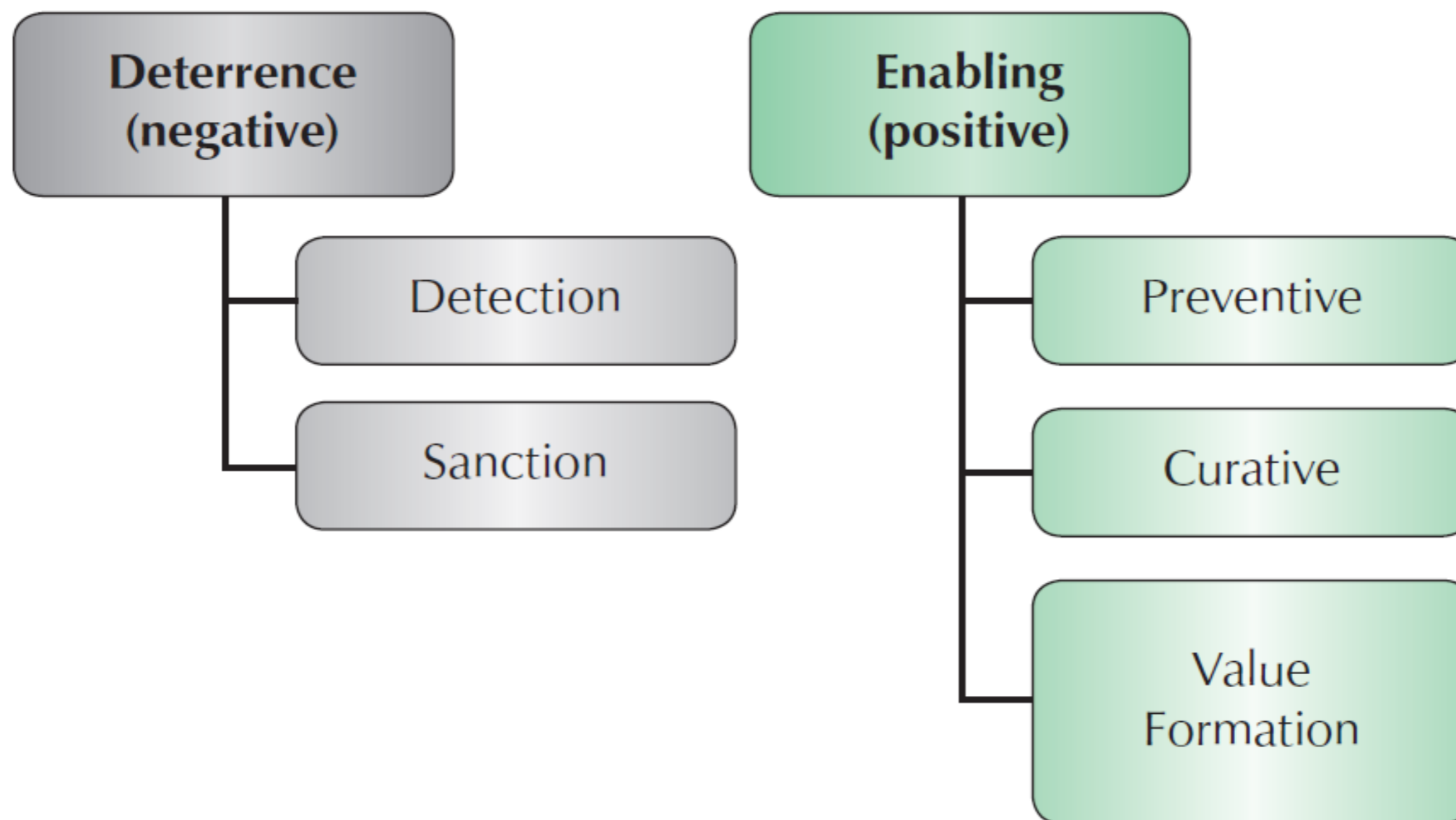
Causes of Hidden Economy

- Tax and Social Security Burden
 - Not only size matters
 - Compliance costs (private and public)
- Regulation
 - Goods quality requirements
 - Price regulations and entry barriers
- Institutional Context

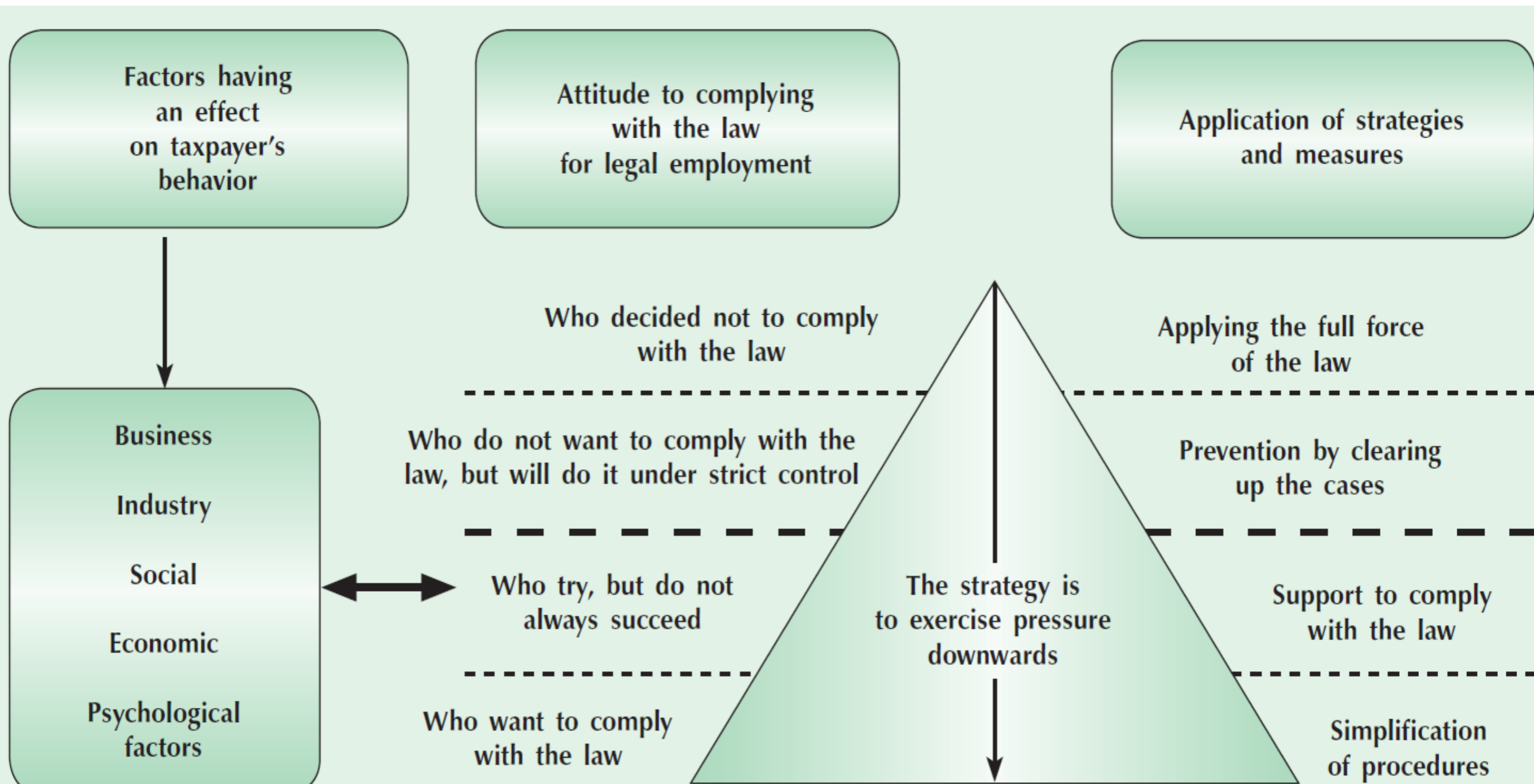
Effects

- **The Economy and Government Policies**
 - Positive – incomes are being spent into the official economy
 - Yet the gray sector has a negative effect on the tax system
 - Might have short term stabilizing function, but in the long-term, can have lasting negative consequences for the institutional legitimacy
 - Government policies are becoming more ineffective – underfunding of public goods
- **Institutional Efficiency – level of fair competition**
 - Inflow of dirty money into politics
 - Aids corruption and the criminalization of the economy
 - Hinders efficient resource allocation
- **Business Efficiency**
 - Lack of enforcement of contractual obligations
 - Increased regulatory burden on legitimate businesses

Types of Measures to Limit Hidden Economy



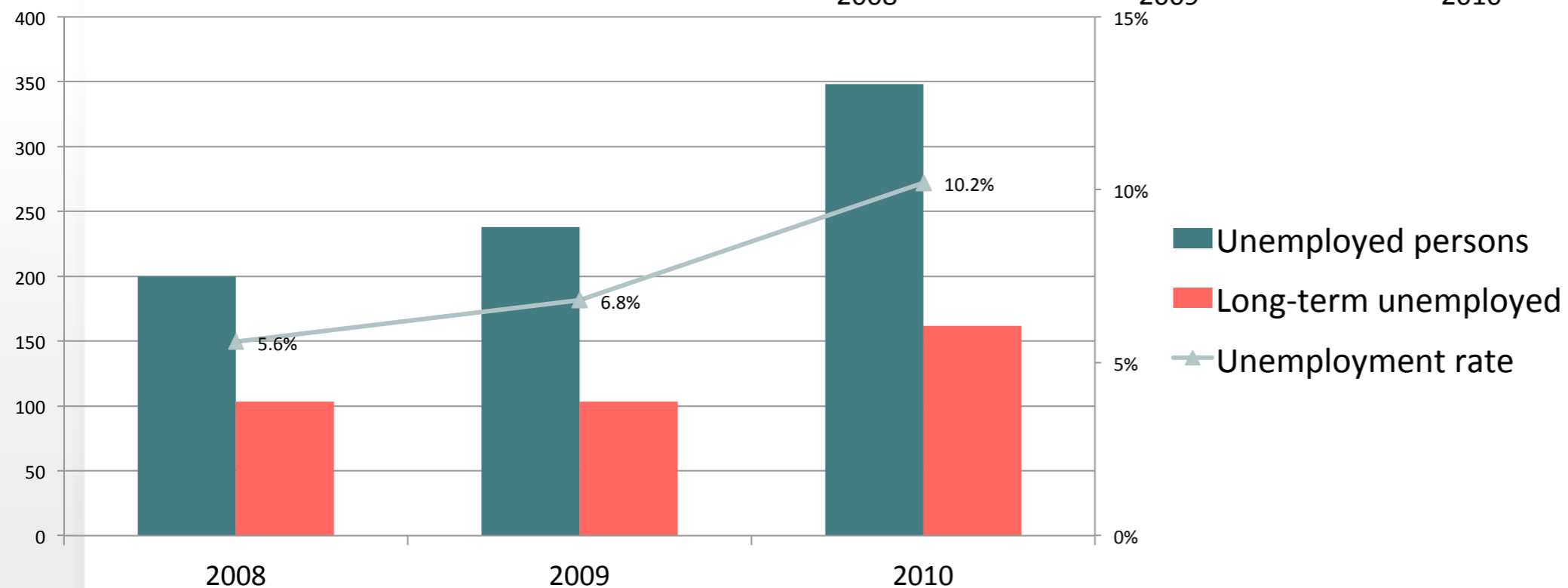
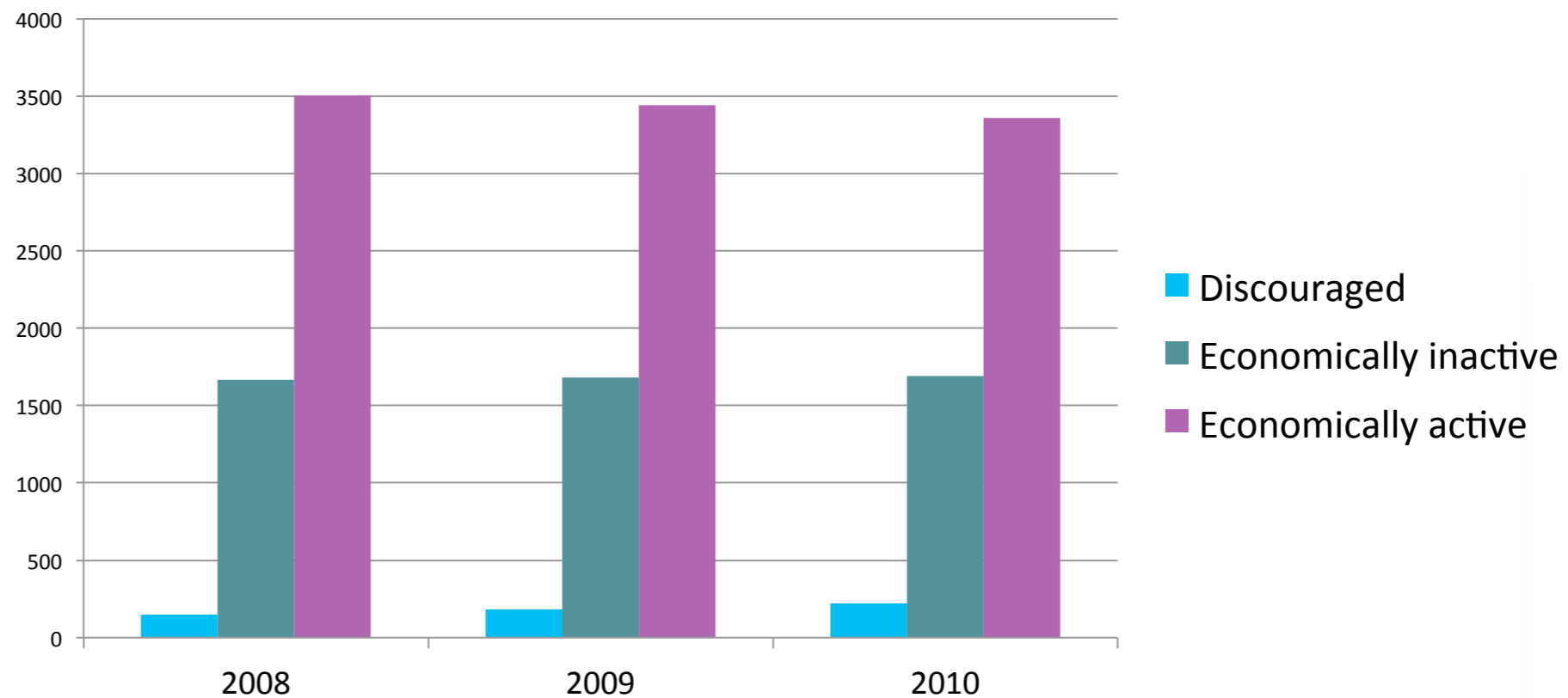
The Australian Tax Office Model “factors -strategies” to counteract the hidden employment



Dynamics of the Hidden Economy in Bulgaria

- Macroeconomic Imbalances
- The Hidden Economy Index
- Exhaustiveness of the National Accounts
- Estimate of the Ministry of Finance
- Assessments of employers' associations and trade unions

Untapped labor potential!?



Source: Center for the Study of Democracy, based on NSI data.

Policy Implications Influenced by the Size of the Hidden Economy

- According to the Ministry of Finance (2011), the share of the hidden economy, since 2000, is about 20% of GDP. NSI has revised GDP with 3% - 4%, in relation to the estimation of the hidden economy in the past decade; external estimates of the hidden economy vary between 18% - 32%
- Even with a smaller share of hidden economy (about 10% - 15% of GDP), many macroeconomic ratios, driving national policies, will undergo significant changes:
 1. Ceilings of 40% of GDP for public spending (according to the new, stricter, fiscal rules) - if the product, produced by the informal economy, is taken into account, the percentage was 33.2% of GDP in 2008 and 34.5 % in 2010.
 2. The competitiveness pact / "Euro Plus".

The Hidden Economy Index

Business



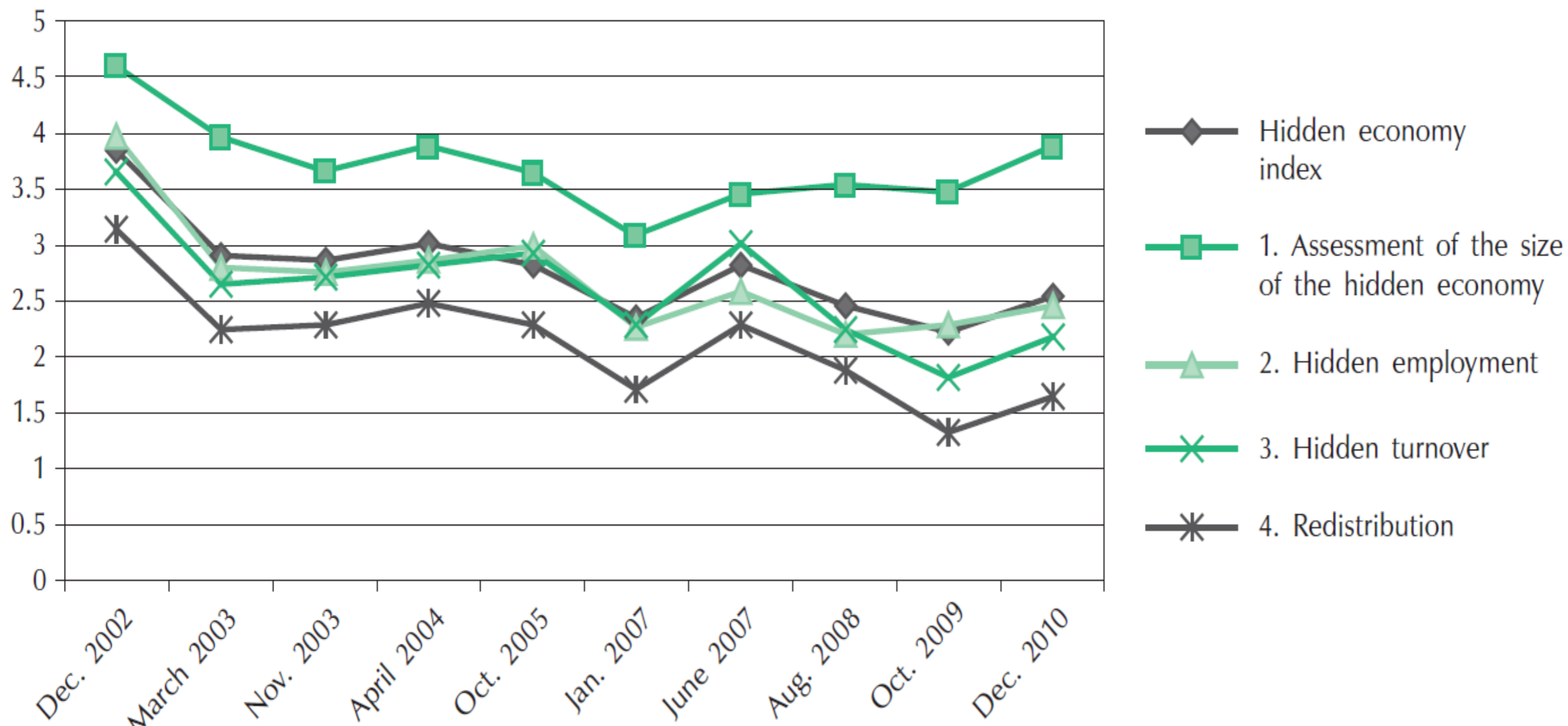
Assessment of the size
Hidden employment
Hidden turnover
Hidden redistribution

Population



Assessment of the size
Hidden employment
Hidden turnover

Dynamics of The Hidden Economy Index, 2002 - 2010 (Business)



Source: Vitosha Research, Center for the Study of Democracy

Undeclared Employment in Bulgaria: Trends

Managers' Assessment of the Share of Employed Workers without a Signed Contract

	December 2002	November 2004	April 2005	January 2007	September 2009	December 2010
Up to 10 %	18.9	34.2	38.6	37.4	22.8	29.6
10 % to 25 %	21.4	23.0	16.8	12.9	11.2	9.9
25 % to 50 %	23.5	9.9	11.5	6.8	17.4	13.6
50 % to 75 %	10.1	3.1	2.8	4.1	1.7	1.6
Over 75 %	4.9	0.9	1.2	0.3	0.0	1.2
No such employees	21.2	28.9	29.0	38.4	46.9	44.0
Base	387	322	321	294	241	243

For the last eight years, the share of people working under a formal contract more than doubled (i.e. from 21.2 % to 44 %)

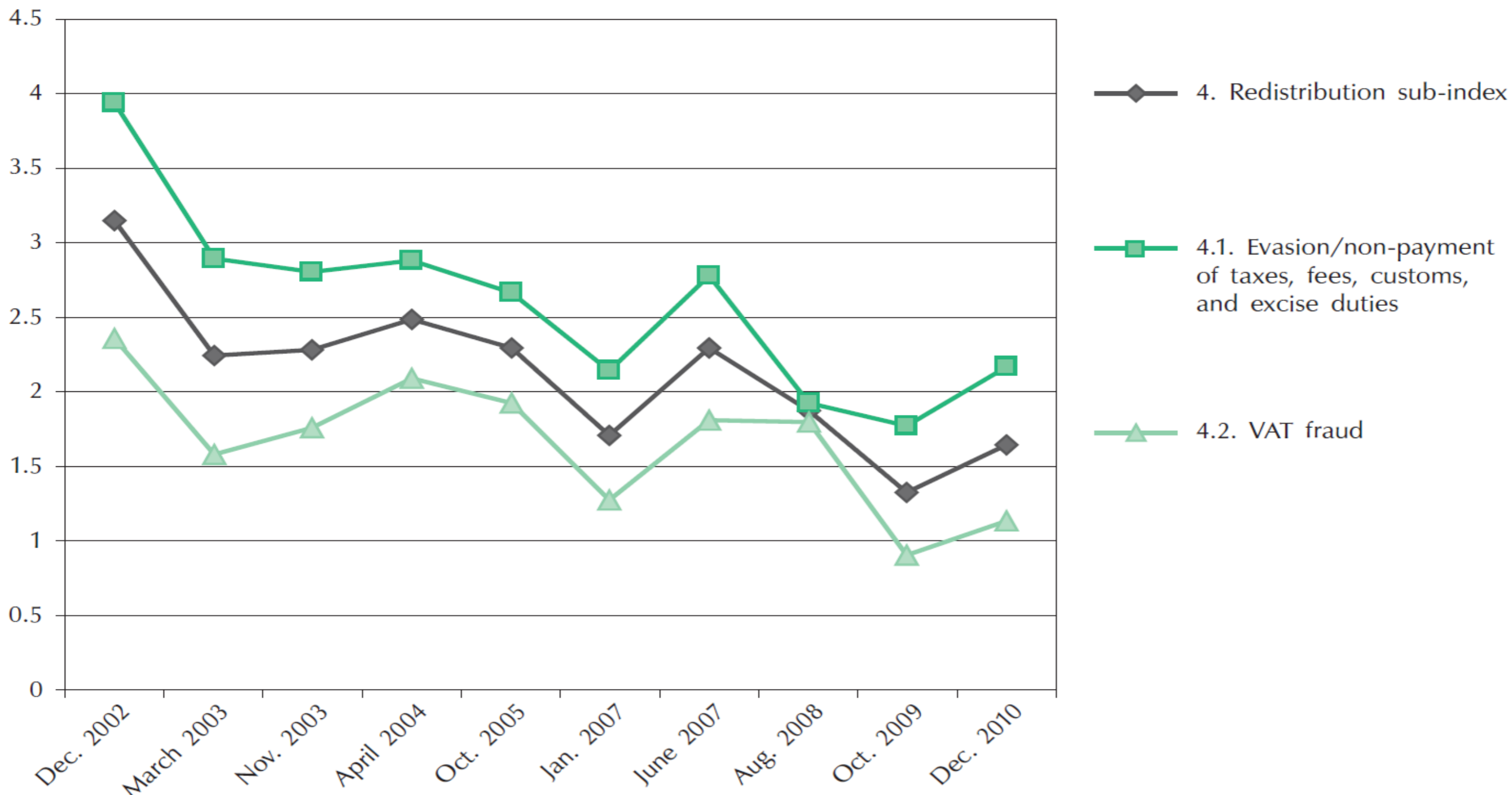
Underdeclared Employment

Managers' Assessment of the Share of Employed Workers with Underdeclared Payments

	December 2002	November 2004	April 2005	January 2007	September 2009	December 2010
Up to 10 %	14.4	23.6	25.6	26.6	22.9	22.8
10 % to 25 %	12.6	24.6	18.7	11.7	14.2	10.1
25 % to 50 %	27.3	16.5	18.4	15.5	19.3	24.1
50 % to 75 %	15.2	8.1	7.8	6.6	3.6	4.4
Over 75 %	12.3	6.8	7.5	4.8	7.3	8.3
No such employees	18.2	20.4	21.9	34.8	32.7	30.3
Base	374	309	347	290	248	228

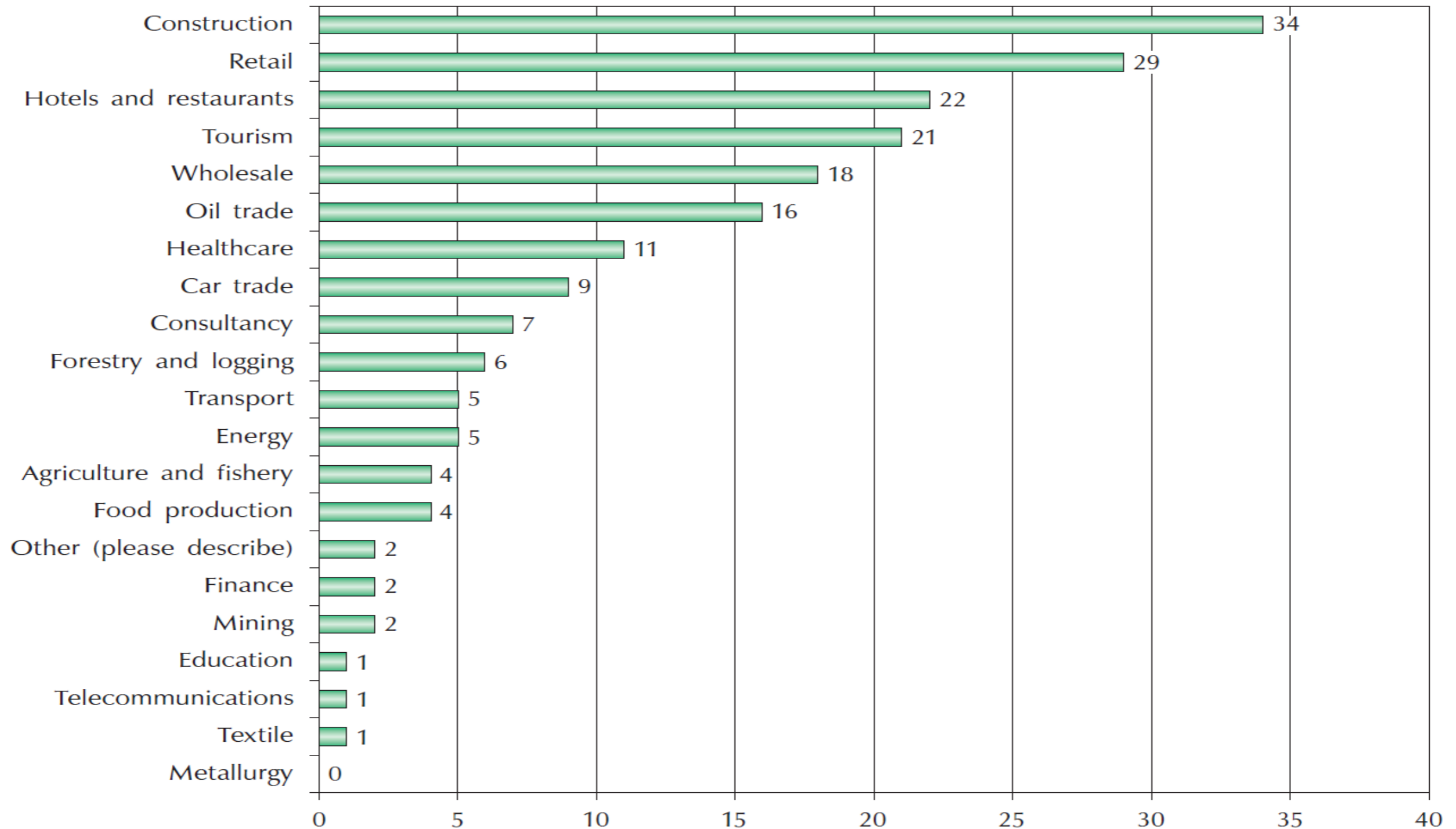
Note: the survey question was “In your opinion, what share of the employed in your branch work under contracts with “hidden clauses”, i.e. receive payments larger than the ones stated in the contract?”

VAT Fraud and Tax Evasion (Business)



Source: Vitosha Research, Center for the Study of Democracy

Sectors with the Largest Shares of Hidden Economic activity, as Reported by the Bulgarian Businesses, 2010



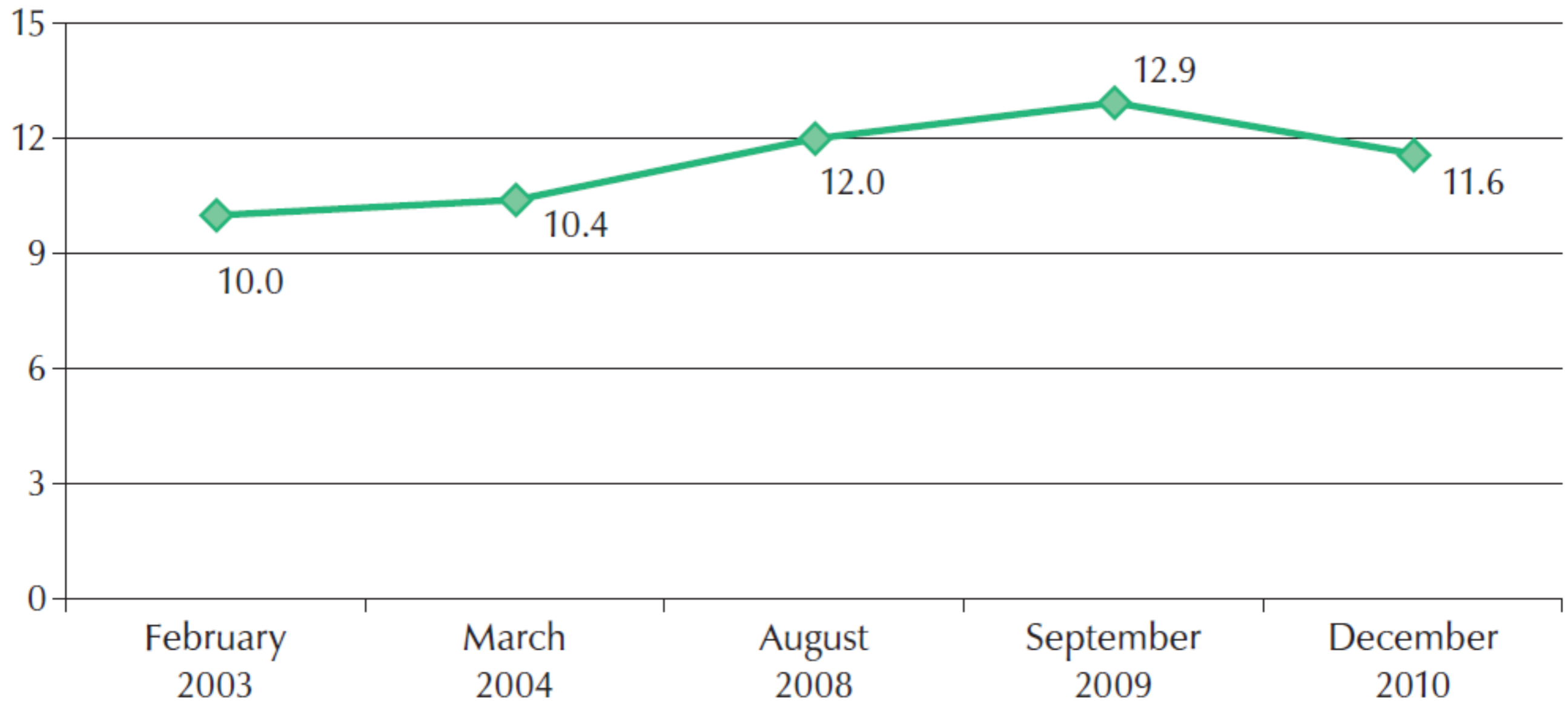
Source: Vitosha Research, Center for the Study of Democracy

The Basis of which Social Security Payments are Calculated, for Primary Employment (%)

	February 2003	March 2004	August 2008	September 2009	December 2010
On the minimal social security threshold, though the total amount of my salary is larger	12.1	13.4	13.5	12.9	10.3
On the minimal social security threshold, which is the real salary I get	10.3	14.3	9.5	12.6	5.9
On the sum set in my contract, though the total amount of my salary is larger	6.7	8.3	15.0	15.5	8.4
On the sum set in my contract, which is the real salary I get	68.3	63.4	61.8	56.2	67.0
Other	2.6	0.6	0.3	2.8	1.5
Base	348	314	378	395	466

Source: Vitosha Research, Center for the Study of Democracy

In the last month, were you paid a higher amount of money than the declared in your contract with your primary employer? (Population)



Share of Workers Reporting no Signed Contract with their Primary or Secondary employer (Population)

	February 2003	March 2004	August 2008	September 2009	December 2010
Without a contract – primary employment	6.0	5.9	5.6	5.9	3.4
Without a contract – secondary employment	77.4	59.1	51.5	51.0	38.1

Bulgaria: Policies and Measures to Limit Undeclared Work

- Introducing compulsory registration of individual labor contracts
- Obligatory social security thresholds in all sectors and branches
- Introducing a “flat” tax on incomes and corporative profits
- Organizing public campaigns on limiting the hidden economy
- Enhancing administrative control and increasing sanctions

- More recently: introducing risk analysis

Main Problems and Countermeasures

- The absence of evaluation tradition
- The economic policy measures are not in unison with the administrative control measures
- Measures are not tailored to the specific characteristics of the Bulgarian economy
- Plenty of measures, no system
- Cost-benefit analysis

Conclusions: form Macro to Micro Stability

- The cost of entrepreneurship continues to be too high
- Informal social and economic structure has been created
- The hidden economy continues to be among the major business problems
- The overall economic development is far more important than the control measures, enforced by the government
- We have to stop discussing macroeconomic stability and fiscal framework and begin concentrating on the markets, firms and people - how the fiscal framework is affecting them.
- Bulgaria has the lowest tax and insurance rates in Europe - then why is it that the hidden economy is not disappearing?

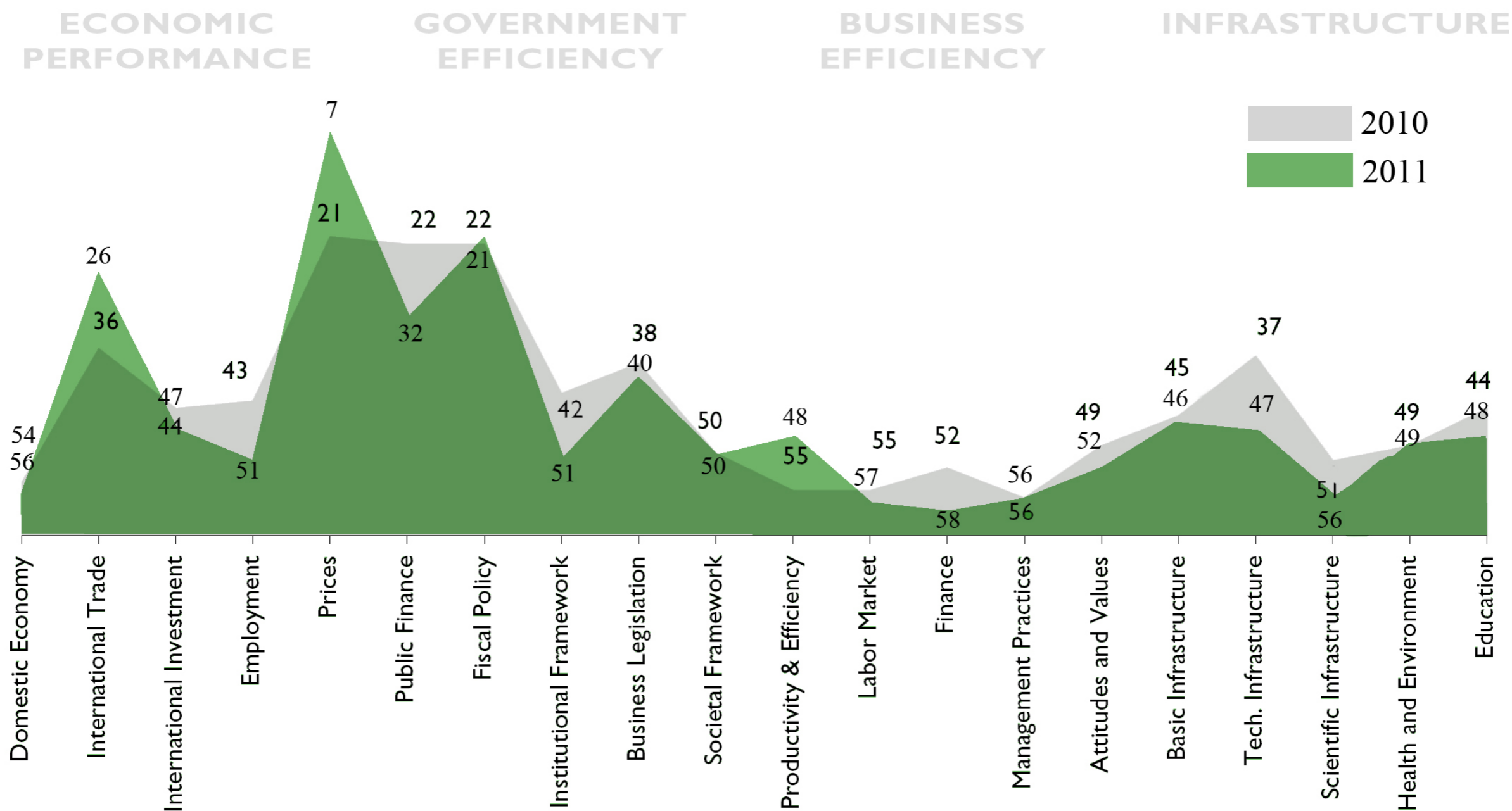
Recommendations

- The GDP estimates of NSI to be publicly announced and to serve as a starting point in deciding public policy
- Make use of more and better budgetary and economic policy, not regulatory and control
- Control over regulatory compliance should be exercised, based on risk assessment and concentrating resources to tackle the greatest threats
- Actively seek interaction of public policy with the practices of the private sector, thus reinforcing the capacity to combat the hidden economy

Recommendations

- give preference to incentives
- introduce the concept of the service nature of the administration
- quality of public services
- structural reforms
- judicial and control systems

Landscape of the Bulgarian Competitiveness



Thank You for Your Attention

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