

GREY – Out of the shadows

Social norms as drivers of participation in the informal economy in Bulgaria



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Sofia, 2 September 2016

Institutional theory and the informal economy

- Need to look beyond **traditional economic explanations** of the informal economy (rational cost-benefit analysis).
- New lines of enquiry into **socio-psychological motivations** behind non-compliance: moral rules and sentiments; the fairness of the tax system; taxpayer's satisfaction with and trust in the government.
- **Tax morale** - a latent socio-psychological factor in individual taxpaying decisions: intrinsic motivations (moral obligation) to pay taxes
- **Institutional theory**: misalignment between official rules (formal institutions) and social norms and practices (informal institutions) as driver for non-compliance

Determinants of the informal economy

- *Key drivers for undeclared work in new EU Member States from CEE*

Structural drivers (external)

- Taxation system/structure (tax burden, compliance costs, enforcement)
- Social protection
- Labour regulation

Social norms and formal institutions (institutional asymmetry) - internal

- Perceived fairness, trust, justice in interaction with authorities
- Institutional credibility, quality of governance
- Tax morale

Research objectives and hypotheses

- How does **institutional asymmetry** (measured by the moral acceptability of tax evasion and the perceived legitimacy of official institutions) affect the undeclared economy in Bulgaria and taxpayers compliance decisions?
- Strong link between **tax morale and informality** found in previous research, but tax morale is multi-dimensional – need for more nuanced measurement of moral reasoning behind it.
- H1 - The higher the **justification of non-compliance**, the greater the readiness to work undeclared and evade taxes
- H2 – The lower the **perceived institutional legitimacy**, the greater the likelihood of non-compliance

Data: the Hidden Economy Population Survey 2015 (1)

- Conducted annually since 2003 by CSD/Vitosha Research
- National representative sample of 1,000 respondents (18+)
- CATI method / telephone interviews
- Measures levels and trends of the hidden economy (work without contract, envelope wages, partial evasion of social security contributions; hidden revenue; hidden redistribution)
- Hidden Economy Index (business + labour)

Incidence of undeclared work in Bulgaria 2003-2015



Data: the Hidden Economy Population Survey 2015 (2)

- Two new sets of questions:
 - Readiness/intent to participate in 8 types of informal economic activities
 - 12 new questions measuring attitudes towards tax compliance and institutional legitimacy

→ Do social norms and attitudes towards tax compliance and official rules impact on individual propensity to engage in the informal economy?

Measuring propensity to participate in the informal economy

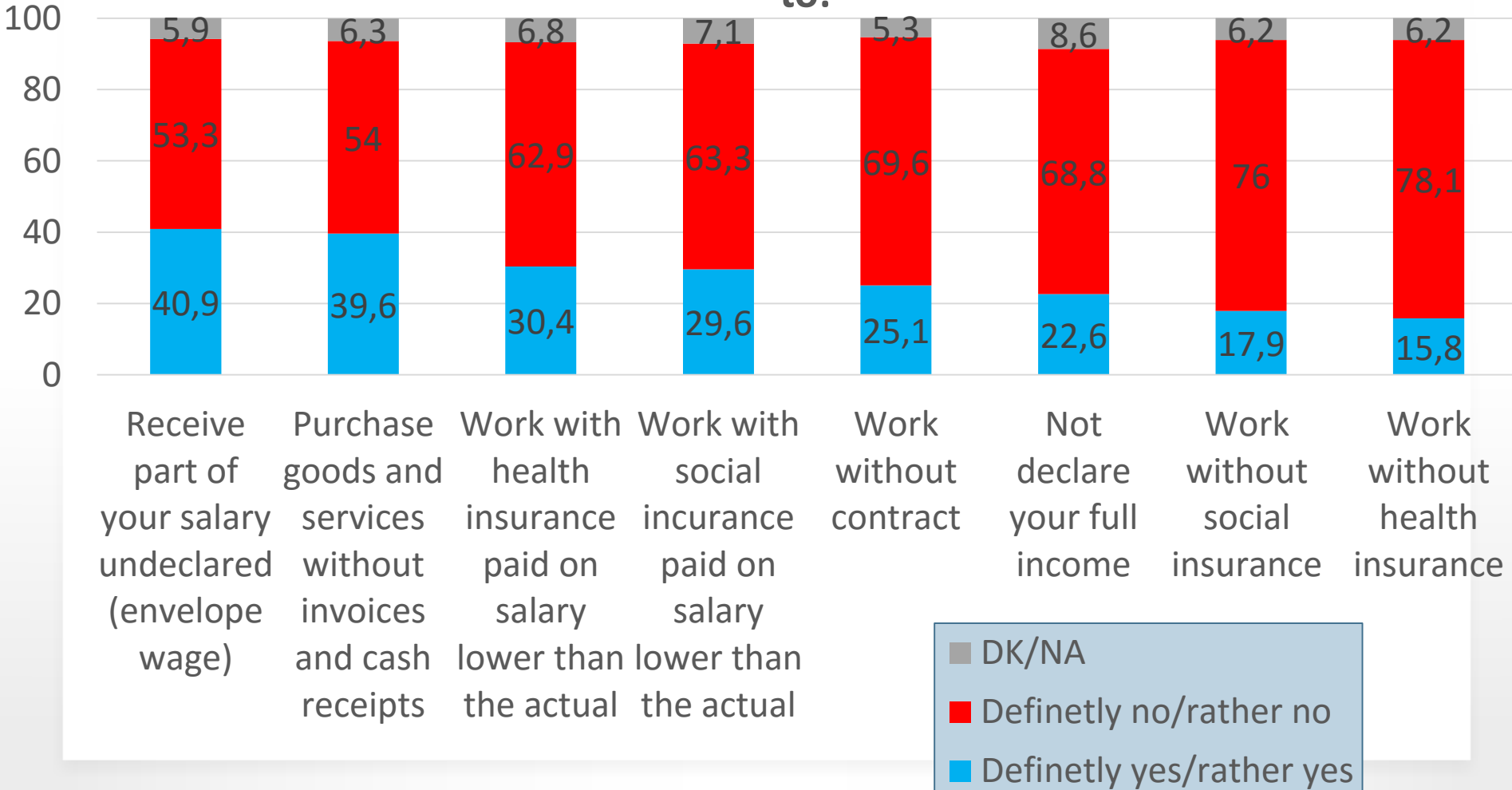
IF YOU PERSONALLY HAD THE OPPORTUNITY, WOULD YOU CHOOSE / ACCEPT TO:

- Work without a contract
- Work with a contract indicating a particular sum, but to receive a higher sum on the basis of verbal agreement (“envelope wage”)
- Socially insured on the basis of lower pay than you actually received
- Pay health insurance contributions on the basis of a lower pay than you actually receive
- Work without being socially insured
- Work without having health insurance
- Purchase products or services without invoices and receipts
- Not declare your full income

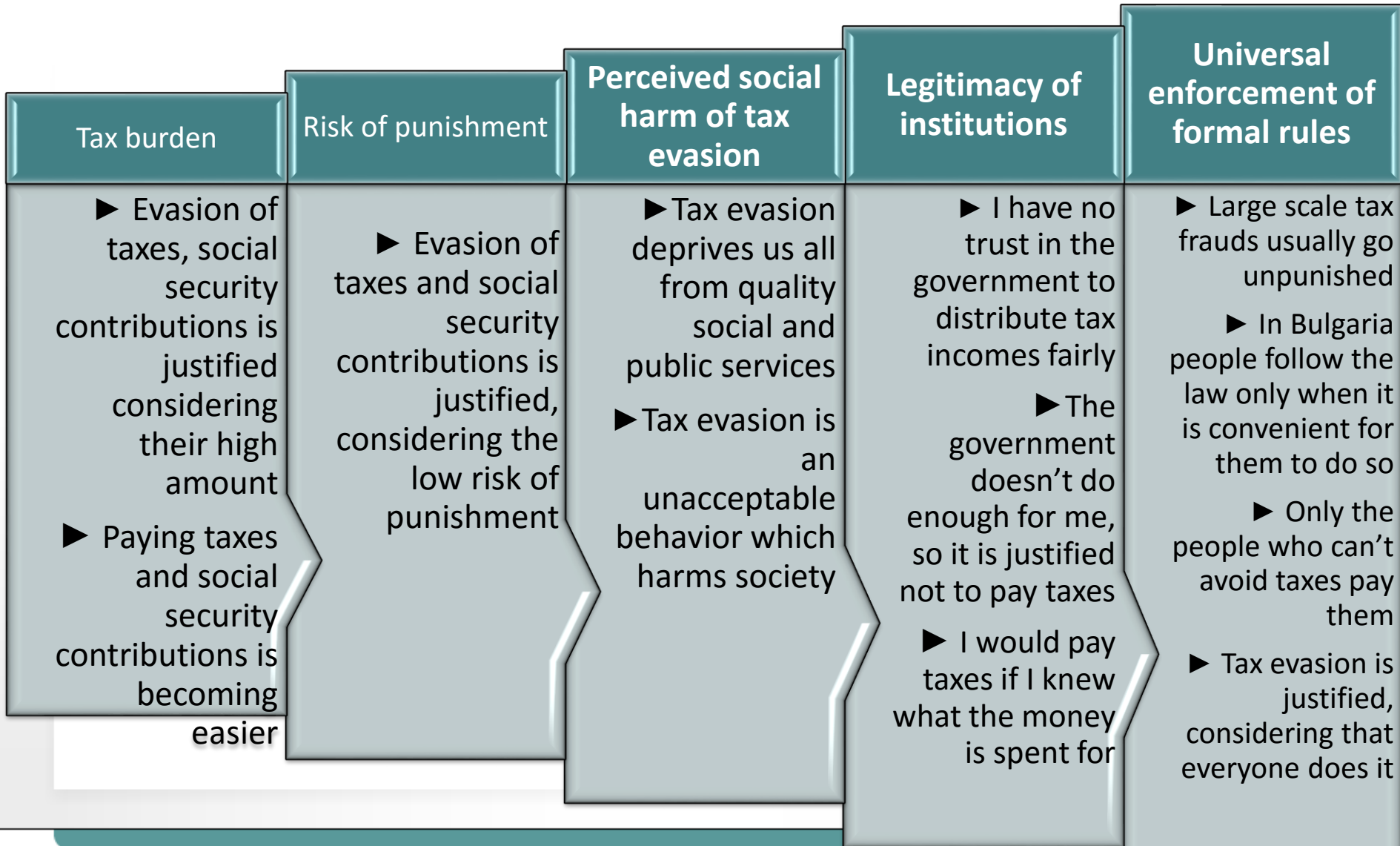
[1 = fully disagree, 2 = rather disagree, 3 = rather agree, 4 = fully agree]

Propensity to engage in undeclared work and tax evasion

If you personally had the opportunity, would you chose / accept to:

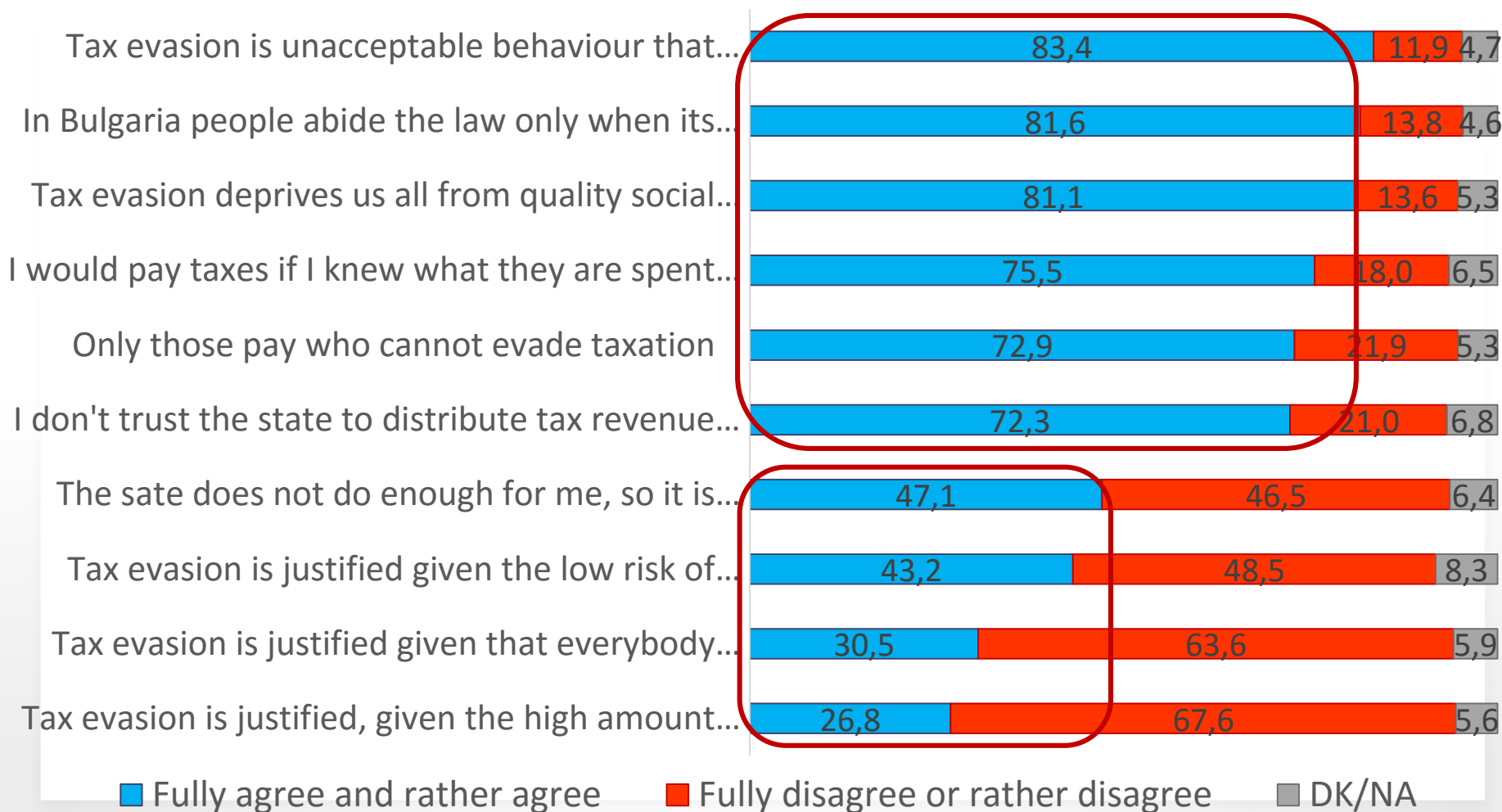


Measuring attitudes towards tax compliance and institutional legitimacy



Attitudes towards tax compliance

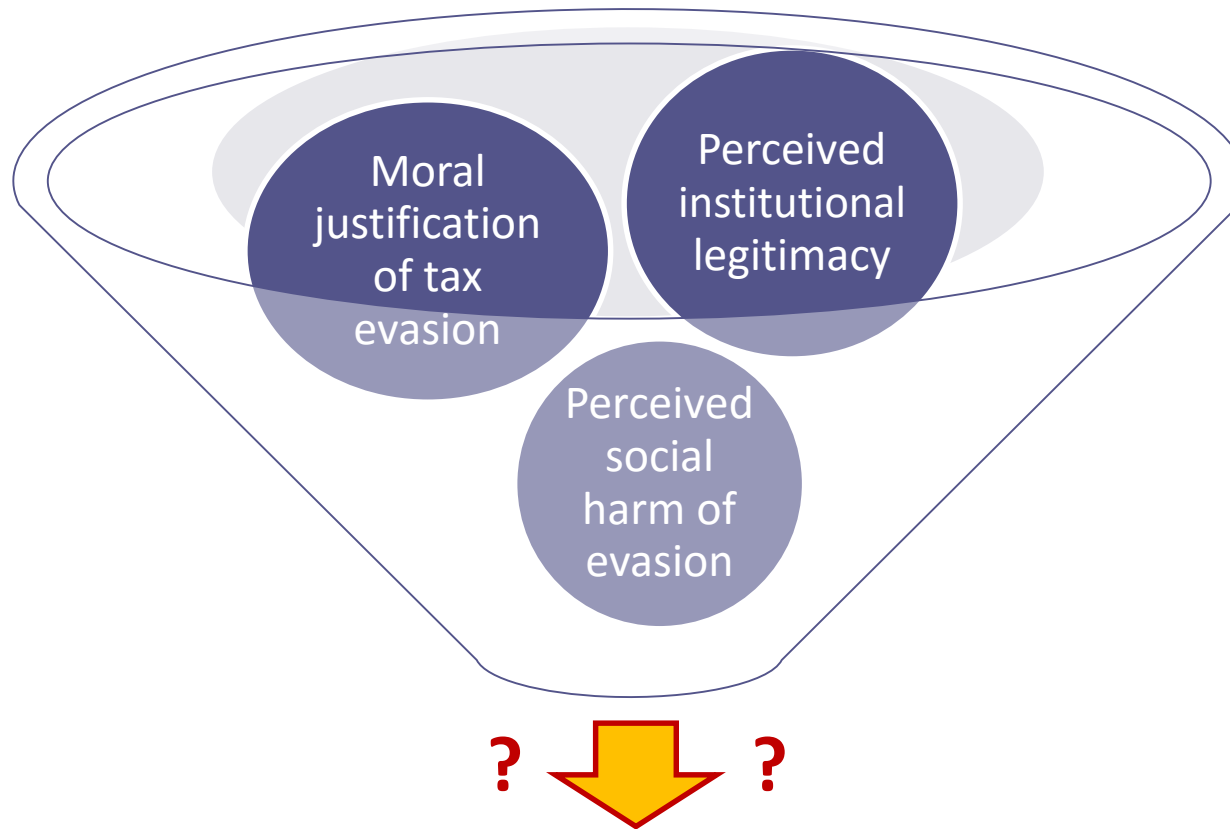
To what extent do you agree or disagree



Attitudes towards tax compliance and formal institutions

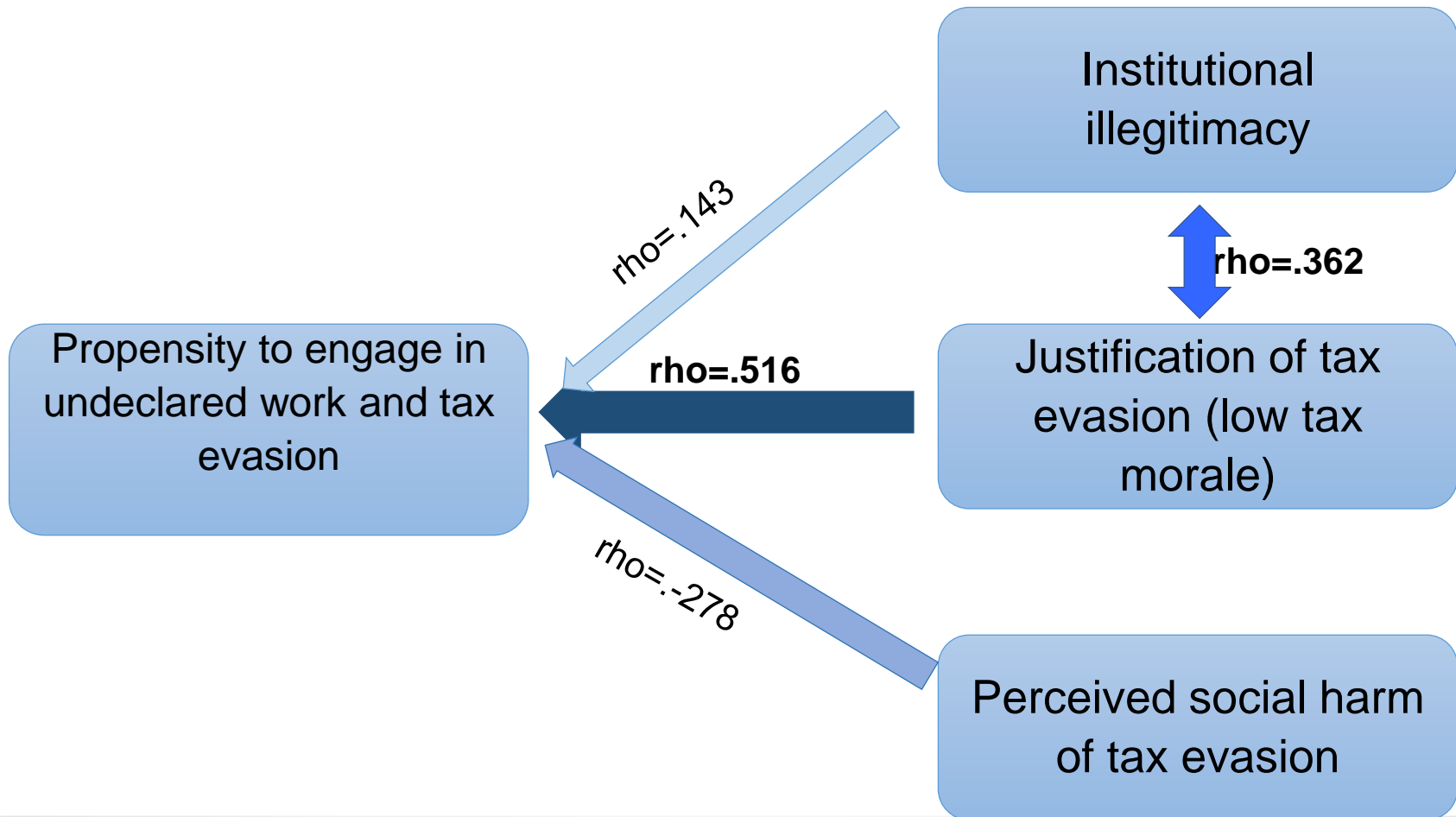
- Over 80% agree that tax evasion is generally unacceptable and harmful for society, as it deprives it from public goods and services (**social harm**).
- At the same time, over 70% agree with statements related to the lack of universal enforcement of rules and compliance, lack of fair punishment; mistrust with the state to distribute tax revenue justly (**formal institutions**).
- Between 27 and 47% find tax evasion and undeclared work justified, for different reasons (**moral justification of non-compliance**).
- Tax burden, the risk of punishment and the non-compliance of others are the least valid reasons for justifying tax evasion (around 30%).

Factors extracted from attitudinal questions



Propensity to participate in the informal economy

How norms and values affect individual propensity to engage in the informal economy – correlation analysis



Multiple regression analysis – predicting informality propensity

Predictor variables	DV: Propensity to engage in undeclared work (Beta)
Justification of tax evasion	,475***
Institutional (il)legitimacy	,081*
Perceived social harm of tax evasion	-,176***
Perceived easiness of paying taxes	
Age	
Gender	
Married or cohabiting	
High social status (compared to middle)	-,085*
Low financial status (compared to middle)	,092*
Occupation	
Education	
Residential area (rural vs urban)	-,123***

Multiple regression analysis - findings

- **Low tax morale** (high justification of tax evasion) had the strongest and positive effect on propensity to work undeclared.
- The higher the **perceived social harm of tax evasion**, the lower the likelihood of non-compliance.
- People from the **upper social class** are less likely to engage in undeclared work than the middle class.
- People assessing their **financial situation** as poor are more prone to work undeclared and evade taxes.
- People from the **rural areas** are less prone to operate informally compared to those from urban areas.

Conclusions

- Between 16% and 41% of respondents would be willing to engage in different forms of undeclared work and tax evasion if they had the opportunity.
- Over 70% of Bulgarian citizens are holding critical views towards the ability of the government to deliver public goods and services in exchange for taxes, distribute resources fairly and enforce rules universally.
- A smaller yet substantial share of respondents find tax evasion highly justifiable (27-40%).
- There is a strong and positive correlation between the degree to which people justify tax evasion (low tax morale) and their propensity to engage in the informal economy.

Policy implications

- Unless formal institutions are perceived as legitimate, fair and trustworthy, and are able to guarantee procedural and redistributive justice, direct controls are unlikely to produce the desired effects.
- Direct controls (inspections, sanctions) need to be preceded, or at least combined with an indirect approach that seeks to reduce the gap between the state and its citizens, promote voluntary culture of commitment.
- Awareness of the harmful consequences of tax evasion for society could deter people from working undeclared – strengthen social solidarity.

THANK YOU

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