

European Employment Observatory

Article on Undeclared Work from SYSDM Correspondent (Update of EEO Review: Autumn 2004)

Bulgaria

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Bulgaria: Undeclared Work

1. Introduction

The debate on undeclared employment and the grey economy was triggered in 2004. It was provoked by the short-term results of measures introduced between 2002 and 2003. The representatives of employers' organisations and professional unions insisted on expanding the measures for bringing the grey economy "into the spot light" and upturning the social security system. The issue of undeclared employment and the grey economy is most frequently viewed as an evidence of the Government's poor work.

The absorption of the Structural Funds demands proper tax behaviour of companies and transparent management. This defies the interests of the correct taxpayers to those evading taxes. It was the businessmen from the first group who launched a campaign against the shadowy sector with the traditional involvement of the professional unions. The high social security contributions are constantly the focus of debates organised by the professional unions. The Government on its part has serious political problems instigated by the grey sector expansion thus reducing the means for social expenditures. These more important reasons induce the 2007 campaign for rethinking the recently applied approaches for limiting the grey economy in Bulgaria.

1. Prevalence of undeclared work in the economy

- i) The study "Undeclared Work in the Enlarged European Union" contained figures on incidence of undeclared work in most Member States, which could be taken as reference. Alternative assessments could be highlighted.

The 1998 Commission Communication concept on undeclared work (UW) is adopted by the National Statistical Institute (NSI) and used in the system of national accounts. No results from new surveys have been published since 2002. Alternative surveys are carried out periodically.

Statistical information on undeclared employment

Data comparison for number of employed after 2003 from the enterprise survey (labour accounts method) and from Labour Force Surveys (LFS) of households shows that the scope of (UW) escalates.

Table 1. Total Number of Employees*

Period /Year	Number of the Employees (in thousands) according to:		Difference (in thousands)
	Survey of the Enterprises *	Labour Force Survey of the Households	
2003	2079,9	2399,6	319,7
2004	2152,3	2478,7	326,4
2005	2189,8	2555,7	365,9
2006	2240,6	2701,5	460,9

* The data in the table compares the number of employees in one and the same period of the year – Q3.

**The Survey is carried out every three months. It presents data about employed people with a labour contract at the end of the month. To ensure comparability, in this table the average monthly employment is calculated for the period of Q3 in 2000 and 2003.

According to the Labour Force Survey, carried out by the NSI, the *number of employed people without a labour contract* increased, except in 2006 (Table 2). This group does not include people at marginal position in the labour market and duplicates the structures of the employees in total¹. The only difference is that after 2003 the industrial sector dominates in the structure of UW by sectors, instead in services, as was previously the case.

Table 2: Employees by Type of Contract with Enterprise

	2006	2005	2004	2003
Total (in thousands)	2760,1	2630,0	2530,5	2453,1
Labour, civil other contract	2670,6	2519,3	2433,2	2355,0
Without contract	89,5	110,7	97,3	98,1
Total in private enterprises	1893,2	1747,2	1609,1	1477,8
Labour contract	1805,4	1638,1	1459,6	1384,7
Without contract	87,8	109,1	104,2	93,1

Source: NSI.

Another group quite vulnerable to illegal hiring is that of discouraged persons (Table 3) who have not been employed in the last eight years. Their number and proportion has increased recently.

Table 3. Number and structure of the discouraged by reasons

	2006	2005	2004
Discouraged (in thousands)	270,5	343,0	391,9
Structure by reasons (in %)			
Total	100.0	100.0	100.0
1. Discouraged with previous employment experience because of:	69,3	68,5	66,5
- Standard seasons	31,6	37,6	37,6
- Others, incl. non-working during the last 8 years	37,6	30,9	28,9
2. Discouraged without employment experience	30,7	31,5	33,5

Strong indicators about undeclared work are those concerning the salaries of the public (State) and private sector employees (Table 4). There are large differences in some which could be explained by some undeclared payments, but also by collective bargaining and its weaknesses in enterprises at the lower levels of negotiations.

¹ For example in Q3.2006, males who were most in demand in the labour market, in general, predominated with the share of 68.7% in this particular group. The share of the young people between 25 and 34 years was 26,9 (the highest), followed by those between 35 and 44 and between 15 and 24 years. Almost half of those with unclear labour status were with secondary education followed by those with basic (40,3%). The private sector continues to 'produce' such type of hiring.

Table 4. Differences between the wages of the employed in the public sector and those in the private (in BGN)

	2006	2005	2004	2001	Increase 2006/2001
Total	1461	1350	1351	1039	1,4
Agriculture, hunting, forestry and fishing	982	745	716	432	2,3
Mining and quarrying	2393	2302	976	393	6,1
Manufacturing	2353	2449	1888	1333	1,8
Electricity, gas and water supply	-97	388	157	675	-0,1
Construction	1151	1375	1017	819	1,4
Trade, repair of motor vehicles and personal and household goods	4228	3620	3110	2519	1,7
Hotels and restaurants	1121	1090	1350	844	1,3
Transport, storage and communication	549	834	902	1512	0,4
Financial intermediation	3522	3567	2484	-402	-8,8
Real estate, renting and business activities	870	703	756	696	1,3
Public administration; compulsory social security					
Education	-1271	-1231	-1075	-892	1,4
Health and social work	2067	2070	1933	1112	1,9
Other community, social and personal service activities	-134	-469	-640	46	-2,9

Source: NSI.

In 2006 other macro-economic indicators pointing to an expansion of the grey economy are: consumption growth – 12% and savings growth – 22% (BGN 5.1 billion) against an increase in new car sales – 26%, fuel consumption increase (in physical volumes) – 7.9 %².

The growth of direct foreign investments (almost three times as much in 2006 compared to 2005) could also be linked with the grey sector, as far as the declared values of the sold property were diminished. In this way, the taxes that have to be paid are lessened. The recent sale of property to large extent must be linked with tourism and the tourist industries.

Information from survey studies

The main alternative data comes from specialised studies of business, specialised studies of the population and national representative population surveys. The studies have been conducted by either private social research or marketing research agencies³ assigned by ministries, business associations (regional, industry and national ones), research projects (mainly on foreign funding) and private companies (mainly foreign)⁴. Specialised representative business studies have been carried out based on interviews with business

² Source: NSI.

³ In Bulgaria some 7 or 8 social research agencies can be quoted as sustainable, half of which are owned by big international market research companies.

⁴ Frequently due to their private character the data never becomes public and even government institutions prefer to keep findings confidential if certain negative tendencies have been registered.

managers at sector level and at different size of companies and by regions⁵. Data from such studies allows some trends to be traced. Unfortunately it is not appropriate for quantitative estimations of employee numbers, social security contributions, undeclared profits, etc. Most promising at this point seems to be the nationally representative surveys among the population and the results of three of them are cited further.

The questionnaire survey carried out by the Bulgarian Industrial Association (BIA) and the Bulgarian Industrial Association⁶ outlines that the grey sector in Bulgaria covers about 35% of the economy and expands like an epidemic after 2004. It is assumed that if employment in the grey economy is added, the GDP will increase against the officially announced growth of 6,5% for 2006 to a real growth of 7,8%, while the reported population income increase will be by 13% higher. The actual survey results indicate that 17,8% of private sector employees pay social security contributions on their real income, and at least two-thirds (62,66%) of all employees in Bulgaria pay taxes and contributions on real income basis.

The nationally representative empirical sociological survey “Factors for applying flexible retirement forms and promotion of elderly employment”⁷ outlines that 87,3% of interviewees think that employers hire workers without a contract, and 90,1% believe that employers pay social security contributions at the minimum insured income, not on the entire salary. The high share of respondents sharing this opinion is evidence of the broad scope of this phenomenon.

The finding cited above runs counter to what the social survey agency ‘Vitosha Research’ found in the course of its periodic business research commencing in 2002.⁸ There is evidence that within the period from 2002 to 2007 the share of the grey economy diminished from 29% to 17,1 % (See Chart 1)

⁵ Regrettably this data is largely unrepresentative due to the lack of clarity on the structure of Bulgarian businesses in terms of employment, sales, and even of type of activity.

⁶ The survey is carried out in the period 1-15 April 2007 r. The number of interviewees is 1000 randomly selected (employed, self-employed, managers, unemployed, pensioners, others) over 18 years of age living in different-size settlement (capital city, district town, town and village). The interviews are of face-to-face type according to a preliminary designed questionnaire. The survey is not nationally representative.

⁷ The survey was carried out in the period May 2006 by the National Social Security Institute. The cluster sample methodology is used and regional factors and the distribution of respondents by districts, towns and villages – 9 respondents and up to 9 substitutes in a cluster. The sample is made on the basis of the personal register of the NSSI.

The Report on the Survey was published on the home page of the National Insurance Institute <http://www.noi.bg/>

⁸ Business operations managers have been surveyed, the sample being on a quota principle attempting to follow the structure of Bulgarian business by industry, regions and size. The sample sizes are as follows: December 2002 N=389, March 2002 N=328, November 2003 N=338, April 2004 N=342, October 2005 N=240, January 2007 N=275.

The Surveys’ results before 2004 were cited in the previous report on the undeclared work in Bulgaria (2004).

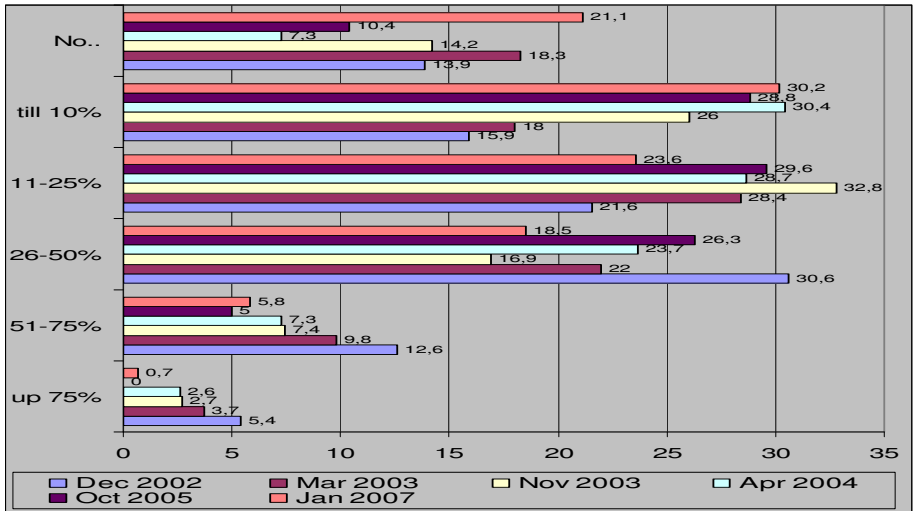


Chart 1. Common assessment of the share of the grey economy (in %) ⁹.

As for employment, surveys give evidence of a clear tendency to hire less people without a contract (see Chart 2), or under contract „hidden clauses“¹⁰ (see Chart 3). A close analysis of the data available proves that the latter predominates and proves to be the common practice.

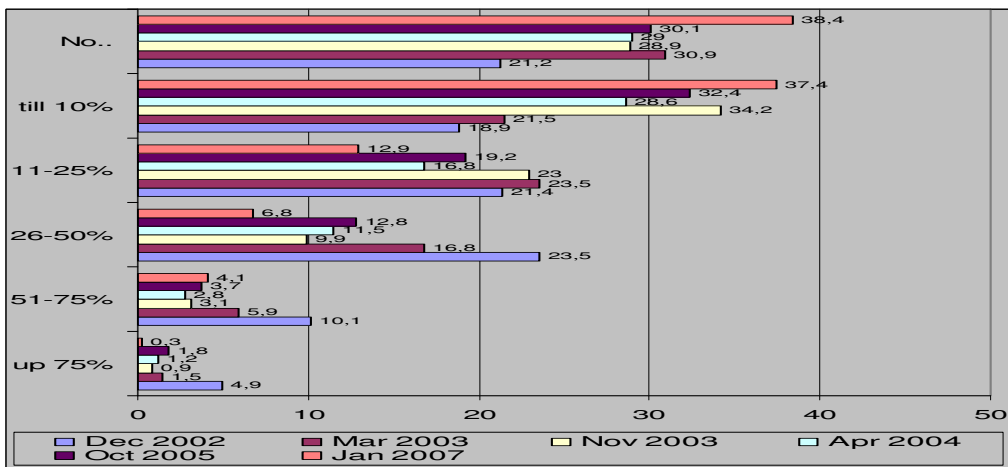


Chart 2. Relative share of those working without a labour contract (by %) ¹⁰

⁹ Chart 1 presents the answer to the question “What is your opinion about the share of the grey economy in the branch you are working with?”

¹⁰ “Hidden clauses” for the Bulgarian employers would be saving on social security and health insurance by hiring on a low-salary labor contract, paying the same people additionally on civil contracts at the same time. It is also widely the practice to pay down cash, or offer perk incentives such as payment of gas, GSM bills, accommodation, all of which are tax deductible as expenses made by the company.

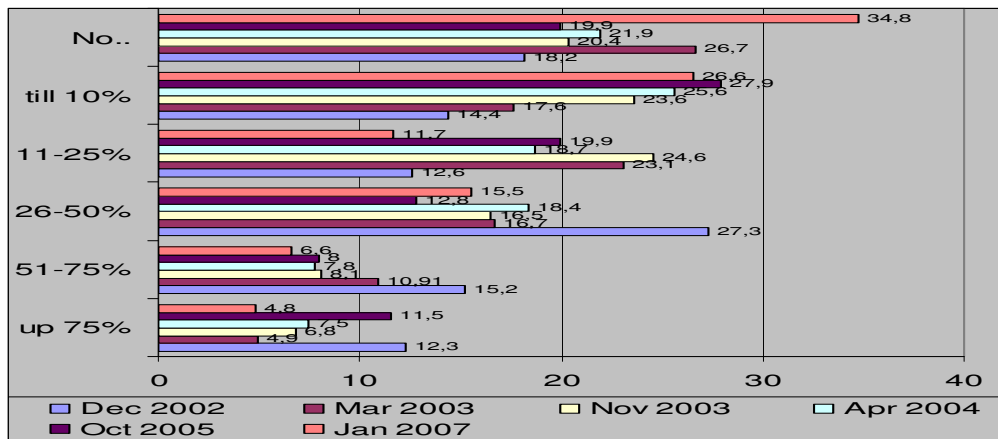


Chart 3. Relative share of those that work under contracts with „hidden clauses

The existing discrepancy between the data of the surveys from Vitosha Research and those cited above have to be explained with the methods applied. The evidence of the decreasing scope of the grey economy relies on the median value of all sectors coming from the first group of surveys. It is biased toward the share of the grey economy in areas such as construction, tourism and some services that are more successful at hiding the grey sector.

The national representative surveys of the real income of the population carried out by `Vitosha Research' and Industry Watch show the significant differences between the officially received incomes and its real size. The analyses was compiled on the basis that the hypothesis that the National Statistical Institute (NSI) assessments of the population incomes are lowered because they are derived from the officially declared labour contracts that as a rule do not present the real figures of the wages¹¹. To avoid such hidings the surveys of `Vitosha Research" and Industry Watch implement a block of indirect questions, such as "What income level would make you to change your current job?", "How much more money would you change your current job for?" The calculated results (juxtaposition of the answers to all questions in this block) gives ground to outlining the share of the grey income. The comparative data of those coming from NSI proves that the difference between official and real incomes consistently grows (by 35.7% in two years). The striking fact is that despite the abrupt rise of official incomes in the past quarter, the "grey" ones continue to grow faster (by a rate of 5.78% versus 7.82%).

¹¹ The officials at NSI are aware of that problem and try to correct these discrepancies; household budgets provide some correctives. However these were not successful due to insufficiencies in the manner of sample selections, applied so far. In the household surveys typically low-income groups are over-represented due to the fact that they are the only ones who actively take part in the survey (those who are better off do not disclose information and the data are impaired as regards their reality).

Table 5. Personal incomes according to the official statistics and sociological surveys (in BGN)

Period of the survey	Wages, NSI data*	Really received incomes** according to Vitosha Research and Industry Watch	Differences
Apr 2005	318	573	-255
Jun 2006	345	652	-307
Dec 2006	363	677	-314
Mar 2007	384	730	-346

* Monthly wages (in cash) of the employees. The NSI data is for the same periods as those of the surveys in the first column.

**Total sum of the incomes (in cash and in kind; declared and hidden) received per month, calculated on the basis of the answers to the indirect questions. These total sums are the alternatives to the officially registered wage but not to all income received.

Source: Industry Watch and “Vitosha research” monthly national representative studies.

The difference between incomes as they were outlined in the surveys and the consumption declared by the interviewees were approximately 5% to 7% in favour of consumption. This fact has to be explained with another group of “side incomes” that top up the actual received payments against labour (Table 5) as those from a second employment, entrepreneurship (that is not the main business), lease and rent properties, money earned abroad and remittances, etc.

What are the recent trends and how can they be explained?

There was a short-term effect of reduction in undeclared employment that was overcome after 2004. The research until now proves that the number of people “abiding by the rule” of the grey economy increases. The most prominent sectors with hidden unemployment seems to be construction; hotel and restaurants; trade, motor vehicle repair and personal and household goods. The agriculture sector is completely in the “undeclared economy”. In the past five years the natural indicators have risen quickly and despite a growth in food prices, the agrarian sector is growing really slowly in terms of produce value.

The marginal group in the labour market, such as the Roma ethnic minority, find shorter or longer term temporary employment by private entrepreneurs without signing labour contracts. According to nationally representative surveys, unemployment among the Roma population has decreased from around 60% in 2002 to 47% in 2006/2007. Approximately 15% say that they have permanent jobs, 6% state that they have temporary work and 4% state that they have seasonal work. The remaining percentages are either retired, or care for children or relatives¹². Frequently the people in the last group are engaged with activities that are in the grey/black employment border line and include: violations in the wood-processing industry; scrap collection; trades with contraband goods such as alcohol and cigarettes, cheap Chinese or Turkish commodities etcetera. The police and the tax office ignore arrested Roma violators, since the process of proving guilt is extremely complicated.

Student labour in some sectors that still lack professionals could be tied to the grey economy; in some respects the employment of highly-paid labour generated by the EU and

¹² Source: Studies of the Centre for Study of Democracy, www.csd.bg

the USA outsourcing in the field of programming, construction design, machine-building, electronics, medical research, etc.. As a rule, these positions are either unregistered (due to VAT not being deductible over export), or if registered, they are at the minimal salary level.

The most substantial number of workers in grey employment seem to be those working after retirement. With their extreme demographic status they distort the labour market balance.

Another very important group in the grey economy are migrating Bulgarian workers to and from the EU. The grey sector in Bulgaria and the EU countries evidently looks like a system of inter-connected vessels.

The research so far allows an outline of two factors that both stimulate and constrain employment in the grey sector and its development¹³. The first group that predominates over the second includes:

- the tax and social security burden;
- growth in demand for personal services by individuals and households;
- poor quality services offered by the public sector, not justifying the allocated target funds;
- burdensome bureaucratic procedures for the registration of single traders and the self-employed, or declaration of labour relations;
- household plots and relevant income still have high importance in poor agricultural areas;
- low competitiveness of Bulgarian firms, who survive by reducing costs by using undeclared labour;
- weak control and ineffective sanctions in cases of law violation thus reducing the risk of undeclared employment and incomes;
- national psychology of mistrust to political authority;
- corrupt State servants, particularly those in higher managerial positions;
- unequal treatment of people employed under the Labour Code (the so-called labour relations) and the State Servant Act¹⁴ (the so-called official labour relations) in terms of mandatory social security.

The grey economy seems to be due to the following:

- The rapid growth of lending practices given the absence of credit history forced the banks and leasing companies to demand proof of income levels. This puts pressure on employees to increase the officially declared incomes. Despite various techniques for overcoming bank requirements, declared incomes in most sectors of the economy are visible.
- During the interval, after it became clear that Bulgaria would be accessed to the EU in 2007-2008, a considerable number of international companies turned to Bulgaria and prefer work without “hidden clauses“. In many cases they bought Bulgarian businesses and changed the policies and practice of grey employment. Typical examples include the banking sector, insurance, and telecommunications.
- In 2006 a new trend stood out – that of listing enterprises on the Bulgarian stock exchange to raise additional capital. This brought about a change in employment practices and abrupt salary growth among this group of companies.

¹³ These two groups of factor were summarised on the basis of the figures coming from the official statistics and the sociological survey. Some of the factors were articulated on the base of authors' opinion and after summarising the already done research in the country and will be proven further.

¹⁴ According to the acting legislation the State fully covers (100%) the due insurance contributions of people working under official labour relations. They are included in the budget of the National Social Security Institute (the consolidated budget respectively) in the item “revenues at the account of the employer“. If the insurance contributions are paid by people working under official relations, such as people working under labour relations, certain budget expenditures will be economized (BGN 103 million for 2006 according to the calculations of the experts at the Confederation of the Independent Trade Unions in Bulgaria).

There is an urgent need for official estimates into the scope of grey employment that the NSI will have to produce.

- ii) The Commission is interested in your assessment of whether minimum wages increase undeclared work (in those countries which have set a minimum wage level).

The minimum wage in Bulgaria has primarily social functions against “falling in the poverty trap”. In 2007, it is bound to the poverty line, however not in compliance with the methodology proposed by the CITUB¹⁵ thus leading to its actual diminishing. Its 2006 amount is BGN 180 (EUR 90), 2007 – BGN 200 (EUR 100). People receiving the minimum wage are relieved from payment of personal social security contributions and are insured by the employers¹⁶. Therefore, the minimum wage does not have the potential to increase undeclared work.

Each year the social partners in Bulgaria negotiate the minimum income levels for different personnel categories by economic activities (the majority of which differ from the minimum wage), that are considered the minimum basis (thresholds by professions) for social security taxation. We do consider expedient their transformation that differentiated, by the same indication, minimum wages would contribute to the “easing up” of part of the hidden incomes.

There is also the self-employed group; for them the practice is to use various techniques to conceal income, declaring minimal levels (higher, but close to two minimal wages)¹⁷. typically in the delivery of educational, medical and other services, and employment in construction.

- iii) The Commission is also interested in your assessment as to what extent differences in taxation regime and levels are drivers for undeclared work in your country. Please respond to the following two questions:

(a) What is the impact of the tax regime in your country on undeclared work? In discussing the tax regime and undeclared work, please elaborate on the type of tax and tax rates that you are referring to? (b) same for the social security regime

Taxes and social security contributions paid by businesses and the persons in Bulgaria are high¹⁸. Certain changes aimed at reducing the amount of the key taxes/contributions were introduced in 2007 – i.e. the amount of the social security contribution for employers and workers, corporate tax, excise duties, and income tax.¹⁹ Despite them, a number of legal acts still deform the pension system, namely:

- state servants do not pay personal contributions thus causing a loss to the budget;

¹⁵ Confederation of the Independent Trade Unions in Bulgaria

¹⁶ The gross monthly incomes are taxed. This allows for taxation of persons' incomes additional to the minimum wage.

¹⁷ Their tax basis of self employed is formed according to the Corporate Income Taxation Act, but the due tax – according to the Physical Persons Income Taxes Act. For the latter reason they declare the minimal level of the incomes in the scale for the physical persons.

¹⁸ The high tax and social security burden is illustrated by a breakdown of a salary of BGN 1000 in 2006. The gross amount of the salary reaches BGN 805 after deduction of the social security contributions paid by the employer. After deducting the personal contributions and the income tax the net salary reaches BGN 593,42 (73,6% of the gross salary). If other direct taxes and fees are also taken into account – vignette fee, vehicle tax, building tax, waste fee and administrative fees, as well as indirect taxes, the employee actually disposes of BGN 398,29, i.e. almost half of the net amount of its salary.

¹⁹ They are reviewed with much detail in 3.2.(b) as the changes are outlines on the basis of the situation till the end of 2006.

- certain groups of workers are entitled to early retirement²⁰. The State budget pays an additional 3% above the usual social security contributions so that these workers retire twenty years before the minimum retirement age. However, the employer pays another 15% of the contribution. It is unexplainable as to why the State does not fund itself the rights it has granted. The State's responsibilities in social security are still not properly specified and are, to a certain extent, transferred to employers and employees. It stimulates the non-declaration of incomes as a reaction to unjust regulation (perceived as such).

(c) Please discuss the impact of the tax regime on undeclared work activity in relation to:

- i) Individuals (unemployed, employed and self employed)
- ii) Small firms
- iii) Larger corporations

According to the observations of the employers' organisations, large and medium sized companies (with minor exceptions) are correct tax-payers. Traditionally, the problems (like in other countries) are concentrated in small and micro companies. They are related to the unsustainable business environment, in which they operate. Meanwhile, the system of preferences for them is insufficiently developed in Bulgaria (this need is not shared by all economists and policy makers). A recent example are the comments on the need for introducing a differentiated VAT rate. However, implementation of this measure requires more competent administration which is currently not available in Bulgaria.

3. Measures taken to combat undeclared work

3.1 Briefly comment on the level of political profile accorded to this problem at national level. Is there any link with the debate on immigration, flexicurity and social security reform?

The immigration of foreigners in Bulgaria is not significant; the current public debates focus much more on the emigration of young and well-educated Bulgarians and the reduction of the inflow of social security contributions, rather than on placing immigrants in the grey economy sectors.

At the same time, 2006 a shortage in labour was officially announced. Bulgarian industry (the construction sector in particular) has to import labour and this has reshaped national legislation in that field. It is now restrictive and quite inflexible and for these reasons it could be accepted as a factor which forces immigrants into being illegal hired. On the other hand, changes in the legislation and employment practices will have to consider the common requirements for the country as a member of the EU and the experience of countries such as Greece, Portugal and Spain.

The flexicurity problems are viewed in the context of untraditional employment and the protection of its legal sources of incomes. The atypical forms of employment in Bulgaria are mostly under the programmes for subsidised employment. The latter could be considered as a generator of undeclared work (or at least to allow the combination with it). This is another aspect of the debate on 'pros' and 'cons' of subsidised employment that needs additional research.

Public debate into social security reforms concern the afore mentioned distribution of the roles and duties between the State, employers and employees. According to a group of independent experts, a flat-rate social contribution tax has to be introduced. Also, a tax amnesty for violation of the tax and security legislation and a hiding of real incomes was

²⁰ This group involves career military servicemen, officials of the Ministry of Interior, investigators, jailers, etc. Their number of over 100 000 according to preliminary data.

suggested in 2006²¹. This could be of “help” for small scale enterprises. However the problem is too complex and until now this measure has not been accepted by business representatives. The amnesty would be meaningful if combined with a drastic reduction of social security rates. The introduction of such changes were not considered until now and were not accepted by all managers.

3.2 Recall briefly the main measures and highlight measures have in recent years been taken to seek to combat undeclared work at national, regional, local or social partner level. Comment on measure falling into the following categories:

- a) **The creation of a legal and administrative environment which is favourable to the declaration of economic activity and employment, through simplifying procedures and by reducing the costs and constraints which limit the creation and development of businesses, in particular start-ups and small undertakings;**

There is still an urgent need to minimise the administrative burden on business and those to begin/end businesses in particular. Bulgaria lags behind the best practices with its nine procedures for starting business; 32 days for opening a business, three years for finalising the procedure and its high costs. Also the licensing and permit systems have to be simplified further as business representatives do not consider them easy.²²

In 2007 the maximum credit amount on the project “Micro-financing Guarantee Fund” was boosted to 50 000 BGN (25 000 Euro)²³. This change reflects inflation fluctuations and could stimulate small business start-ups.

Information given by the Employment Agency reveals a limited general interest to the policies and programmes promoting entrepreneurship.²⁴ However, the capacity of the policy should not be overestimated as it refers mainly to unemployed who do not have a high level of education and this predetermines some difficulties in starting own business.

The broad reasons for the low attractiveness of entrepreneurship in Bulgaria are related to difficulties in business development in an unstable macro-economic environment and preserved throughout the past years restricted credit access²⁵. The development of the credit activity of banks, particularly over the last two years will continue. It is expected that they will orientate, like some other economic agents, towards preferential credit lines and towards those for risk ventures for entrepreneurs in the near future. Some opportunities will be revealed in relation to the absorption of the EU Structural Funds.

- b) **Strengthening incentives and removing disincentives to declare work on both the demand and the supply sides:**

²¹ No mechanism for forcing firms to pay the due contributions for past years to the state budget on the actual salaries of the workers is now applied even if they are willing to do so. According to the comments of the business representatives many of them cannot pay fresh money, which are not allocated for investments, to “clean their name”.

²² All these requirements we agree with, were included in the World Bank draft for report 38570, April 2007 for accelerating Bulgaria’s convergence: the challenge of raising productivity. The mentioned above figures were compared to those for OECD countries as 6 days for starting business for those countries; 16 days for opening of business; 1.5 years for its closure, etc.

²³ The minimum social requirements for applicants are also changed – with up to BGN 25 000 credit, at least one permanent work place should be opened, if the credit is over BGN 25 000 – at least two should. The operating deadlines for opening work places remain – up to 6 months from the date of the first credit absorption for one working place and up to 12 months for two. Signing two permanent contracts at a four-hour working day is considered as opening of one new permanent working place at full time.

²⁴ These programs include one training course in entrepreneurship out of work and another – transfer potential to energy. The measures cover promotion of starting own economic activity (art. 47, 48, 49b of the Employment Promotion Act); starting own economic activity as a micro company (art. 49); starting agriculture activity (art. 49a).

²⁵ In that case we ignored the access to ‘bad’ credits due to political or other marketeering reasons.

- **reviewing and, where appropriate reforming tax and benefit systems and their interaction to reduce high marginal effective tax rates and, where appropriate, the tax burden on low paid workers.**

As mentioned already, the taxation regime in Bulgaria is one of the most important prerequisites and incentives for moving into the grey sector. This issue is not so much related to just tax reduction but also to the improvement of its structure and subordination to an overall philosophy, and not to a complex balance of interests of the ruling political parties. The following changes have been undertaken as a means to try to curb the grey sector:

- o The pension contribution for the most common third category of labour was reduced by 6% in 2006 (from 29% to 23%) and will probably be reduced to 20% after 01.07.2007²⁶.
- o The personal taxable annual income in 2007 was reduced by the costs for tax purposes²⁷.
- o The non-taxable income²⁸ and tax alleviations for children have been increased²⁹.
- o 50% of the taxable annual income of craftsmen will be regarded as legally acknowledged costs³⁰ instead of 35%, and for authorship and licensing remunerations it will be 70% instead of 50%.
- o The scope of non-taxable income increased in 2007 by: income from voluntary supplementary insurance received after becoming eligible for supplementary pension; income from mandatory insurance abroad, food vouchers; lump-sum payments for medical treatment, birth-giving (provided by the employer), marriage, and death of a family member.
- o Patent tax is paid only by physical persons and single traders, as legal bodies are excluded. The patent tax may be reduced if the activity is terminated before the end of the year³¹.
- o A new Corporate Income Taxation Act was enforced in 2007, reducing the rate of the income tax from 15% to 10%.
- o The direct social security burden of the employer will continue to decrease and should become 50% of the due overall social security contribution in 2009³².

A 25% growth of the revenues from corporate tax is reported at the beginning of 2007. The same is valid for the paid dividends, since the tax rate is reduced from 15% to 7%, and for certain taxpayer categories to 0%. The potential risks for the budget may be covered by the accumulated fiscal reserve.

The scope of goods for which excise duty is due increased considerably in 2007, as well as the very excise duty rate (especially for electrical energy). Therefore, a price increase is expected and new incentives for hiding income.

It may be summarised that in the framework of current tax policy and the expected inflation growth, the reduction of the direct tax burden for the population may be neutralised by the

²⁶ This is planned only if the planned budget revenues are collected and existing fiscal stability. After the reduction of the contribution, the subsidy for the NSSI for 2006 increased 2.6 times compared to the 2005 subsidy. The continuing decrease of the contribution will lead to increase of the deficit and the redistribution of the budget, what in our opinion is not an appropriate way for developing the national insurance system. It obviously needs additional financial revenues.

²⁷ The personal insurance contributions are reduced from 45% to 35%.

²⁸ The increase is from BGN 180 per month to BGN 200.

²⁹ The amount that can be deducted from the taxable income is: for one child – from BGN 360 to BGN 420, for two children – from BGN 780 to BGN 840, and for three or more – from BGN 1140 to BGN 1260.

³⁰ Only for those who do not perform activities for which patent tax is due.

³¹ Except for hotels and restaurants.

³² The current distribution of the payment of the insurance contribution between employers and worker is frozen at 65: 35.

increase of the personal social security burden. Again, it may be forecast that the effect of the measures introduced will be temporary – for the next two (maximum three) year.

- **setting up suitable employer policies vis-à-vis beneficiaries of social protection measures which will help them to participate in the regular labour market³³**

The extensive Programme “From Social Assistance to Employment” (FSAE) is of special importance for the job placement of poor unemployed persons since it is particularly directed towards them. Many of these people are placed in ‘common good’ activities and the social service sphere. The leading importance of the programme in the Bulgarian labour market since 2003 has been preserved³⁴. In 2007 it will guarantee employment to 27% of the total number of the registered unemployed. 72% of the total state budget amount for active policies will be allocated only for that programme. This distribution testifies the continuing strong centralised management of the labour market with an expenses structure in favour of subsidised employment of poor people.

The national policies are well directed towards people in a marginal position in the labour market. These are programmes for literacy and vocational training of poor people, specialised labour exchanges, specially designed measure to stimulate hiring of young and old people before pensioning, and programmes toward the population of the poorest municipalities.

- **reducing the risk of unemployment and poverty traps by eliminating undesirable interactions between tax and benefit systems;**

According to a Government Decision as of 1 July, 2006 the period for assisting unemployed people of working age without permanent disabilities is limited to a maximum of 18 months. Thus, the personal initiative, responsibility for realisation in the labour market, as well as ensuring labour income to poor long-term unemployed people having low (or no) chance to find a job³⁵ has to be encouraged.

Unemployment insurance is not paid for participants in the FSAE programme. In such a way they are stimulated to look for further non-subsidised employment.

The unemployment insurance scheme³⁶ includes relatively short periods of assistance with low benefits that are bound with the declared insurance basis and length of the service. The purpose is to stimulate active job search and not the occasional (illegal) work.

- c) **Set up of policies which go beyond creating right incentives/remove disincentives in legal, tax and welfare regimes and focus on active provision of services in support of firms/workers in transition from undeclared to declared economy. These are relevant in those economic environments where undeclared work is a structural feature due to historical, social and cultural reasons.**

A real prerequisite for declaring income by ability and legal status is the opportunity for receiving bank credits and involvement in the distribution of Structural Funds. They require

³³ In 2007, the active labour market policy will be prioritised towards the unemployed with low level of education and without specialisation or profession; unemployed young people with specialisation and profession; inactive discouraged persons; unemployed with disabilities; unemployed over 50 years of age. It is expected that in 2007 the employment ratio will increase over 59% for people between 15-64 years of age and the average annual employment rate will drop below 9%.

³⁴ The programme combines vocational training and literacy courses with subsidized employment.

³⁵ According to MLSP data they are 70,000 people in the period January – April 2006.

³⁶ Persons that are allowed to receive unemployment benefit are those under mandatory insurance schemes for all social risks for a period of 9 months at least in the last 15 months before the cease of the insurance. These persons have to be: registered at the employment offices: not pensioners; and not to be engaged in work that is a subject of mandatory insurance.

declaring of sufficiently high monthly income and/or property mortgaging, real annual profit and turnover.

See also: **(f)** To raise social awareness of the costs of undeclared work.

- d) To strengthen surveillance, where appropriate with the active support of the social partners, and the application of appropriate sanctions, in particular in respect of those who organise or benefit from clandestine labour, whilst ensuring appropriate protection for the victims of undeclared work, through cooperation between the relevant authorities.**

According to amendments to the Labour Code (2006) the penalties and fines for employers violating provision of labour legislation are significantly increased. This includes fines and penalties for non-compliance with the notification obligation in the case of conclusion and amendments to employment contracts, violation of the labour-safety requirements and of the labour legislation. The fines for the individuals with certain responsibilities in such cases are also increased.

The Pact for Economic and Social Cooperation for the period 2007-2009 was signed on the 26 September 2006 by the social partners. It sets the principals for the development of the economic and social sector until 2009 and the general objectives and recommendations that have importance for the grey economy regulation.

- e) To strengthen transnational co-operation between competent bodies in different Member States aimed at combating undeclared work.**

VAT collection³⁷ is the main problem threatening the financial stability in 2007. The Tax administration and the available information systems are not ready to counteract. A further concern is the high probability the key European actors specialised in unlawful VAT refund to concentrate their efforts in Bulgaria, where they will find much weaker resistance.

Another field, where positive experience has already been accumulated, is the customs operation under the new conditions of the country European membership. The process of improvement of the information systems, the links within the European Community and the requirements for strengthening its borders and control should continue.

Bulgaria is not threatened by an inflow of foreign workers yet, although firms need workers to import. Future fears are that there will be a need for strengthening transnational co-operation between competent bodies in this field in view of free movement of people, but also setting barriers to the participation of foreigners in the grey economy. The priority again is the provision of information and links between employment offices and other State bodies.

- f) To raise social awareness of the costs of undeclared work.**

The initiative "IN THE LIGHT"³⁸ for legalisation of the grey economy was initiated by the Bulgarian Industrial Association (BIA) on 2 May 2007. The BIA launched a discussion forum "PRO" or "CONS" the non-payment of social security contributions and taxes on real income³⁹.

The CITUB systematically organised discussions on the problems of informal employment; income, tax and social security policy, strengthening of the social security system⁴⁰. In 2005, CITUB experts suggested the introduction of differentiated personal social security

³⁷ According to preliminary data of the Ministry of Finance losses of BGN 150 million are expected. The goods coming from the EU are not treated as imported, and half of the VAT revenues for 2006 are from import from EU Member States.

³⁸ www.nasvetlo.net

³⁹ pr@bia-bg.com

⁴⁰ The CITUB organized a forum on 9 March 2005 at which the launching of a national campaign for legalization of the informal economy was announced.

contributions. The reform has two options – with and without State financial support. The first option envisages distributions of the mandatory contributions in a ratio for example 65:25:10 for employers, workers and state respectively. One of the reasons for this change is its capacity to stimulate declaration of hidden remuneration.

The National Social Security Institute regularly published lists of correct and incorrect employers in terms of due amounts.

g) **Other measures taken which do not fall into any of the above categories.**

*Amendments in the Labour Code*⁴¹ touch upon certain specifics as regards the implementation of *partial work-time schemes, non-standard working day, night-time labour*, as well as the rules and regulations regarding *additional employment contracts* (supplementary to the main employment relationship).

From the beginning of 2007, the period for receiving paid benefit for raising a child until it reaches three years old will be nine months (instead of the now existing pay leave of 135 days). The amendment will cover also women who have not been insured for accidents at work, professional disease and unemployment. The measure could support the overall tendency of unemployment reduction and legalisation of the work of some groups of women.

At the end of 2006, the Government announced changes in the Law on Occupational Safety and Health. The Law will be applied not only for people on labour contracts but to “all aspects relevant to work” and all “working persons”⁴². It was proposed to invite obligatory occupational and safety representatives of employees in case of investigation of occupational injury and occupational disease. The texts regarding establishment, registration and functions of „Service Medicine Office” were supplemented. The establishment of Working Conditions Committees with up to ten members is envisaged in trade companies or other organisations of more than fifty workers and employees.

Since January 2005, the insured years of service are calculated in days, months, years, and also in hours. The extra hours worked are, at present, also considered to be insured periods of service. Legislation also allows the inclusion of the overtime hours of work in the payroll files for the respective month. These possibilities stimulate the declaration of the real working time and incomes.

(e) Please comment in particular, on any evaluations carried out on the measures undertaken and their outcomes. Are there any measures which could be highlighted as good practices which could be recommended to other Member States?

The evaluations of the new measures against the grey economy and related employment have been carried out so far. However, there are grounds for negative expectations and proposals of a practical-applied nature.

The first year of country membership in the EU will be accompanied by inflation growth and decrease of real incomes and the population will try to hide the actual amount of its nominal income.

Drought has already caused irreversible damage to agriculture production. It may be expected that employment in agriculture and in related industries will become greyer. It is quite unlikely for the economic growth to exceed the 2006 rate and consumption will shrink.

⁴¹ State Gazette No. 48, 2006. The changes become effective on 1 July 2006.

⁴² „Working person” is each person who is hired by employer, as well as a person who is self-employed, including those who are trained or interns – for the period of training, internship and practice

As mentioned above, the reduction of the direct tax burden will be neutralised by the increase in the direct social security burden and will have a temporary effect.

The prospects for limiting the scale of grey economy are not optimistic for the near future. The proposals of practical-applied nature for the future changes in Bulgaria encompass:

- introduction of differentiated personal social security contributions;
- State participation in the distribution of the social security burden;
- changes in the social security scheme for the employed under official labour relations;
- introduction of a system for an electronic link between cash machines and tax offices – the cash bills in the shops may be reported directly to the tax authorities;
- tax control privatisation with the aim to increasing its efficiency.

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