

Economic Program

The main objective of the Economic Program in 2003 was to support the development of a sound competitive environment, business integrity and enterprise. Its activities focused on three thematic areas: informal economy, corporate governance and self-regulation and horizontal accountability and enterprise.

2003 Highlights

Informal Economy

- *Watchdog*: Informal economy measures topped the national economic policy agenda in 2003. In the framework of *Coalition 2000*, CSD developed and tested an informal economy index, measuring its dynamics in its different forms (labor market, taxes, contraband, etc.) to assess economic policy impact. The index received wide media and policy attention.
- *Networking*: CSD expanded its domestic and international expert networks in 2003 sharing best practices in research, advocacy and policy actions. Economic program experts presented CSD research at two international conferences on informal labor, which aimed to advise the EU Italian Presidency on EU wide strategy against undeclared work
- *Knowledge Sharing*: CSD published two conference books (one in Bulgarian and one in English) and more than 15 articles in leading media on the causes, specific forms, dynamics, consequences and policy responses of informal economic activities in EU candidate countries. The books combine a balanced academic and applied policy approach, presenting challenges for further research and policy recommendations.
- *Information Dissemination*: CSD is Google's prime Bulgarian site on informal economy. The Economic Program disseminated more than 1000 copies of its books and publications on the subject to domestic and international libraries and organizations. It also supports a resource thematic page on the Bulgaria Development Gateway (<http://www.bulgaria-gateway.org>).

Corporate Governance

- *Regional Outreach*: CSD was commissioned by the World Bank and developed a corporate governance community knowledge-sharing tool for NGOs in Europe and Central Asia countries. It also piloted the first two corporate governance newsletters to initiate the network's work.

- *Awareness Raising:* Partnering with *Coalition 2000* grantee Integra, in 2003 CSD took part in promoting ethical standards and self-regulation among SMEs to curb supply side corruption pressures. Giving practical examples of accomplished high standards of business integrity to SMEs was the first step in a coalition building process to promote strong self-governance principles.

Horizontal Accountability and Enterprise

- *Horizontal Accountability:* In 2003 CSD started an initiative to assist improvement in local administrative governance in Sofia in the area of licensing, registration and permit regimes by establishing horizontal accountability and lowering barriers to business. This would require that all 24 Sofia districts conform to common principles of administrative regulation and business friendly practices.
- *Advocating Change:* Together with partners from *Coalition 2000* and other NGOs CSD contributed to the introduction of transparency and accountability in the work of the Sofia Municipal Council by proposing changes to its new statutes.

I. Informal Economy

In the wake of transition in Eastern Europe informality was the only way to operate a private business in post-communist countries. And for the first decade many economists considered the benefits of informal economy to outweigh the losses. With the establishment of market institutions and the approaching EU accession informal economies started pulling back social and economic change in Eastern Europe and countries took appropriate actions to downsize it – both through administrative and business environment improvement measures.

Three years ago CSD opened up the debate on informal economy in Bulgaria, developing a network of experts and holding two high-profile international conferences - raising public and the policy makers' awareness of the problem. Informal economy topped the economic policy agenda in 2003. Ministry of Labor and Social Policy,

Ministry of Finance and Ministry of Economy proposed their separate sets of measures for reducing the informal economy in the country.

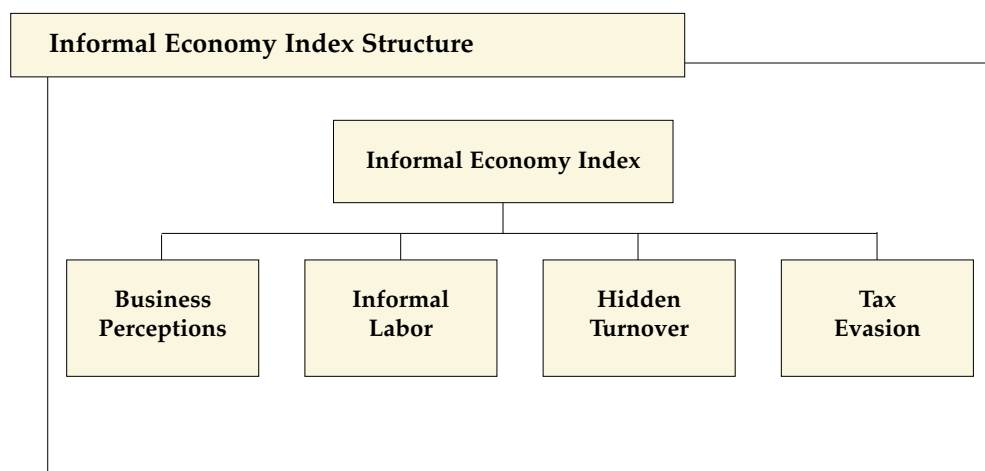
1. Watchdog

Informality is an integral and dynamic part of the economy – representing the disparity between formal socio-economic rules and more dynamic informal interactions that underlie them. Informal economy figures are always disputed because of the hidden nature of the phenomenon they are trying to capture. But in public policy design on informal economy what matters more than absolute figures is dynamics – do undertaken measures result in an effective and sustainable downsizing of the informal economy in the country.

To capture and assess policy impact in 2003 CSD developed and tested a pilot

informal economy dynamics index. The index was produced in cooperation with Vitosha Research Agency (CSD's sociological unit) within the framework of *Coalition 2000*. It is based on sociological surveys among businesses and assumes values between 1 (no informal economic activity) and 10 (very high informal economic activity). The index not only records overall informal economy dynamics but also tracks the different forms of informality. The index has proven a powerful tool for focusing public attention and tracing policy effectiveness.

For 2003 the index registered considerable decrease in the level of informal economy, which resulted primarily from administratively enforced mandatory registration of contracts. However, its components unveiled that after the initial general business compliance to introduced administrative measures towards year-end businesses are increasingly unwilling to support government's policy in this area. Hidden employment contracts, undocumented sales and tax evasion index components rebounded from mid-year lows.



Informal Economy Index Dynamics 2002 – 2003

	Dec. 2002	March 2003	Nov. 2003
Business Perceptions	4.60	3.96	3.66
Informal Work	3.98	2.79	2.76
Hidden Turnover	3.65	2.66	2.72
Tax Evasion	3.15	2.24	2.28
Overall Index	3.82	2.91	2.86
<i>Source: Vitosha Research Agency</i>			

2. Knowledge Sharing

Publications

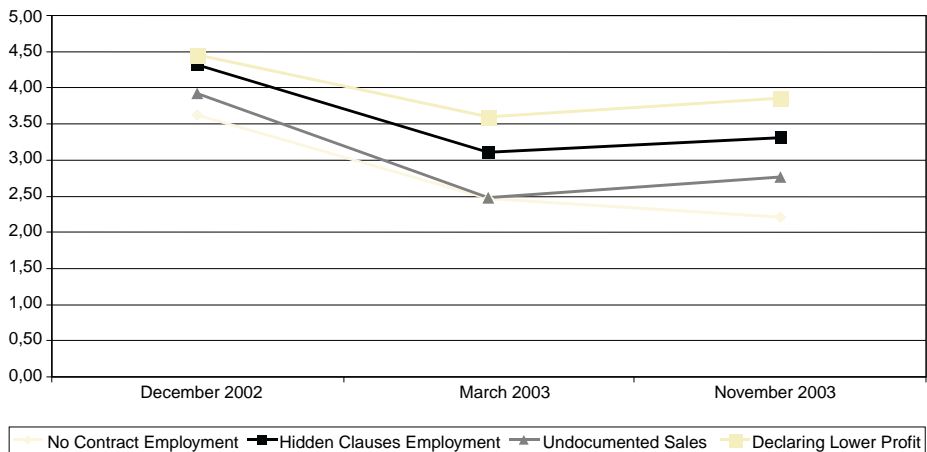
In 2003 CSD published two conference books – one in Bulgarian and one in English – on the causes, specific forms, dynamics, consequences and policy responses of informal economic activities in EU candidate countries. The books combine a balanced academic and applied policy approach, presenting specific challenges for further research and particular policy recommendations. More than 1000 copies of the two books were distributed to local and international libraries and interested organizations.

The book *Informal Economy in the EU Accession Countries: Size, Scope, Trends and Challenges in the Process of EU Enlargement* contains contributions from more than 20 scholars. It reveals that the principal causes of informal economy in accession countries and EU member-states are the same but they have disproportionately

larger negative impact on the former, which is further exacerbated by the institutional transition. Informal economies in some EU member countries are of comparable size to those in accession countries although the forms of informality differ. The book concludes that informality tends to spill over national borders, which makes the problem a matter of European concern and collective efforts should be applied to find appropriate solutions. Introducing stricter EU regulations in the softer administrative enforcement environment in the accession countries might have an adverse effect and push more enterprises in the informal economy.

The Bulgarian version of the book contains a separate part dedicated to specific problems in this country – the links of grey economy to contraband, corruption and criminal activities. The considerable size of the informal economy in Bulgaria – moderate estimates put it at a quarter of GDP – ensures free resources for corruption payments

Informal Economy Index Components' Dynamic



Source: Vitosha Research Agency, Coalition 2000



and is a hide-out place for criminal economic activities in times of more active law enforcement measures. This has largely been the case in Italy in the early nineties when strong anti-mafia actions have led to an increase in informal economic activities.

In 2003 CSD published more than 15 articles in leading Bulgarian newspapers on informal economy keeping the public and the professional community aware of the latest developments in this area in the country.

On the Web

CSD is Google's prime Bulgarian site on informal economy – search words “informal economy”, “grey economy”, “criminal economy”, etc. The Economic Program has created a special informal economy page on the newly re-designed CSD web-site and supports a separate resource page on the Bulgaria Development Gateway on the issues of informal economy.

Events

The Economic Program held two thematic round-tables on the informal economy during the year. These events targeted specific issues important to this country. In search for viable solutions they gathered all stakeholders to the particular problem ensuring alternative view points and plurality of opinion.

The first round table “Grey Economy in Bulgaria – Recent Trends” organized on July 23, focused on the informal economy in the IT sector. Representatives of the Applied Research and Communications Fund (leadng Bulga-



Mr. Ruslan Stefanov, Project Coordinator, Center for the Study of Democracy (left) and Dr. Boyan Belev, Senior Fellow, Center for the Study of Democracy at the Grey Economy in Bulgaria – Recent Trends Round Table, July 23, 2003

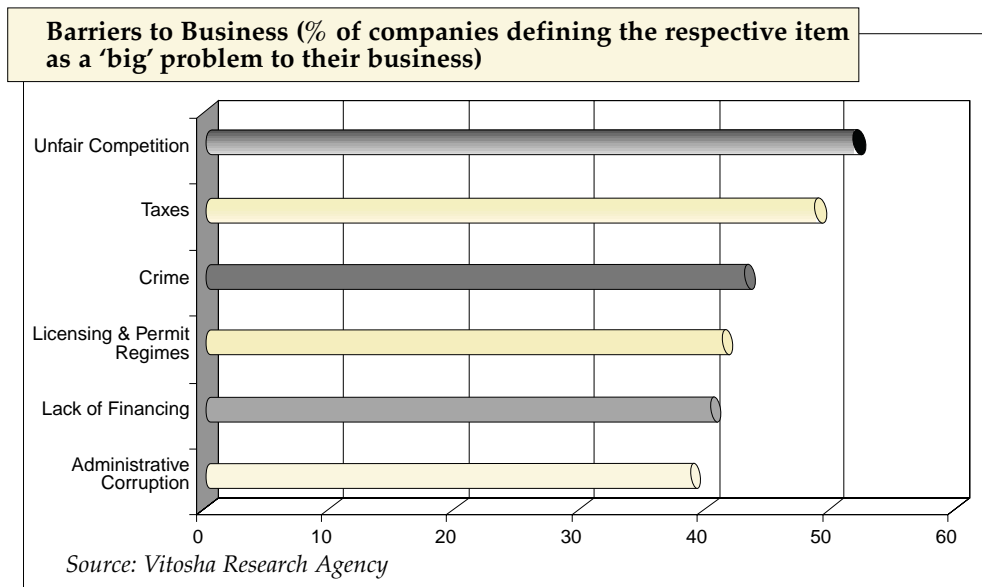
rian IT NGO), BAIT (the Bulgarian IT companies' association), BASSCOM (the industry association of Bulgarian software development companies), Bulgarian International Business Association (BIBA), the Ministry of Economy, the General Tax Directorate, the Intellectual Property Department at the National Service for Combating Organized Crime and others discussed the latest trends in informality in the industry. The informal economy in the IT sector is about the average percent in the country, i.e. 25%. Hidden clause employment and its mirror hidden turnover are the dominant forms of informality in the sector with some salaries being three to four times higher than officially disclosed. While contraband channels seem to be less of a factor, software piracy and new forms of informality (e.g. money laundering through Internet) appear. The experts concluded that a well-functioning public-private partnership including international industry suppliers, local businesses, public and law enforcement administration and NGOs is instrumental for achieving a sustainable reduction in the share of informality in

the sector. Problems of particular attention should be: (i) improving public procurement transparency and lowering corrupt transactions, (ii) upgrading tax service and control and (iii) reducing administrative compliance costs in the official economy.

The second round table "Competitive Environment and the Informal Economy in Bulgaria" organized on December 18 dealt with the worst economic consequence of the informal economy – unfair competition – the additional non-market pressure it exerts on official businesses. Vitosha Research Agency surveys show that by far unfair competition is defined by entrepreneurs as the single most detrimental factor to their business, which bends the rules of competition and creates huge incentives for going informal. The three biggest industrial associations in the country BIBA, Bulgarian Chamber of Commerce and Industry and Bulgarian Industrial Association, which represent jointly more than 70% of the private sector in the country, shared with public administration, NGO and donor organizations' representatives outlined their



From left: Mr. Georgi Tchernev, Vice President, Bulgarian Chamber of Commerce and Industry, Mr. Petkan Iliev, Senior Fellow, Center for the Study of Democracy, Ms. Andriana Sukova-Tosheva, Executive Director, Bulgarian International Business Association at the Round Table Competitive Environment and the Informal Economy in Bulgaria, December 18, 2003



points of view on informality and unfair competition and proposed measures for dealing with them. Smuggling, contraband and fraud at import, inefficient customs, public procurement and unclear legislation are the main sources of gray economic activity. While companies have already managed to reduce internal company economic crime and fraud, external, organized crime and physical threats still remain a problem and discourage companies' investment and innovation activity. The round table concluded that public policy should specifically target a stricter enforcement of existing customs and competition regulations and improvement in the business environment and public service for officially operating businesses.

3. Networking

CSD continued to expand and strengthen its networking to local and international experts and stakeholders on informal economy placing a focus on community building and knowledge sharing. Good knowledge of the inter-

nal expert community and contribution from distinguished international experts in the area formed the basis for achieving sustainable policy impact in the country.

In 2003 Economic Program experts were invited to present Bulgaria's experience and achievements in countering informal economic activity to the Italian presidency of the EU. They participated at two international events on undeclared labor in Europe: (i) a joint DG Research and DG Employment and Social Affairs Seminar "Informal/Undeclared Work: Research on its Changing Nature and Policy Strategies in an Enlarged Europe" on May 21 in Brussels and (ii) "European Conference on Policies for Employment and Against Undeclared Work: From Segmentation to Integration of Labour Markets" on December 12-13 in Catania, Italy.

II. Corporate Governance and Self-Regulation

Private sector business integrity is of high importance not only to the

separate company but for the overall economic and social development of the country. Private companies produce currently more than 70% of GDP and few of them are of size, which might inflict considerable damage on the economy if mismanaged.

1. Pioneer Awareness Raising and Coalition Building

In 2003 CSD shifted its corporate governance work towards company self-regulation and internal ethics rule establishment. For the first time in this country CSD presented figures on corruption in the private sector – its magnitude and its specific forms at a round table in June. In December BIBA invited Economic Program experts to present their findings at an international conference “Countering Corruption – a Factor for Improving the Business Climate in Bulgaria”, which highlighted that businesses are already aware of the size and severity of the problem and are taking responsive action. Active companies are primarily foreign multinationals, which transfer their standard

internal regulations and ethical rules to their local subsidiaries. Home-grown SMEs remain overwhelmingly unaware of existing conflicts of interest and methods of dealing with them.

In cooperation with Integra – Bulgaria (a *Coalition 2000* grantee) CSD presented to SMEs and the public a model “Code of Ethics and Social Audit”. The publication is intended to aid SMEs in uncovering conflicts of interest and handling them professionally, avoiding conflicts with employees and building their own internal system for integrity. Preventive measures put a long-term downward pressure on supply of corruption in the economy. Reducing corrupt practices in the private sector levels the playing field and improves the competitive environment thus raising economic efficiency.

2. Outreach

CSD continued its work in the framework of the Corporate Governance Initiative on promoting the values of good corporate governance



From left: Mr. Ruslan Stefanov, Project Coordinator, CSD Economic Program; Mr. Todor Yalamov, Corporate Governance Group Coordinator, Coalition 2000 and Mr. Ludmil Mandichev, Integra Bulgaria at the Round Table Anti-Corruption in the Private Sector: Institutional Reform and Company Behavior, June 18, 2003

and strengthening and servicing the corporate governance community in the country and the region. In 2003 CSD initiated a working group under *Coalition 2000*, which prepared an updated report on corporate governance in Bulgaria. The report is expected in the beginning of 2004.

Recognizing the extensive experience and resources CSD and the Corporate Governance Initiative have acquired during their work in 2003 the World Bank commissioned the economic program team to develop a community knowledge sharing portal for the ECA region. The portal was successfully launched and CSD prepared the first two pilot newsletters for its clients. It is intended to become a clearing house for information and best practices sharing among expert communities in the region.

III. Horizontal Accountability and Enterprise

Contemporary economic development is increasingly local, cluster and urban in character. Therefore local administrative governance is imperative to the development of viable national economies. In big cities where governance is shared among many district administrations horizontal accountability in administering business regulations is key to creating a welcome entrepreneurial and business climate.

In Bulgaria the economy of the capital city of Sofia accounts for more than 1/3

of the country's GDP and hosts about 40% of SMEs. It has one central and 24 district administrations, which often enforce business administrative rules in substantially different ways. This imposes considerable costs on businesses in Sofia and hampers the capital city's development. In the end of 2003 CSD started work on introducing horizontal accountability and common principles of administrative governance in the 24 districts of Sofia through institutional and legislative changes. It aims at lowering business transaction costs and improving the overall business environment in the city.

CSD established a working group on local administrative governance, which comprises of representatives from the Sofia Municipality, the Municipal Council, the Bulgarian Chamber of Commerce and Industry and NGOs to prepare a report on the administration of licensing, registration and permit regimes in Sofia and propose legislative and institutional improvements to the City Council. The group has identified two sets of regimes that impose the highest compliance costs on businesses and are sources of corruption – (1) regulating commercial activities and (2) regulating construction and architecture. Members of the group proposed changes to the City Council's statutes, establishing the principles of public-private partnership and transparency in the Council's work. The proposed texts have been largely incorporated by the Councilors in the new statutes.