

The “hidden” economy in Bulgaria

(BUSINESS))



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SURVEY METHODOLOGY

Sample

The survey of the business sector encompasses 530 companies throughout the country.

Survey method

The survey method is personal standard interview.

Fieldwork

The fieldwork was carried out during the period: 25 November – 16 December 2002

MAIN GOALS OF THE PROJECT

- The main goal of the research project is to initiate *systematic monitoring of the size and dynamics of the “hidden” economy in Bulgaria (HEM)*.
- The project provides for conducting a series of representative surveys of the *adult population of the country* and of *the business sector* at three-month intervals.
- This will enable not only the dynamics of the problem to be monitored, but also to collect reliable information about the differences in the attitudes of the *population* and *businessmen* to the manifestations and reasons for the spread of the “hidden” economy in the country.
- The results of *the “hidden” economy monitoring (HEM)* include:
 - ✓ *Annual assessment report on the “hidden” economy in Bulgaria.* It will present the summarized results of all surveys conducted during the year and will show the development of the problem and the changes in the gray sector of the economy.
 - ✓ *An index system to monitor the size and dynamics of the “hidden” economy.* On the basis of the pilot survey data a system of synthetic indicators has been developed, which incorporates different aspects of the “hidden” economy and allows the dynamics and changes in its size and characteristics to be explored.

“HIDDEN” ECONOMY INDICES

- “Hidden” economy indices are the main product of the *monitoring of the size and dynamics of the “hidden” economy in Bulgaria (HEM)* which the Vitosha Research sociological agency started conducting in 2002. The value of the indices is updated every three months on the basis of data from empirical sociological studies.
- “Hidden” economy indices range from 0 to 10 in value.
- The closer the value of the indices is to 10, the more negative the assessments of the size and manifestations of the “hidden” economy in the country.
- Indices whose value tends towards 0 are an indicator of a low level of “hidden” economy.
- “Hidden” economy indices are grouped in the following categories:
 - I. General assessment of the size of the “hidden” economy;*
 - II. Specific manifestations of the “hidden” economy:*
 - 1. Labor relations;*
 - 2. “Suppressed” turnover;*
 - 3. Redistribution.*
- The values of the “hidden” economy indices are shown in an Appendix.

I. BASIC SOCIAL PROBLEMS AND OBSTACLES TO THE DEVELOPMENT OF BUSINESS

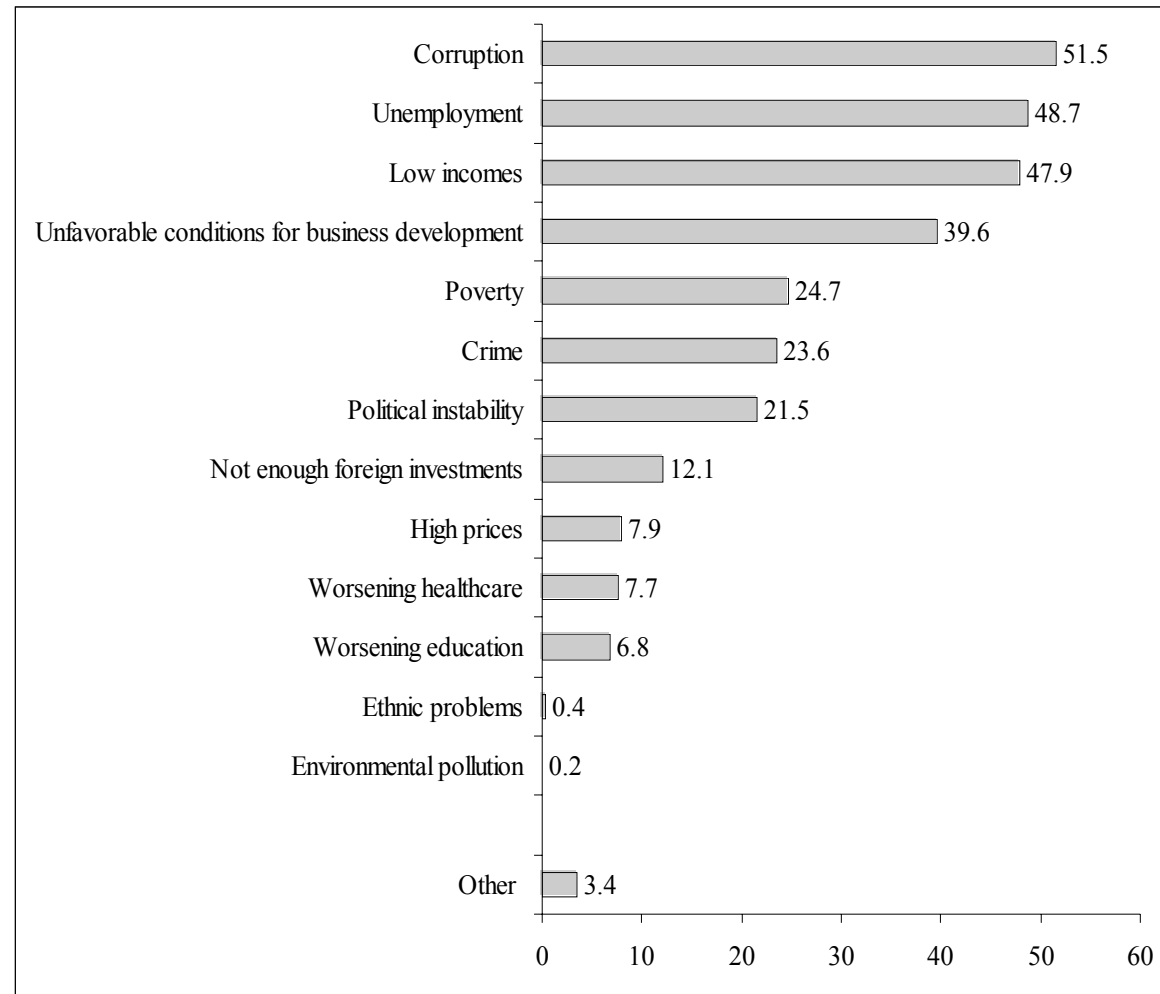
1. THE COUNTRY'S MOST IMPORTANT PROBLEMS

The *unfavorable conditions for the development of business* are cited as one of the country's most important problems at the present moment. Despite their importance, however, they rank only in fourth place after *corruption, unemployment and low incomes*. Oddly enough, acute social problems and the population's low living standard are regarded by businessmen as more important than the specific economic problems of the actual business. For the representatives of small and medium-sized businesses, especially in the sphere of trade and services, poverty and unemployment among the population have in themselves become an obstacle to the development of their activity.

(Figure 1)

This kind of business environment, characterized by insecurity and a high level of corruption, forces many companies to work in the gray sector of the economy to some extent or another.

FIGURE 1 THE MOST IMPORTANT PROBLEMS FACING THE COUNTRY (%)



Base: N= 530

2. *OBSTACLES TO BUSINESS ACTIVITY AND DEVELOPMENT*

The main obstacles to business activity cited by respondents are again linked with the situation in the country as a whole and with the role of the state for the development of the business sector. More than half the respondents cite as the most serious problems *the lack of government incentives for the development of private business, disloyal/illegal competition and crime, thefts and disorder.*

Businessmen expect the state if not to stimulate private business, at least not to hinder it. It turns out that the *procedures involved in the issue of permits and licenses and the corruption among administrative employees* also represent a serious problem for the activity of the surveyed companies. (Table 1)

TABLE 1 OBSTACLES TO BUSINESS ACTIVITY AND DEVELOPMENT

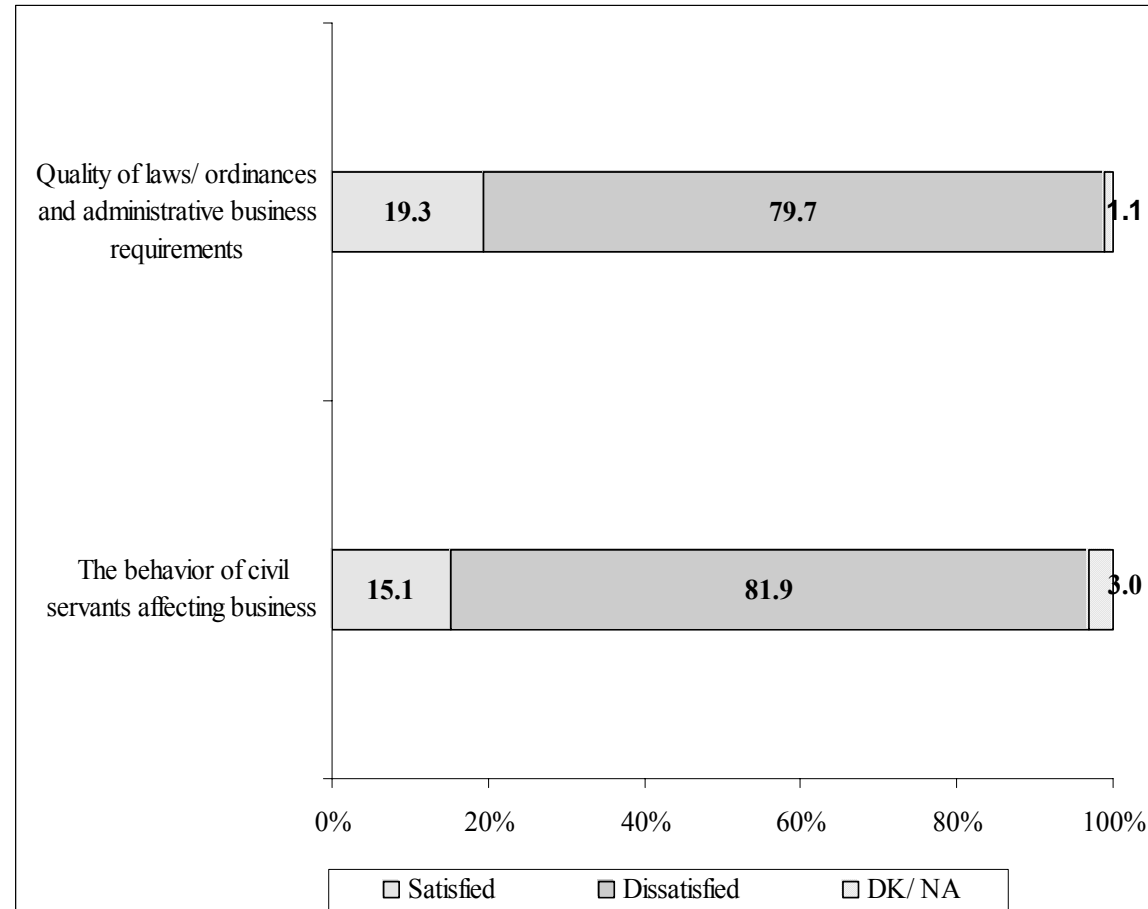
	No problem	Small problem	Medium problem	Big problem	DK/ NA
Government incentives for the development of private business	5.8	4.7	19.4	59.1	10.9
Disloyal/ illegal competition	7.2	7.5	23.6	57.4	4.3
Crime, thefts and disorder	6.8	13.0	24.7	52.5	3.0
Access to credits for funding business activities	9.4	9.1	20.6	49.6	11.3
Procedures in the issue of permits and licenses	13.8	10.2	26.6	41.1	8.3
The macro-economic situation in the country	8.1	11.5	29.1	39.8	11.5
Corruption among administrative employees	10.6	13.8	30.6	39.6	5.5
Tax system	15.3	17.2	33.8	32.5	1.3
Corruption among involved contracting parties	17.0	17.4	26.6	25.5	13.6
Judicial system	20.6	15.5	25.8	21.5	16.6
Requirements of documentation	23.6	21.9	31.9	20.8	1.9
Current political situation	26.4	20.9	22.5	19.8	10.4
Laws relating to buying land / premises / buildings	21.9	19.8	22.3	19.8	16.2
Labor legislation	19.8	24.5	29.6	16.8	9.2
Rules and administrative procedures in opening a company	40.0	25.8	19.8	10.9	3.4
Currency regulations; foreign exchange regime; provisions for different currency transactions	36.0	16.8	10.4	5.3	31.5

3. *SATISFACTION WITH THE QUALITY OF LAWS AND THE BEHAVIOR OF CIVIL SERVANTS*

An important factor in limiting the size and manifestations of the “hidden” economy is the existence of clear business rules and requirements, applied quickly and effectively. At present the majority of businessmen consider such rules to be lacking and that the already existing ones are constantly being changed without guaranteeing the necessary stability and possibility for long-term planning.

It is not surprising that eight out of ten interviewed businessmen are dissatisfied both with the quality of laws and administrative business requirements, as well as with the behavior of civil servants they come in contact with. (Figure 2)

FIGURE 2 **SATISFACTION WITH THE QUALITY OF LAWS AND THE BEHAVIOR OF CIVIL SERVANTS**

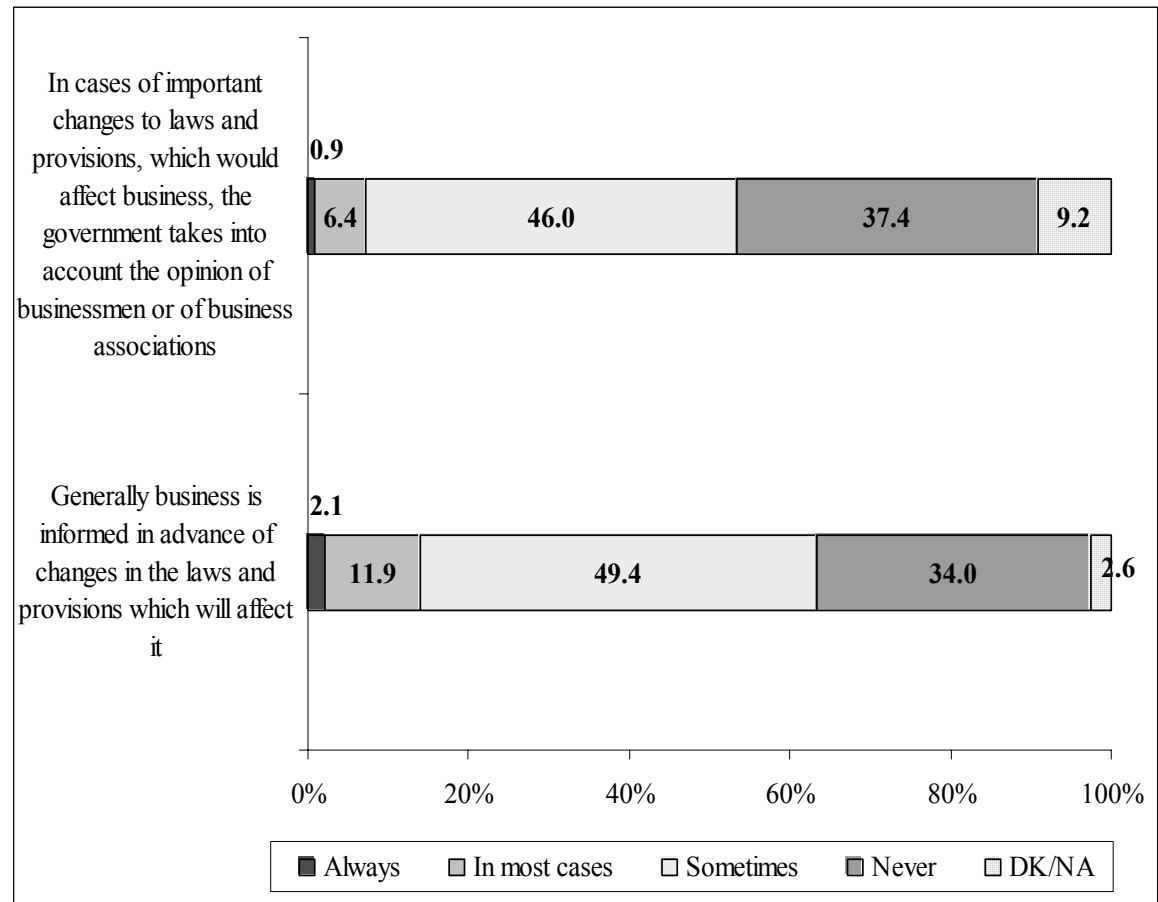


Base: N= 530

Only one quarter of the businessmen believe that they can predict to some extent the changes in provisions and decrees, which significantly affect business. Over two-thirds consider that most of the changes to the laws are unpredictable and impede long-term planning in their business. A significant part of the respondents – more than one third – assess that in the last three years laws and administrative requirements have become less predictable.

Besides the frequent changes in state requirements of business, it is seldom informed in advance of impending changes, which will affect it, and is even less rarely sought as a partner in drafting new legal provisions.
(Figure 3)

FIGURE 3 HOW TRUE DO YOU CONSIDER THE FOLLOWING STATEMENTS TO BE?



Base: N= 530

4. GENERAL ASSESSMENT OF THE BUSINESS CLIMATE IN THE COUNTRY

Besides due to the many administrative obstacles and state interference, the business climate in the country is also defined as unfavorable for the development of private business for its purely economic characteristics – *high interest rates on credits, difficult access to bank credits, uncertainty and lack of confidence in banks.*

One third of the respondents consider that illegal and power methods continue to characterize private business in the country. The influence of power groups in the Bulgarian economy is still big according to 37.2 %. More than one third consider that a considerable part of companies in the country engage in activities linked with the so-called “hidden economy”. (Table 2)

TABLE 2 GENERAL ASSESSMENT OF THE BUSINESS CLIMATE IN THE COUNTRY

Interest rates on credits in Bulgaria are high	53.0
Getting a bank credit in Bulgaria is difficult	52.3
Private business in Bulgaria faces many administrative obstacles	49.2
The influence of power groups in the Bulgarian economy is big	37.2
A considerable part of companies in the country engage in activities linked with the so-called “hidden economy”	36.8
State interference in private business activity in Bulgaria is big	20.0
Banks in Bulgaria are unreliable and do not enjoy great confidence	19.8
The state administration in Bulgaria is independent and not affected by private economic interests	4.0
The police in Bulgaria effectively defends the security of companies	3.2
In Bulgaria today there are favorable conditions for the development of private business	2.6
The economic situation in the country will improve in the coming year	2.3
The tax system in Bulgaria is good and stimulates the development of business	1.7
The economic policy, pursued by the government, encourages the development of private business	1.3
The statutory framework for private business activity in Bulgaria is good	1.3

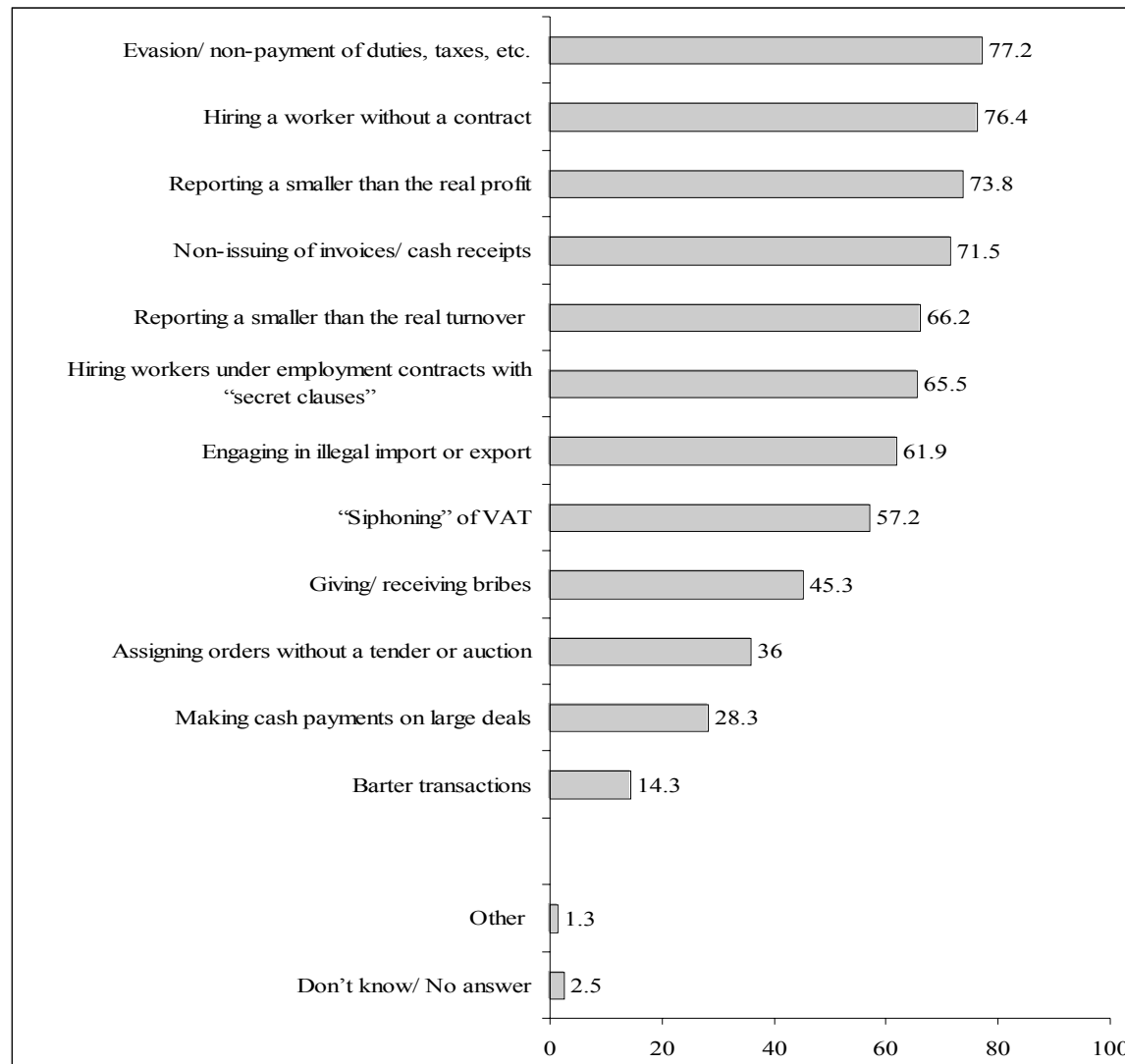
II. GENERAL ASSESSMENT OF THE SIZE AND REASONS FOR THE EXISTENCE OF THE “HIDDEN” ECONOMY

I. MANIFESTATIONS OF THE “HIDDEN” ECONOMY

The concept of “hidden economy” is mostly linked with *unreported incomes, unpaid duties and excise, employing workers without a contract or under a contract with “secret clauses”, reporting a smaller than the real profit and non-issuing of invoices/cash receipts.*

Engaging in illegal import / export, the “siphoning” of VAT and corruption are also cited as widespread manifestations of the “hidden” economy. (Figure 4)

FIGURE 4 MANIFESTATIONS OF “HIDDEN” ECONOMY

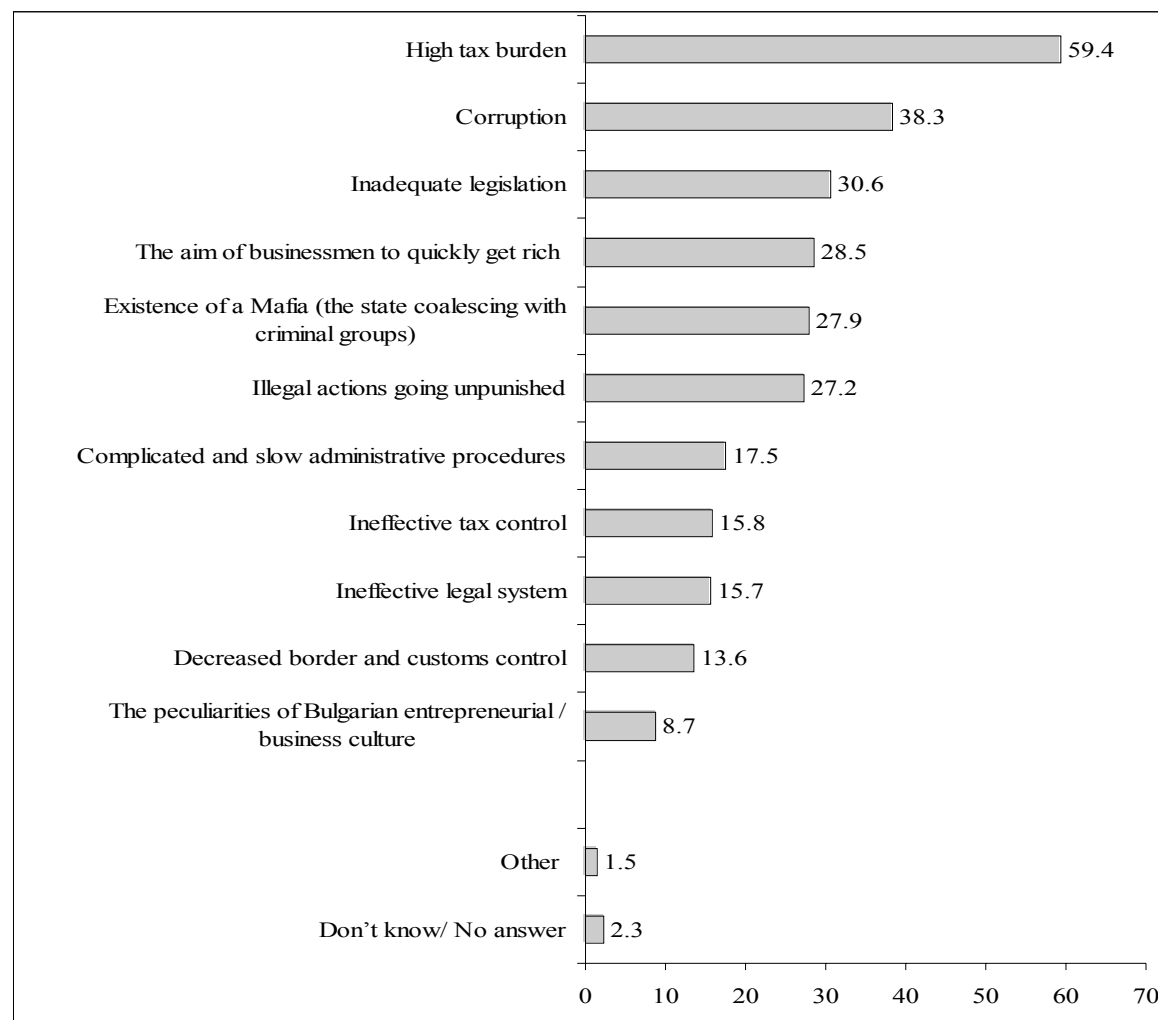


Base: N= 530

2. REASONS FOR THE EXISTENCE OF
“HIDDEN” ECONOMY

The *high tax burden* is categorically cited as the most significant reason for the existence of “hidden” economy in the country. Combined with *corruption and inadequate legislation*, it creates a favorable environment for the flourishing of illegal activities. (Figure 5)

FIGURE 5 REASONS FOR THE EXISTENCE OF “HIDDEN” ECONOMY



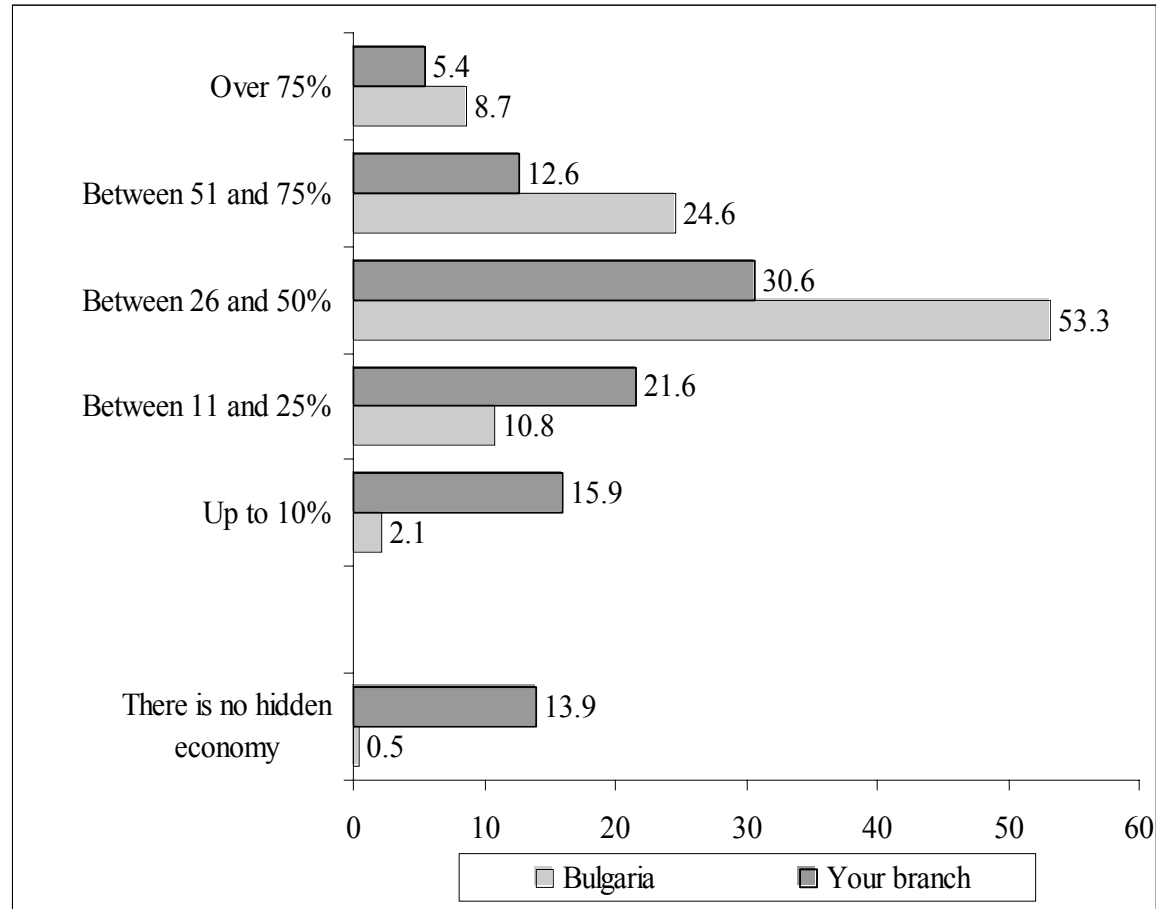
Base: N= 530

3. GENERAL ASSESSMENT OF THE SHARE OF THE “HIDDEN” ECONOMY

The assessment of the share of the “hidden” economy in the country is alarmingly high – one third of the respondents consider that over 50% of the economy is in the “gray” sector, and every one in two believes that the size of unreported economic activity varies from 26 to 50%.

Generally speaking, the assessment of the share of the “hidden” economy in the country is almost twice higher than that of the different sectors. In contrast to the general assessment, a significant part of the respondents - 13.9% - state that there are no manifestations of “hidden” economy in their branch. (Figure 6)

FIGURE 6 GENERAL ASSESSMENT OF THE SHARE OF THE “HIDDEN” ECONOMY

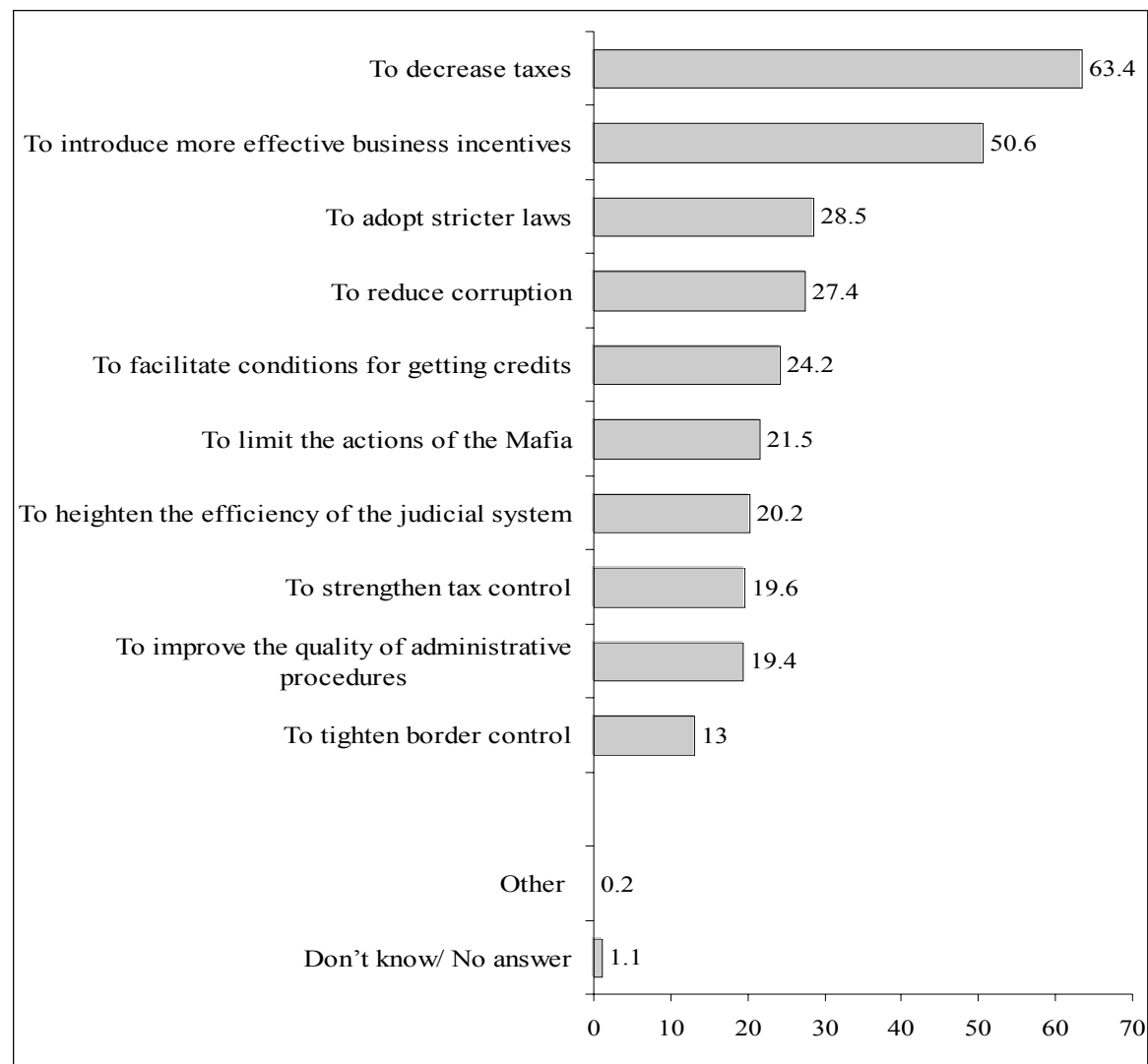


Base: N= 530

4. MEASURES FOR LIMITING THE “HIDDEN” ECONOMY IN THE COUNTRY

The measures for limiting the “hidden” economy proposed by the respondents again gravitate around the already mentioned problems facing the development of business in the country. Almost two-thirds of the respondents consider that *taxes should be reduced*, and every one in two that *more effective business incentives should be introduced*. The adoption of *stricter laws and reducing the level of corruption* would also have a positive effect according to more than one fourth of the respondents. (Figure 7)

FIGURE 7 MEASURES FOR LIMITING THE “HIDDEN” ECONOMY IN THE COUNTRY



Base: N= 530

III. SPREAD OF THE SPECIFIC MANIFESTATIONS OF THE “HIDDEN” ECONOMY

1. LABOR RELATIONS

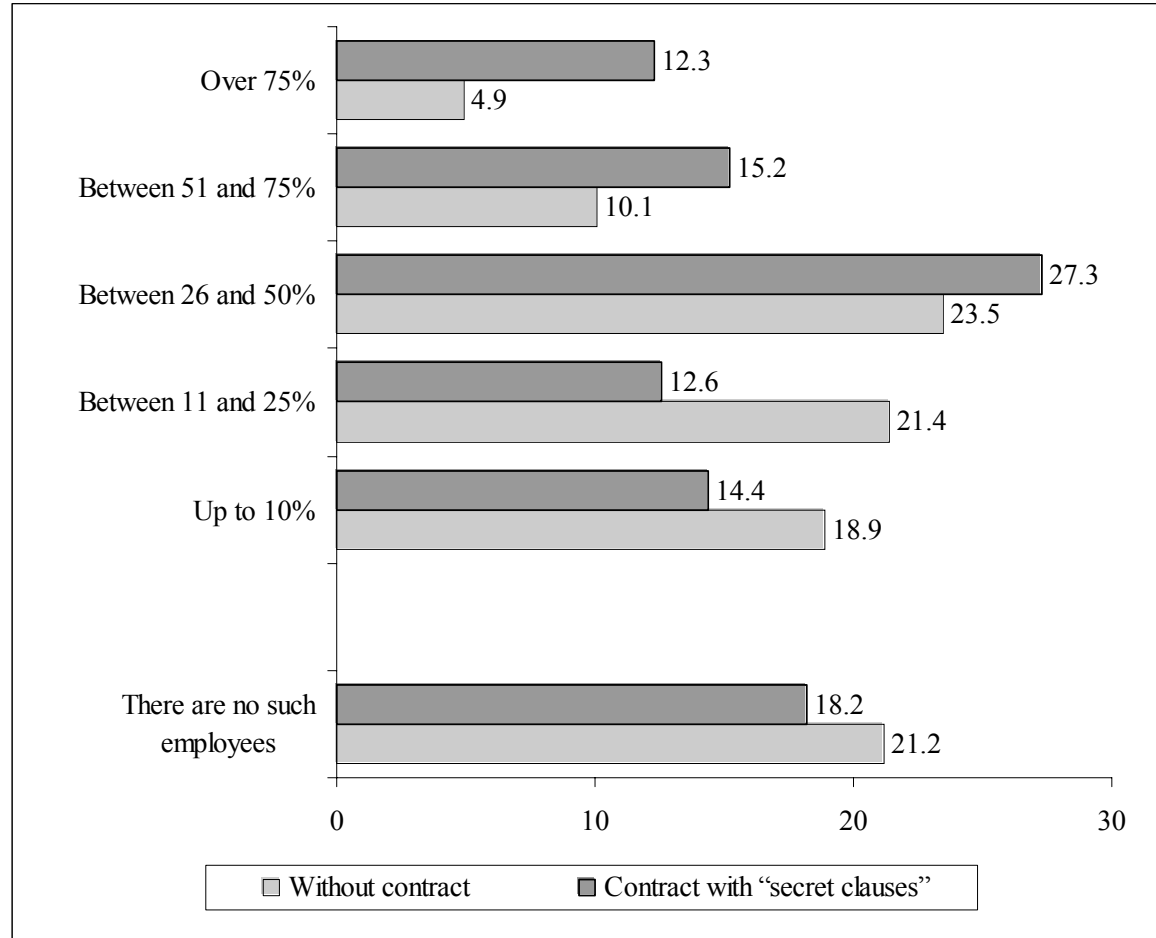
SHARE OF EMPLOYEES WITHOUT CONTRACT OR UNDER A CONTRACT WITH “SECRET CLAUSES” IN THE RESPECTIVE BRANCH

One of the most frequent manifestations of the “hidden” economy is to hire workers without employment contracts or under contracts, which do not conform to the actual labor remuneration. According to 15.2% of the respondents, the share of employees without employment contracts in their branch exceeds 50%, and one quarter considers it to be between 25 и 50%.

Every one in four believes that more than half of the employees in his branch are working under contracts with “secret clauses” – i.e. smaller social security and health insurance contributions are paid than applicable to their real labor remuneration, additional remuneration is paid without documents, etc. (Figure 8)

Although these statements express subjective assessments and only approximately reflect real labor relations, they testify to a very high level of “graying” of the job market in the country.

FIGURE 8 SHARE OF EMPLOYEES WITHOUT CONTRACT OR UNDER A CONTRACT WITH “SECRET CLAUSES” IN THE RESPECTIVE BRANCH



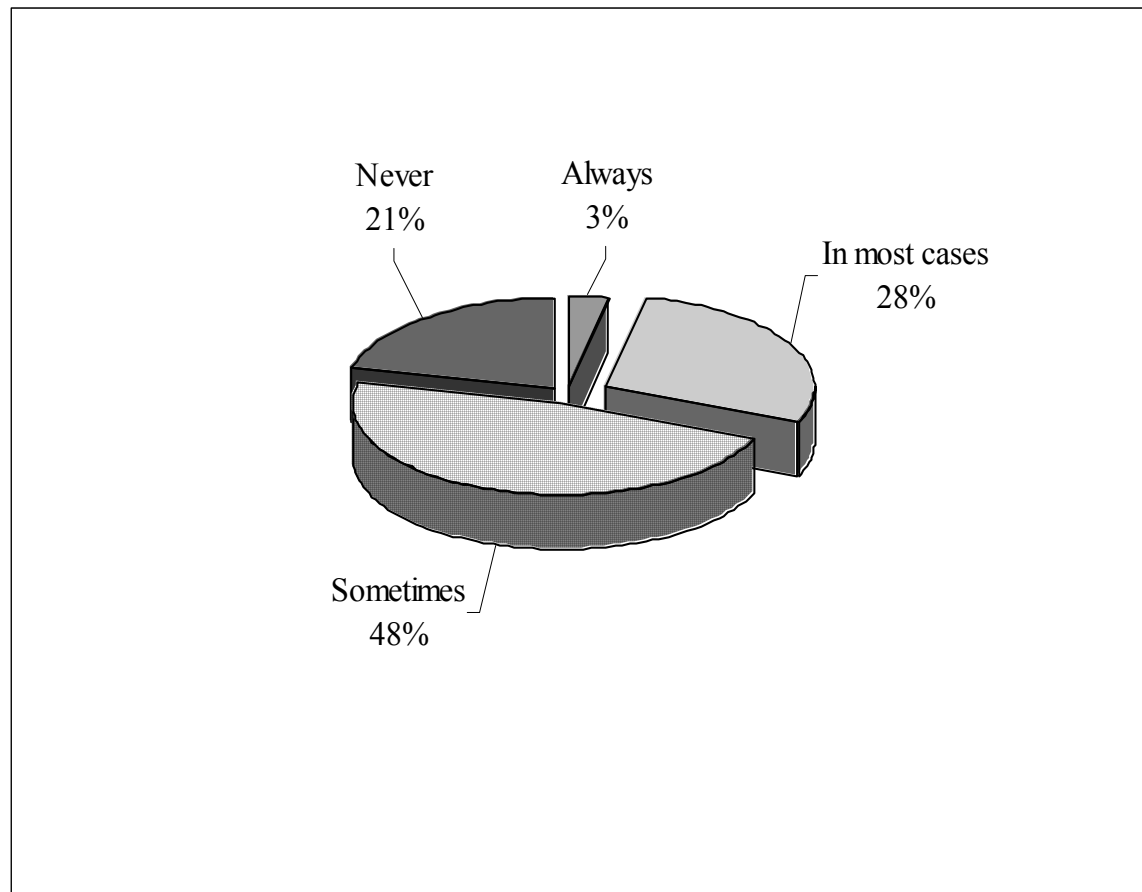
Base: N= 530

2. "SUPPRESSED" TURNOVER

1) NON-ISSUING OF TAX RECEIPTS FOR CERTAIN SALES IN THE RESPECTIVE BRANCH

The non-issuing of documents of account – cash receipts and invoices – is frequent practice in business relations. One in four respondents states that no tax receipts are issued in his branch in most cases. (Figure 9)

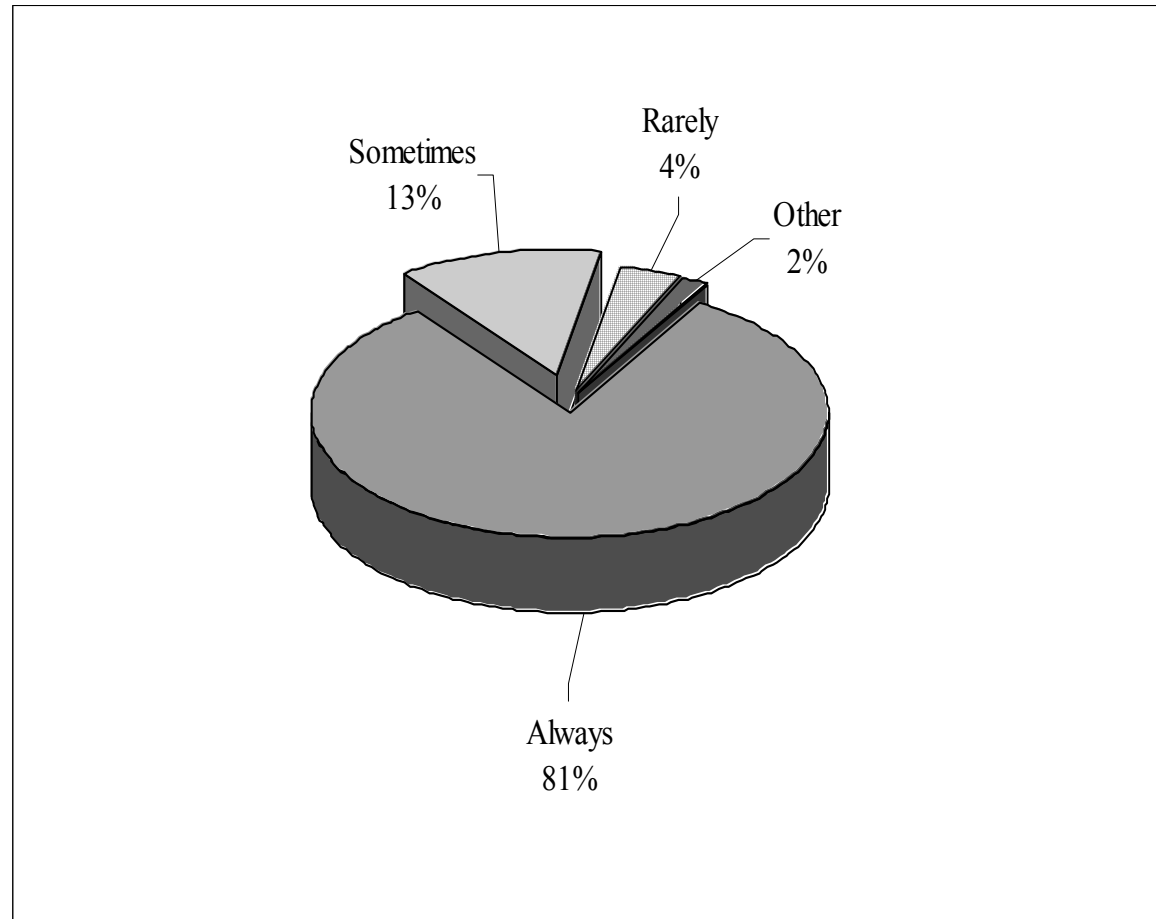
FIGURE 9 FREQUENCY OF NON-ISSUING OF INVOICES/ CASH RECEIPTS



Base: N= 530

In turn, the interviewed businessmen claim that their companies require documents of account when working with another company – over three-quarters of the respondents state that they do so in all cases. (Figure 10)

FIGURE 10 FREQUENCY OF REQUESTING DOCUMENTS OF ACCOUNT



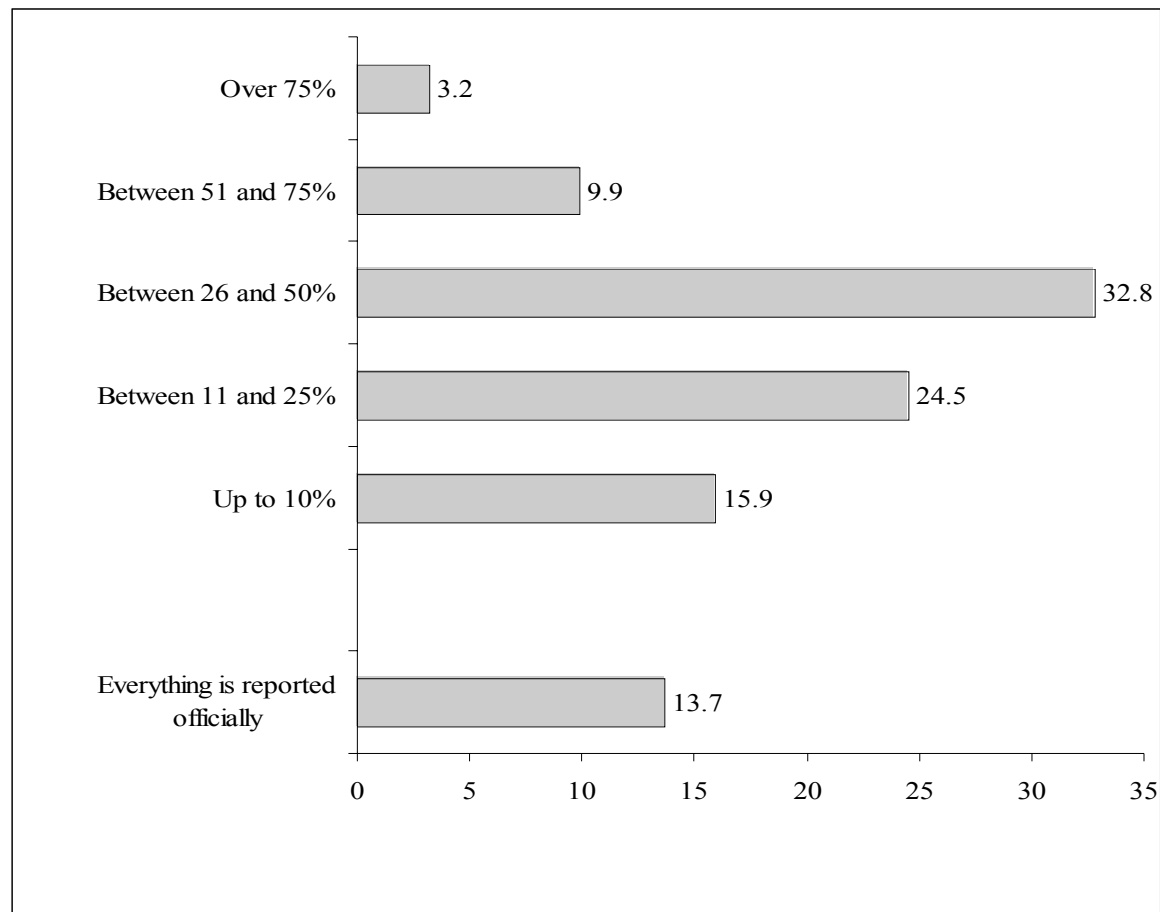
Base: N= 530

2) *REPORTING LOWER THAN THE REAL
TURNOVER IN THE RESPECTIVE BRANCH*

Declaring *lower than the real turnover* is one of the most widespread manifestations of “hidden” economy in the business sector.

Every other company does not officially report between 11 and 50% of its real turnover. (Figure 11)

FIGURE 11 SHARE OF TURNOVER NOT REPORTED OFFICIALLY



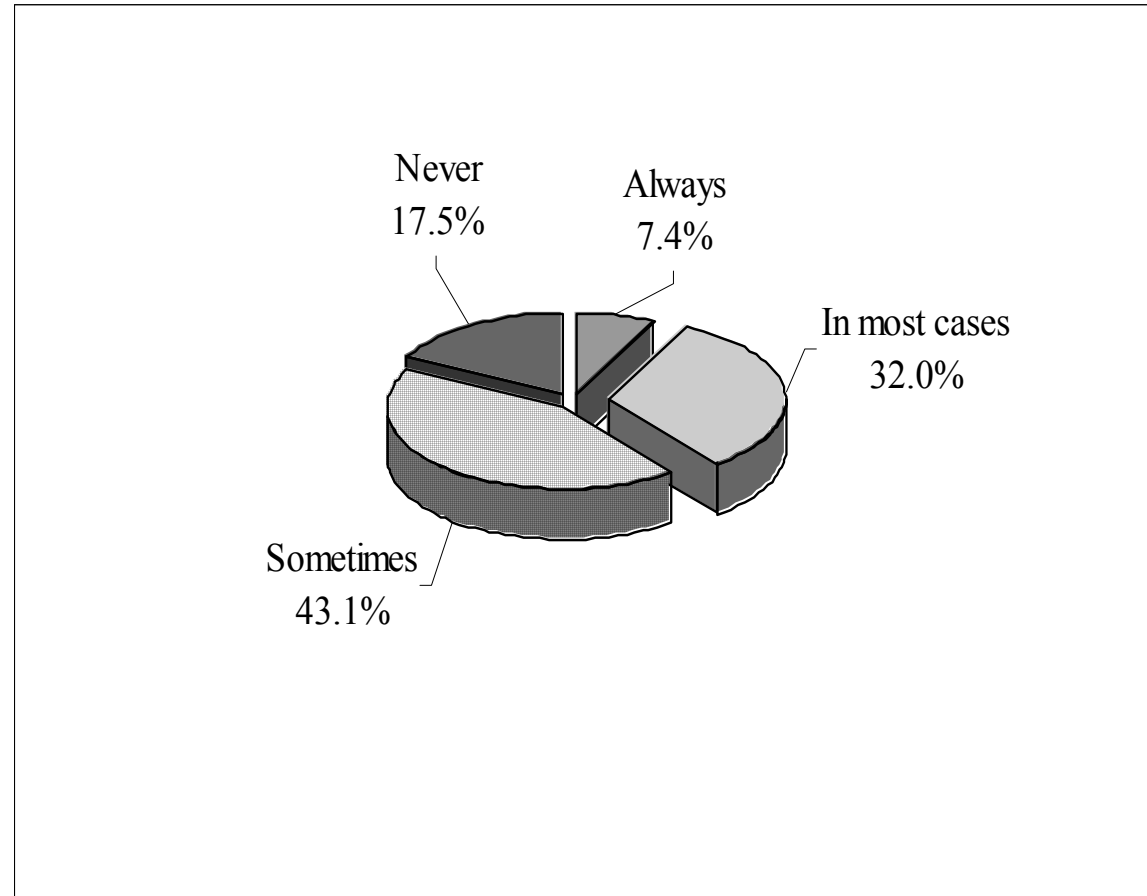
Base: N= 530

3) *REPORTING SMALLER THAN THE REAL PROFIT IN THE RESPECTIVE BRANCH*

Besides concealing their real turnover, companies very often also report a smaller profit than the real one. Four out of ten companies do so sometimes, and nearly one third in most cases.

Only 17.5% state that they never conceal their real profit. (Figure 12)

FIGURE 12 REPORTING SMALLER THAN THE REAL PROFIT



Base: N= 530

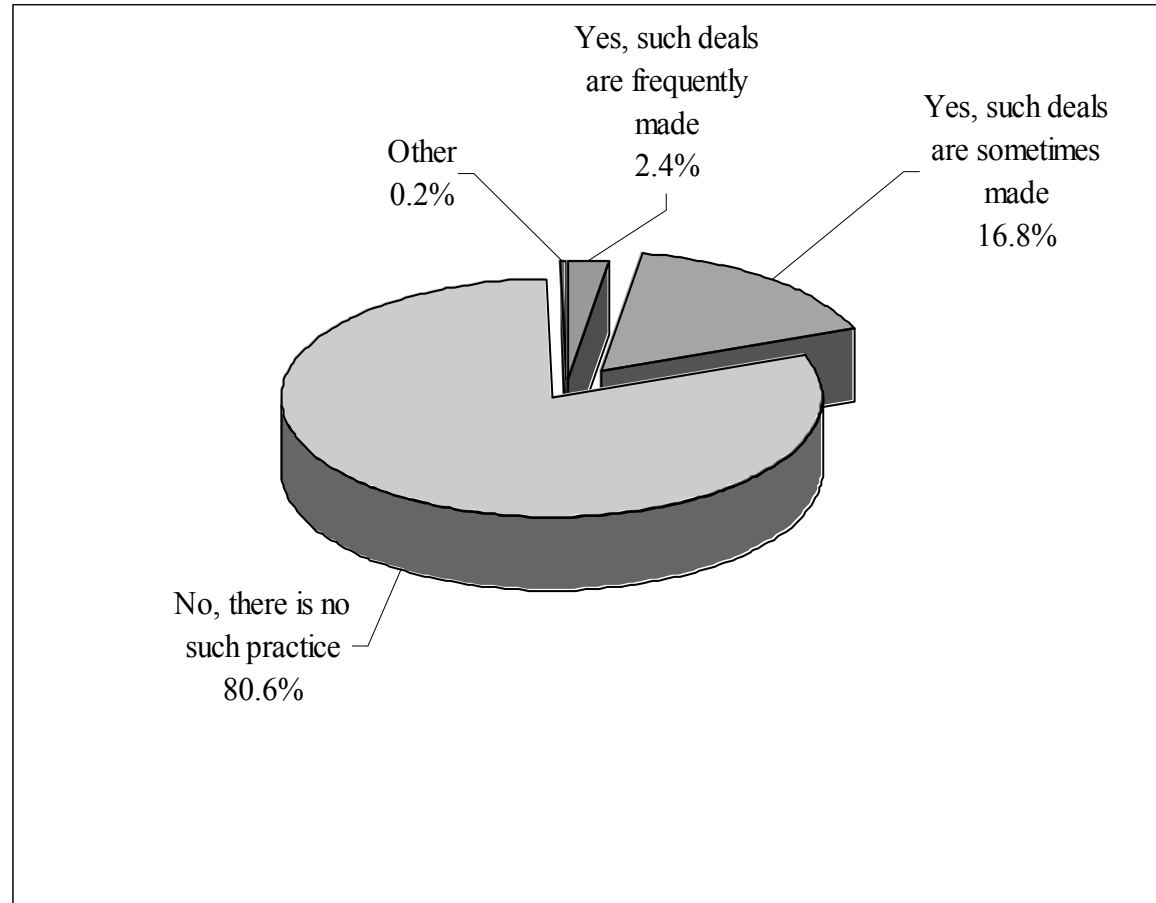
4) *FREQUENCY OF BARTER DEALS IN THE RESPECTIVE BRANCH*

Striking *barter deals* is not a frequent phenomenon in the country's business sector. *Eight out of ten companies do not make such deals.*

Nevertheless, part of the respondents - 17% - reply that they sometimes make barter deals, and for 2% this is common practice.

(Figure 13)

FIGURE 13 BARTER DEALS



Base: N= 530

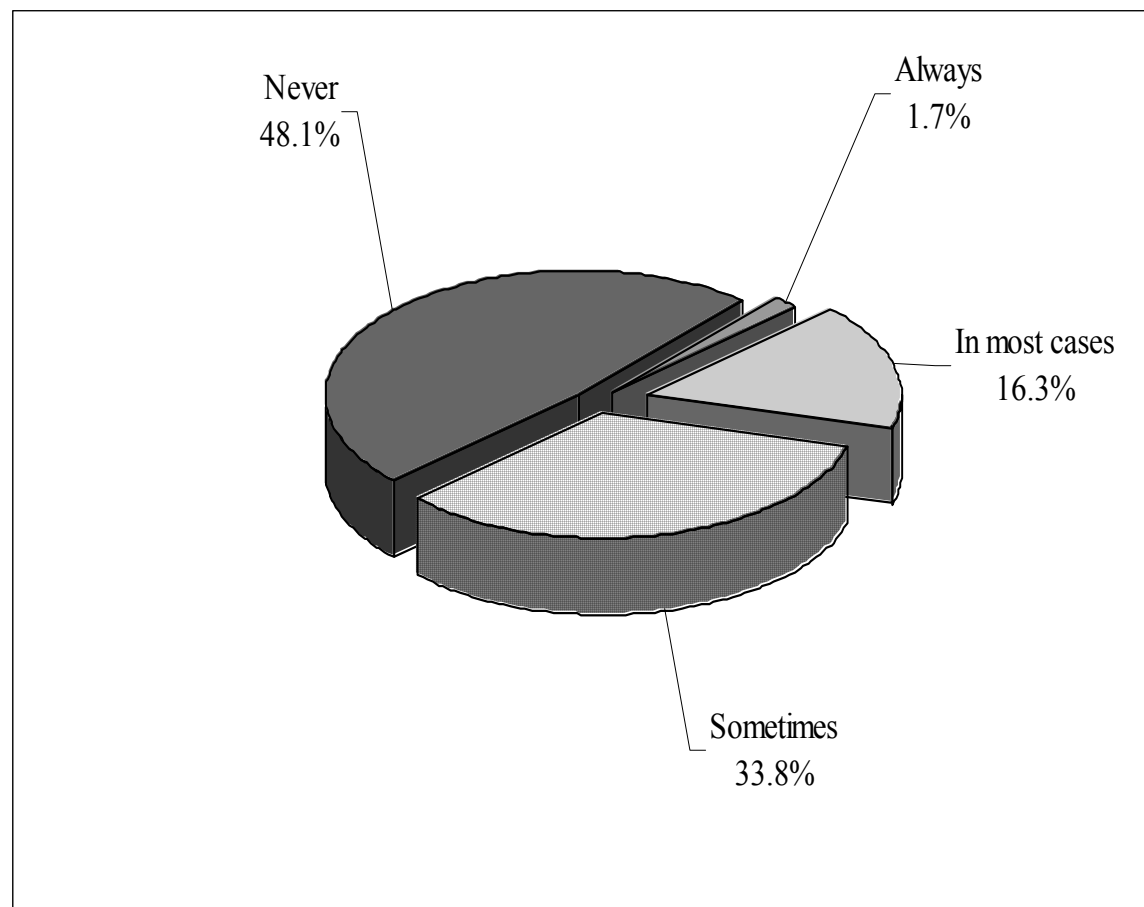
5) *ILLEGAL IMPORT/ EXPORT IN THE RESPECTIVE BRANCH*

Import and export of goods and materials is realized by a relatively small part of the surveyed companies. Only 15.7% of them import prime and raw materials for their work, and 11% export some of the goods produced by them.

According to the subjective assessment of almost half the respondents *there is no illegal import or export in their branch*, which is largely due to the relatively low share of companies engaged in foreign trade operations. One third of the respondents consider that this aspect of the “hidden” economy is manifested occasionally, and according to 16.3% the phenomenon is characteristic in most cases.

(Figure 14)

FIGURE 14 FREQUENCY OF ILLEGAL IMPORT / EXPORT IN THE RESPECTIVE BRANCH



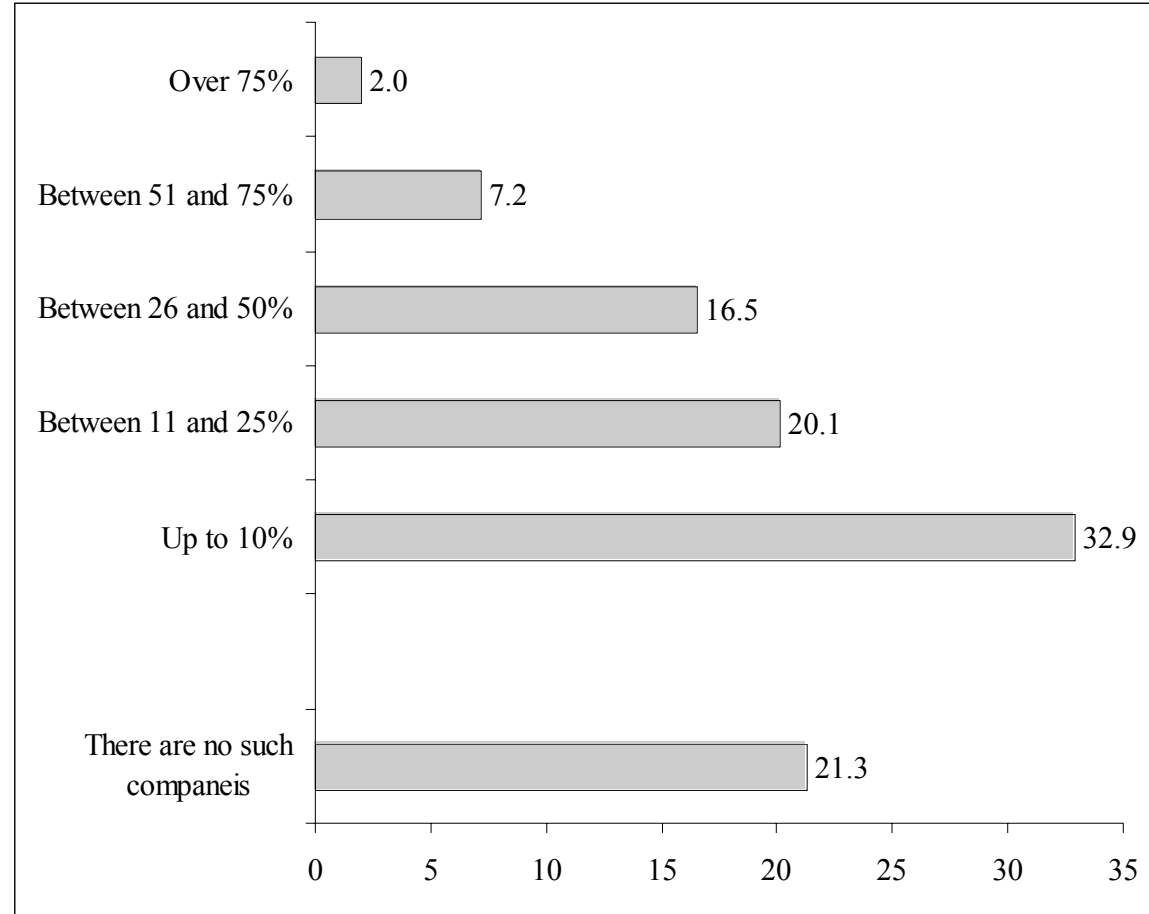
Base: N= 530

6) *USE OF PROTECTION IN SETTLING TAX AND ADMINISTRATIVE RELATIONS IN THE RESPECTIVE BRANCH*

It may be said that the use of protection by companies for settling their tax, statutory and administrative relations is not a widespread practice – more than half the respondents consider that there are no such companies in their branch, and if there are, that their share does not exceed 10%.

Nevertheless more than one quarter of the interviewed businessmen state that the share of companies using different forms of protection is between 11 and 50%. (Figure 15)

FIGURE 15 SHARE OF COMPANIES IN THE BRANCH WHICH USE PROTECTION/ AN “UMBRELLA” TO SETTLE THEIR TAX, STATUTORY AND ADMINISTRATIVE RELATIONS



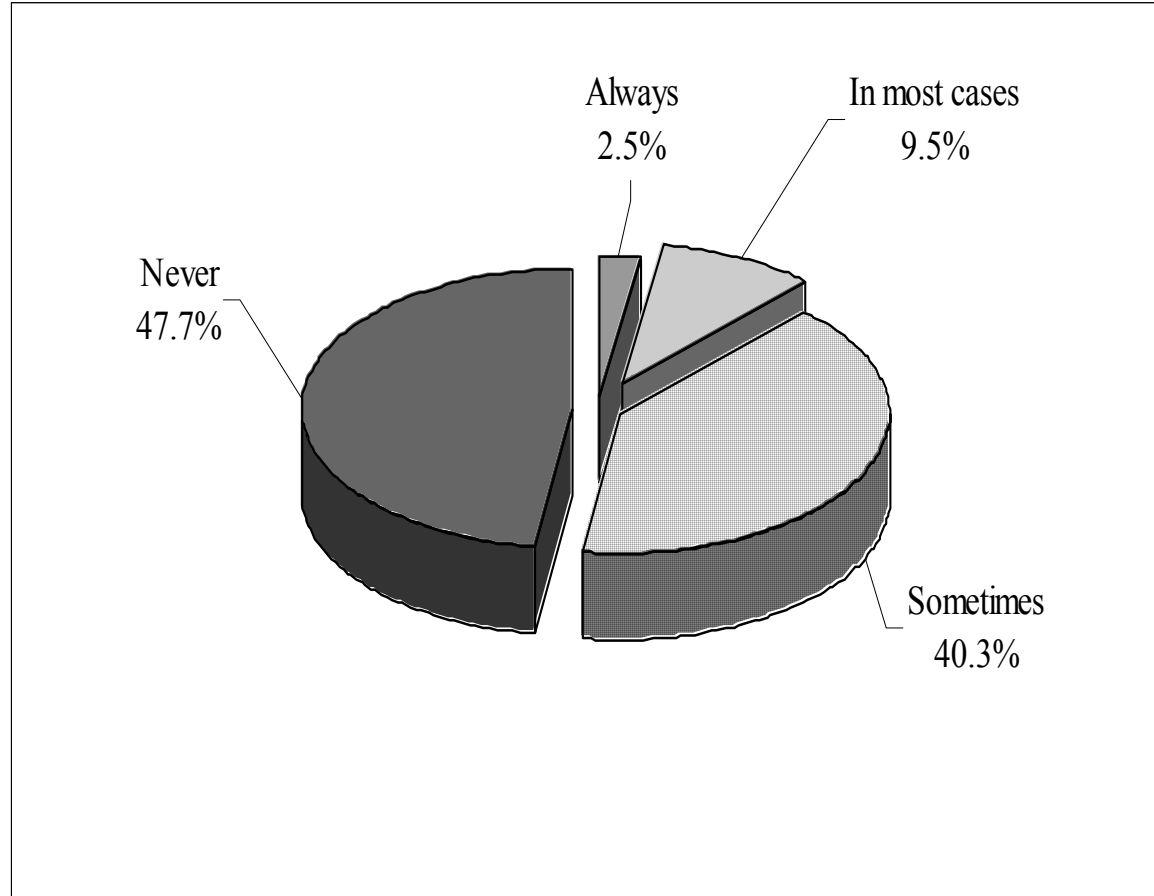
Base: N= 530

7) "SIPHONING VAT" IN THE RESPECTIVE BRANCH

Every other respondent believes that the companies in his branch do not resort to "siphoning VAT" through accounting tricks.

Four in ten respondents state that such cases occur sometimes, and for 12% this is common practice to which they resort always or in most cases. (Figure 16)

FIGURE 16 FREQUENCY OF "SIPHONING VAT" BY COMPANIES IN THE RESPECTIVE BRANCH



Base: N= 530

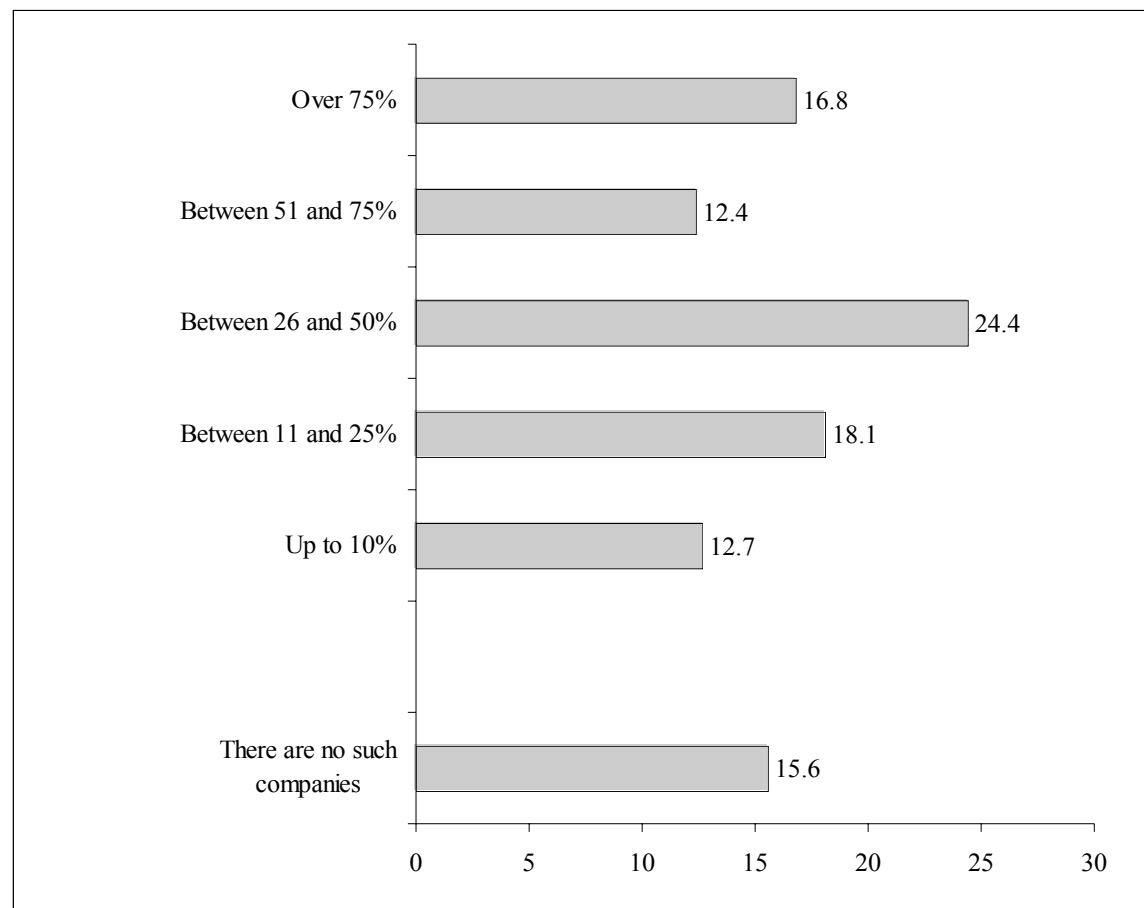
3. REDISTRIBUTION

EVASION/ NON-PAYMENT OF TAXES, DUTIES, EXCISE IN THE RESPECTIVE BRANCH

The payment of lower taxes is frequent practice in Bulgarian business – *three out of ten companies do so whenever they can, and 41% - sometimes.*

According to one quarter of the respondents, more than half the companies in the respective branch conceal part of the due taxes and duties through accounting tricks. (*Figure 17*)

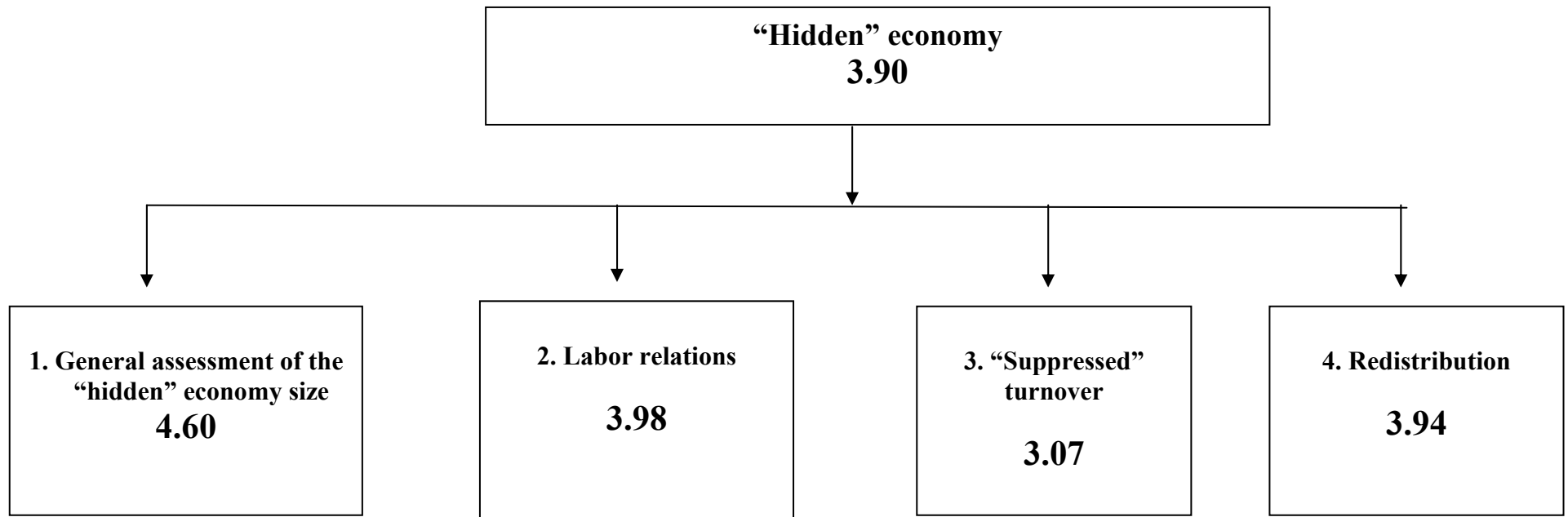
FIGURE 17 SHARE OF THE COMPANIES, WHICH EVADE/ DO NOT PAY TAXES, DUTIES, EXCISE IN THE RESPECTIVE BRANCH



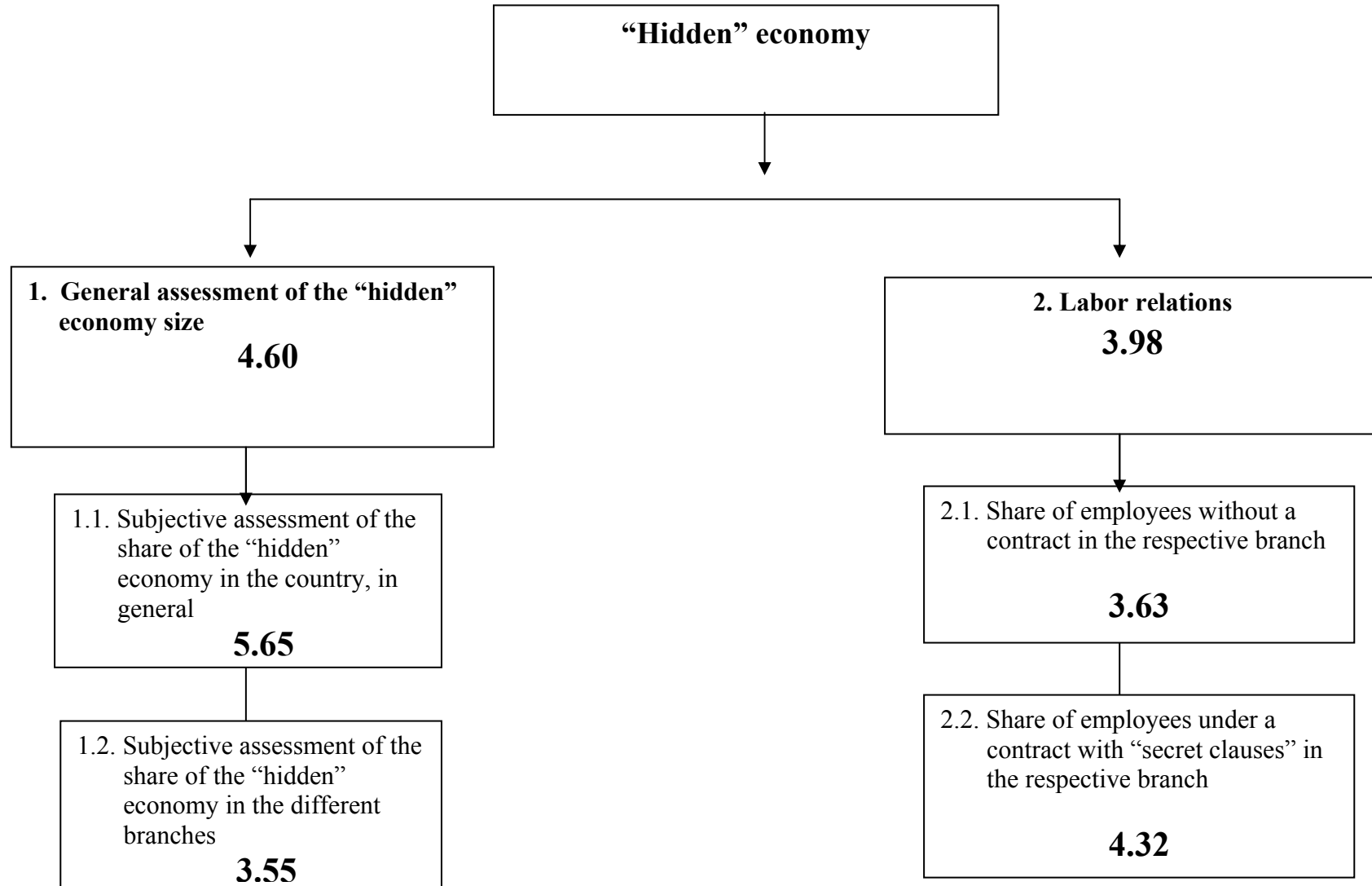
Base: N = 530

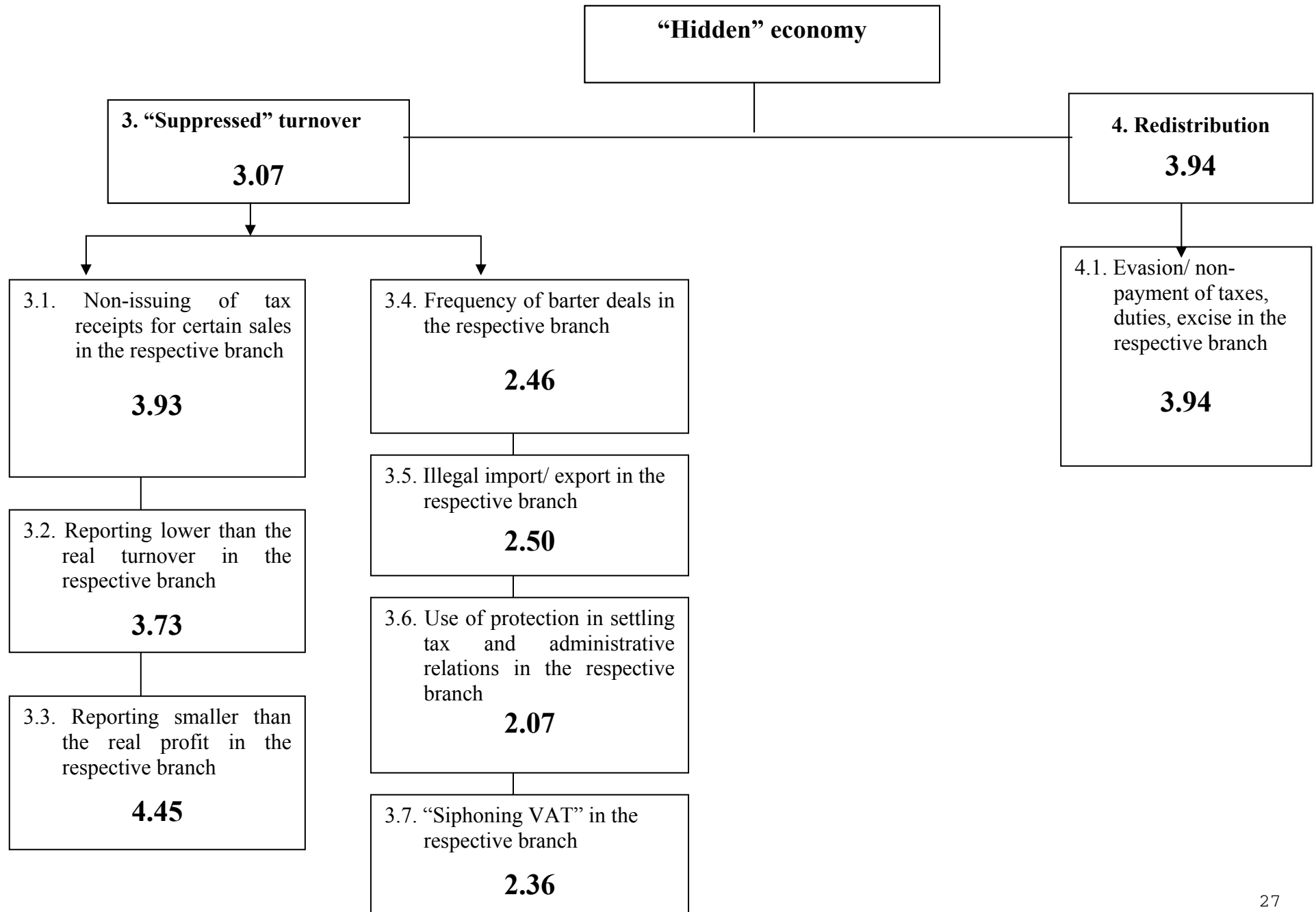
APPENDIX. "HIDDEN" ECONOMY INDICES VALUES

I. GENERAL INDEX STRUCTURE



II. STRUCTURE AND VALUES OF THE “HIDDEN” ECONOMY INDICES





Vitosha Research (VR) is a social and market research agency. It has been established as a result of the development of the Sociological program of the Center for the Study of Democracy and started its work in 1989.

Vitosha Research is specialized in carrying out social and market research in the fields of corruption and crime, social policies, economic, political and electoral behaviour, privatization, value orientations and attitudes of Bulgarians, public opinion studies, surveys of media audiences and programs, advertising and market research and others.



5, Alexander Zhendov Street
1113 Sofia
Tel.: 971 3000
Fax: 971 2233
E-mail: vr@online.bg
<http://www.online.bg/vr>
<http://www.online.bg/coalition2000>