

3. UNDECLARED WORK IN BULGARIA: TRENDS AND CHALLENGES TO PUBLIC POLICIES

Bulgaria's accession to the European Union provided a new context for the assessments of the hidden economy and undeclared work/employment. The factors determining the scope of and the effects from the hidden economy are increasingly international. The efficiency of the national initiatives to limit the hidden economy and undeclared work/employment are becoming more and more dependent on coordinated international efforts. This calls for a new approach to measuring and estimating these phenomena, which is based on a **unified European standard allowing for credible international comparisons**. The collection of credible empirical data on the structure, size, and the dynamics of undeclared work is a prerequisite for assessing policies and activities on its restriction, and will contribute to the effectiveness of policies.

3.1. UNDECLARED WORK – DEFINITIONS AND METHODS FOR ASSESSMENT

Undeclared work is one of the most important and socially significant aspects of hidden economy. Still, even within the European Union, **there is no unified terminology and accepted definition of undeclared work**. For example, the National Reform Programs of EU Member States use many similar concepts:

- *Undeclared work* in Denmark, Austria, Greece, Finland, Cyprus, and Estonia;
- *Undeclared employment* in Latvia and Hungary;
- *Unregistered employment* in Poland;
- *Illegal work* in Lithuania, Slovakia, France, and Sweden;
- *Illegitimate employment* in Malta and others.

This plethora of concepts reflects two discerning criteria of hidden employment – whether or not it is legal and/or reported. It is common that the terms *work* and *employment* are used interchangeably reflecting two aspects of the hidden economic activity. The term *work*, as a rule, refers to the activity, whereas *employment* to the people who do it. Thus, these two terms will be used interchangeably in the analysis to follow. Following the logic when defining hidden economy, **three basic segments of hidden work/employment** can be discerned to aid a more precise definition.

- **Informal work/employment.** This term stands for work that is legal yet not officially reported. Examples of informal employment could be working at one's own farm, when the produce is not intended for the market; domestic labor and work done at home; voluntary labor among friends, neighbors, or relatives; the labor of people, who define themselves as economically inactive

(unemployed, retirees, housewives, students), but work without a contract; and others.

- **Illegal work/employment within the black economy.** This concept encompasses all people engaged in the production of commodities and activities prohibited by the law. This includes people engaged in illegal economic organizations, who have no permission to perform certain activities. Examples of the illegal work include drug production and trade, trafficking people and arms, smuggling activities, illegal gambling and prostitution, and others. In the 1980s, the International Labor Organization (ILO) defined illegal employment as “employment, which does not comply with the requirements of national laws, regulations and practice” (ILO, 1984). Although the scope of illegal economic activity and the associated incomes are significant, they are not officially reported.
- **Undeclared work/employment within the gray economy.** This term includes employment that is legal, yet not declared to state authorities. Thus, undeclared employment is related to the avoidance of paying taxes, social security, or healthcare security. The evasion of income taxes, social security, and healthcare security payments is the basis of the unregistered economic activity.

Different definitions of undeclared work/employment have been proposed. The Organization for Economic Co-operation and Development (OECD) defines hidden employment as work that “although not illegal in itself, has not been declared to one or more administrative authorities” (OECD, 2004). **The European Commission describes undeclared work** as “any paid activities that are lawful as regards their nature but not declared to the public authorities, taking into account differences in the regulatory systems of Member States. This definition excludes criminal activities and work which does not have to be declared.”⁴¹ The definition of the EC was used for the development of a special employment strategy for transforming undeclared work into regular employment, which then re-affirmed the goals of the *European Employment Strategy*.⁴² The same definition is used in a number of publications by European organizations, such as the report “Undeclared Work in an Enlarged Union” (Renooy et al., 2004).

Approaches to measuring hidden employment are based on the estimates of different indicators – share of the labor force engaged in gray, black, and/or informal economy; working hours spent on hidden labor activities; undeclared incomes from hidden economic activity; and others. Most frequently, data about official and hidden employment are compiled through Work Force Surveys (WFS), the SNA, business statistics (of enterprises), and representative surveys of the population and business. **The hidden employment is estimated as the difference between the officially reported and the actual level of employment in a national economy.** This difference is seen as a result of hidden economic activities,

⁴¹ Communication of the European Commission on undeclared work, April 7, 1998, COM(98) 219 – not published in the Official Journal of the EU.

⁴² The 2003 Council resolution on transforming undeclared work into regular employment aimed at strengthening employment guideline 9 (2003 – 2005) and guideline 20 (2005 – 2008) on the transformation of undeclared work into regular employment in the framework of the European Employment Strategy (EES).

undeclared work places, and unreported employment activities. Data from other countries with a similar level of economic development and analogous economic structure serve as a base for determining the actual number and share of the employed. National employment data for previous years is also used in dynamic series. The possibility that the economically active population, whose employment is officially registered, can be involved simultaneously in undeclared work activities should be taken into account. Some countries (e.g., Slovenia, Poland, Lithuania, Romania, and others) use the so-called *Italian method* to assess the actual employment through sampling surveys, which are then compared with other sources of employment data (e.g., official observations of the workforce and/or the census). As of 2002, the Bulgarian NSI is using a system of indicators (e.g., the structure of wages by occupation, maintenance of the work force, time spent working, and others) to additionally assess the size of the hidden employment.

3.2. POLICIES TO LIMIT UNDECLARED WORK – SUCCESSSES AND CHALLENGES

Over the past twenty years, **undeclared work is emerging as an increasingly important element of employment policies, necessitating the adoption of effective measures for transforming undeclared into regular employment.** The European Union focused its attention on undeclared work in 1993 in the *White Paper on Growth, Competitiveness, and Employment*. A Communication of the Commission in 1998⁴³ analyzes the economic reasons that motivate employers, workers, and self-employed individuals to participate in the hidden economy. In 2003, the Council of the European Union passed a resolution on undeclared work,⁴⁴ which called upon Member States to work in cooperation to limit the phenomenon. The resolution emphasized the role of social partners, whose joint efforts will contribute to transforming undeclared work into legal/registered employment. In 2003, EU's guidelines on employment⁴⁵ include recommendations to Member States on how to develop and apply a wide range of measures and initiatives to limit undeclared work. These measures include improving the business environment, simplifying administrative procedures, developing tax incentives for operating within the official economy, restricting factors that bring about undeclared work, as well as enforcing compliance with the law and imposing serious sanctions for non-compliance. A wider use of incentives and preventive measures in reducing undeclared work is recommended by the consecutive Communication of the Commission on undeclared work.⁴⁶

⁴³ European Commission, Communication of the Commission on undeclared work, COM (98) 219, http://europa.eu.int/comm/employment_social/employment_analysis/work/com98_219_en.pdf.

⁴⁴ Council of the European Union, Resolution on transforming undeclared work into regular employment, Official Journal of the European Union, C260, October 2003, http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/c_260/c_26020031029en00010003.pdf.

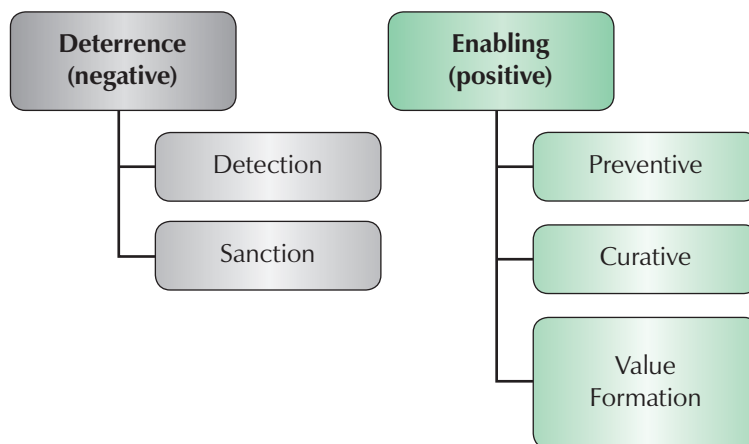
⁴⁵ Council Decision of 22 July 2003 on guidelines for the employment policies of the Member States (2003/578/EC).

⁴⁶ European Commission, Communication of the Commission on undeclared work "Stepping up the fight against undeclared work", COM (2007) 628.

3.2.1. Measures for Counteracting Undeclared Work in the EU

EU Member States have proposed and tested a number of concrete measures to limit undeclared work (see, for example: European Employment Observatory, 2004 and 2007, Renooy et al., 2004, Williams and Renooy, 2007). Generally, **two main approaches and types of interventions** can be distinguished – deterrence and enabling. They have been analyzed and interpreted differently by different authors: *deterrence vs. tax morale* (Ahmed and Braithwaite, 2005); *deterrence vs. enabling* (Williams, 2006); *a model of deterrence vs. a model of compliance* (Murphy, 2005, 2008); and others. The first approach focuses on the exposure and punishment of undeclared employment instances, while the second approach stresses on the provision of conditions and stimuli for compliance with the law, registering economic activity, and paying taxes and social security. So far, the administrative practice is traditionally dominated by the first approach; however, the second approach has been utilized more and more frequently in recent years.

Figure 14. Approaches to and Types of Measures for Counteracting Undeclared Employment



Source: Center for the Study of Democracy using of Williams and Renooy (2007), 2011.

The latter provides a context to the logic behind and the content of adopted measures, which use these two approaches:

- **Precluding law violations** related to undeclared employment. The logic of this approach is that economically rational individuals evade tax and social security payments when the benefits from these actions exceed the anticipated losses in case of exposure and punishment of the illegitimate behavior. The purpose of these types of measures is to increase the probability of establishing violations, while also increasing the sanctions. These actions would make the non-registration of work and the concealment of payments to the state disadvantageous to economically-rational individuals (see, for example, Bardach and

Kagan, 1982, Milliron and Toy, 1988, Gramsick and Bursik, 1990, Hasseldine and Li, 1999, Dodd and Hutter, 2000, Richardson and Sawyer, 2001, Job and Honaker, 2003). This approach could be defined as a “negative” imposition of compliance with the law, hindering, and restricting illegitimate behavior. Among the most frequently used measures of this type are:

- A. Measures to **expose undeclared employment**, aimed at increasing the efficiency of inspections. Such a measure is, for example, the registration of all employees and employment contracts signed. Another possibility is introducing photo-IDs/personal identification cards. Yet another way for advancing the activities of control organs is perfecting their strategic and operational coordination, as well as the data exchange between different inspection agencies. New coordinating institutions are being established to serve as connecting elements between labor inspectorates, tax and duties services, social security institutions, and others. In some countries, in order to facilitate the exposure of unregistered work (especially in the service sector), consumers are obliged to keep their receipts or other documents verifying payments for commodities or services (e.g., construction, repairs, maintenance, and others). In addition, international organizations were founded (e.g., the European Network against Undeclared Work, which includes public institutions in Belgium, Germany, Italy, Romania, and France) to support the exchange of experience and expertise in policies and measures counteracting undeclared employment.
- B. Measures to **sanction undeclared employment**. Most commonly, these measures entail serious sanctions for uncovered instances of undeclared employment, of employing workers without a contract, of non-registration of the employed and the signed contracts, and others. In some Member States (e.g., Finland), companies hiring subcontractors are to ensure that the subcontractor is registered in the registry of employers and the tax register (including the VAT register). It is also required that the subcontractor has no unpaid tax or social security obligations, and that the subcontractor abides by the legal work standards and collective labor agreements. Contractors not complying with these obligations are fined according to the seriousness of their violation.

Critics of deterrence measures argue that **there is no reliable evidence of these measures’ effectiveness** (Williams, 2001, Feld and Frey, 2002, Chang and Lai, 2004, Murphy, 2008, and others). It is argued that these measures may increase the unwillingness of individuals or businesses to abide by the law, while potentially encouraging the creativity in violations. These measures, it is argued, may also hinder the voluntary cooperation between state institutions and economic entities. In addition, these measures are often related to high expenses for uncovering and sanctioning the offenders. This is why in the last few years a greater attention is paid to the second, “positive”, approach to restricting undeclared employment.

- **Stimulating compliance with the law**, declaring employment, and paying tax and social security obligations. In the last few years, this approach gained popularity and attracted a number of supporters (see, for example, Slemrod,

1992, Renooy et al, 2004, Williams, 2006). It takes into account not only the short-term economic rationality, but also the willingness of social actors to observe “the rules of the game”, thus their long-term interests (Kagan and Scholz, 1984, Murphy, 2008). In this case, the aim is to support willingness and facilitate law-abiding behavior, which in many cases seems to be more efficient than imposing sanctions. The role of the public institutions and the state administration is not so much in punishing “bad” behavior, but rather in providing accessible and adequate services to encourage a voluntary compliance with regulations. “Positive” measures may have different features:

- A. Measures **to prevent undeclared employment**. These measures can be aimed at simplification of the regulatory requirements and procedures; providing direct and indirect tax incentives; introducing new categories of legal employment; providing expertise and consultation to businesses and the employed, etc.
- B. Measures **to encourage and ease the transition to regular/official employment**. These measures offer direct and indirect incentives for declaring one’s employment; grant amnesty to employees who register their employment within a certain time-frame; provide services and consultations on employment opportunities and procedures for legalizing one’s work; provide stimuli to consumers for using legal services and products, etc.
- C. Measures **to form law-abiding values and culture**. These measures encourage observing the law and order, as well as labor standards, taxation and social security legislation (Alm et al, 1995, Cullis and Lewis, 1997, Torgler, 2003). These measures also include pro-active campaigns encouraging honesty, justice, and integrity of economic activities; an increase of information on the advantages of declared economic activity and its accessibility to employers and employees; as well as building a culture of paying taxes that requires educated economic actors.

The two approaches to decreasing undeclared work/employment are not mutually exclusive and their coordinated use is recommended. For example, simplifying the legislation and administrative procedures, decreasing the tax and social security burden, and campaigning for the transition to legal/ registered employment are entirely compatible with stricter control measures, increased efficiency in the work of inspection agencies, and stricter sanctions for offenders. **Using mutually reinforcing “positive” and “negative” measures** was recommended by the Second Communication of the Commission on undeclared work in 2007,⁴⁷ with an emphasis on the wider use of initiatives forming sustainable values and attitudes toward complying with labor, tax, and social security laws.

Currently, **the lack of reliable assessment of the effectiveness of various measures in restricting undeclared work** poses a serious problem to national economic and social policies. In an attempt to solve this problem, the study *Tack-*

⁴⁷ Communication of the Commission on undeclared work “Stepping up the fight against undeclared work” (European Commission, 2007), http://ec.europa.eu/employment_social/news/2007/oct/undeclared_work_en.pdf.

*ling Undeclared Work in the EU*⁴⁸ assesses the measures adopted in five Member States – Belgium, Great Britain, Denmark, Italy, and Poland (Williams, Horlings and Renooy, 2008). Another step in this direction was a study commissioned by the European Foundation for the Improvement of Living and Working Conditions (Eurofound) in the 27 EU Member States and Norway, which enabled the creation of a database that contains assessments of a minimum of three measures adopted in the surveyed countries.⁴⁹

Table 3. Estimates of the Share of Undeclared Work in the GNP (%)⁵⁰

Country	Data reported to EIRO			Data reported to the EC		
	Share	Year	Source	Share	Year	Source
Austria	10 %	2003	University of Linz	1.5 %	1995	Austria Statistics
Belgium	20 %	2004	Government of Belgium	3-4 %	1999	National Bank of Belgium
Bulgaria	25 %	2007	Center for the Study of Democracy	22 % 30 %	2003	National Statistical Institute Institute for Market Economics
Great Britain	1.5 %	2003	National Employment Action Plan	2 %	2000	Rockwool Foundation
Germany	17 %	2004	Federal Government of Germany	6 %	2001	Rockwool Foundation
Greece	25-40 %	No data	No data	Over 20 %	1998	Unconfirmed press data
Denmark	No data	No data	No data	5.5 %	2001	Rockwool Foundation
Estonia	No data	No data	No data	8-9 %	2001	Eurostat
Ireland	5-10 %	1998	No data	No data	No data	No data
Spain	No data	No data	No data	No data	No data	No data
Italy	17 %	2000	No data	16-17 %	2001	National Institute of Statistics

⁴⁸ European Foundation for the Improvement of Living and Working Conditions (Eurofound), "Tackling undeclared work in the European Union", <http://www.eurofound.europa.eu/publications/htmlfiles/ef0813.htm>.

⁴⁹ Eurofound, "Tackling undeclared work in the European Union", <http://www.eurofound.europa.eu/areas/labourmarket/tackling/search.php>.

⁵⁰ The data provide a general idea about the scope of undeclared work in some European countries. Estimates are based on different methods provided by various institutions, and refer to different periods. Thus, estimates are used only as an illustration.

Table 3. Estimates of the Share of Undeclared Work in the GNP (%) (Continued)

Country	Data reported to EIRO			Data reported to the EC		
	Share	Year	Source	Share	Year	Source
Cyprus	No data	No data	No data	4.2 %	2003	Greek Cypriot Administration
Latvia	No data	No data	No data	18 %	2000	Central Statistical Bureau of Latvia
Poland	27.4 %	2000	Institute for the Study of Labor (IZA), Bonn	14 %	2003	Central Statistical Office of Poland
Romania	20 %	2003	Alliance for the Economic Development	21 %	2000	National Institute of Statistics
Slovakia	18 %	2003	Friedrich Ebert Foundation	13-15 %	2000	Friedrich Ebert Foundation
Slovenia	17-25 %	1997	Government Commission for Detection and Prevention of Undeclared Work	17 %	2003	Government
Hungary	25-35 %	2004	Ecostat, Hungary	18 %	1998	Borboli
The Netherlands	13.8 %	2002	European Commission	2 %	1995	Statistics Netherlands
Finland	4.2 %	No data	No data	4.2 %	1992	Finnish Ministry of Finance
France	10-20 %	2003	Central Agency of Social Security	4-6.5 %	1998	Rockwool Foundation
Sweden	4.6 %	1998	Swedish National Audit Office	2 %	2000	Rockwool Foundation

Source: European Commission report CE-V/1-04-021-EN-C; EIRO Thematic Feature, Industrial Relations and Undeclared work, <http://www.eiro.eurofound.eu.int/thematicfeature8.html>

International comparisons allow us to draw several conclusions on the undeclared work in Europe. *First*, according to data from the European Industrial Relations Observatory (EIRO), Dublin, the share of the **undeclared work in Bulgaria (about 25 % for 2007) is among the highest in the EU**. Compatible levels of unregistered work are observed in Greece (25-40 %), Hungary (25-35 %), Poland (over 25 %), Romania (20 %), and Slovenia (17-25 %).

Second, the countries with the lowest levels of undeclared work are Sweden (2 %), the Netherlands (2 %), Great Britain (2 %), and Finland (4.2 %). The level of undeclared work in these countries is times less than in Central and Southern Europe.

Third, data on undeclared work reported to the European Commission are, as a rule, lower than the real level of the phenomenon, as detected by independent surveys. This indicates some **serious problems with the reliability of the official statistics on hidden economic activity and the methods for its observation**.

3.2.2. Measures to Restrict Undeclared Work in Bulgaria

Proposed and adopted measures to restrict undeclared employment in Bulgaria focus on its manifestations and the reasons for the re-occurring phenomenon. Different manifestations include:

- employing workers for permanent or temporary work without signing a contract, whereby the employer conceals the real number of employees;
- incomplete reporting of the work done and the received revenues, whereby the employer pays its employees higher wages than formally declared and officially reported;
- covering up the actual character of the employment by signing contracts for other kinds of activity.

The basic reason for not declaring actual employment is **the avoidance of taxes and social security payments** by employers or workers. Examples of such avoidance include inaccurate accounts of the number of employees in employers' official reports; oral agreements in place of signed contracts on the size of remuneration and the job description; or hiring unemployed individuals without a labor contract for a minimum payment. **Additional motives to not declare employment** are:

- non-compliance with state standards and norms on production processes – minimal wages, working hours, safety at the workplace;
- refusal of registration, including providing information for the required administrative forms and statistical questionnaires.

Policies and measures restricting undeclared work/employment are directed toward restricting the factors and incentives for its existence. Since 2002, Bulgaria has taken many steps to restrict undeclared employment:

- At the end of 2002, the *Labor Code* was amended by introducing **compulsory registration of individual labor contracts** at the National Social Security Institute. This measure had a positive effect on the number of signed labor contracts and newly registered employers, which saw an increase. In 2003, the number of registered labor contracts rose by over 300,000 and about 60,000 new employers were reported.
- Parallel to *Labor Code* amendments, there were changes to the *Code for the Obligatory Public Social Security*. **Obligatory social security thresholds** were introduced in all sectors and branches, as well as for nine types of professional

groups. This measure restricted the widespread practice of paying social security contributions on the basis of the minimal salary. In 88 % of the cases, the minimal social security thresholds were negotiated between representatives from trade unions and employers' organizations in each sector. In 12 % of the cases minimum thresholds were introduced by the administration due to a failure of negotiations. The thresholds were accepted as obligatory for the respective sector, branch, and/or professional group. These thresholds are negotiated every year via a three-partite dialogue between social partners. As a result of these measures, in 2003, the revenues from social security rose by BGN 405 million compared to 2002. **In 2004, the increase was by BGN 305 million**, and in 2005 by BGN 183 million. Gradually, **the positive effects of these measures began subsiding**, especially in the context of the world economic crisis.

- **Introducing a flat tax on incomes and corporative profits.** The high tax and social security burden on citizens and businesses is seen as a basic incentive for not declaring employment and incomes. Thus, classical basic measure to decrease hidden employment and incomes is lowering tax levels and social and healthcare security. In the past few years, Bulgaria followed this policy by: first, lowering the total level of tax and social security burden, and second, introducing a flat rate on income and corporate taxes, which, with a few exceptions, were reduced to 10 %. **The results from these measures are not one-sided and are a subject to controversy.** For example, the average income on which social security is paid for the self-employed remains in the range of BGN 250-260, notwithstanding drastic decreases of the total income tax from a maximum of 24 % to a 10 % flat tax in 2008. This indicates that the flat tax does not lead to a significant transformation of economic activity from hidden to official. In another instance, the weak effect of the flat tax on hidden economic activity is demonstrated by the persistence of a heavy social security burden despite several decreases in the past few years. As noted, it appears that cumbersome administrative and regulatory procedures greatly affect the level of social burden and hidden economy, while taxation and social security rates have a marginal effect.
- **Organizing public campaigns** on restricting hidden economy. In 2007, The Bulgarian Industrial Association initiated an "Out of the Shadow" campaign directed toward restricting the hidden economy in Bulgaria. Partners in the program included governmental institutions (Ministry of Labor and Social Policy, Ministry of Finance, National Revenue Agency, Chief Labor Inspectorate, etc.), trade unions and NGOs (e.g., the Confederation of Independent Trade Unions of Bulgaria, the Confederation of Labor "Podkrepa", the Bulgarian Economic and Social Council, and others), business organizations, major national media (e.g., Bulgarian National TV, Bulgarian National Radio, "Darik" Radio, "Trud" Newspaper, "24 Hours" Newspaper, "Sega" Newspaper, and others). A special website was created gathering and summarizing suggestions for coping with the challenges of hidden economy. Although difficult to evaluate the actual impact of the initiative, it attracted public attention on the phenomenon and sparked public debate for reducing the size and share of the hidden economy in the country. After 2008, the Ministry of Labor and Social Policy launched the campaign "Work Legally". Then, at the end of 2009, these initiatives were followed by projects launched by employers' and trade-unions' organizations that were financially supported

through the European Social Fund. The focus of these projects was on examining and restricting the manifestations of hidden economy and undeclared employment. They all share one and the same shortfalls, such as their short-term, campaign character and/or the lack of credible enforcement mechanisms.

An on-going problem is that business associations actively supporting measures to decrease the hidden economy predominantly offer suggestions for altering the legislative and executive powers, yet **there is no single suggestion for self-regulation**. In practice no firm has ever been sanctioned (for example, by excluding it from the association) for hiding its economic activity. It is hardly realistic that all members of business associations operate entirely “out of the shadow”, while those breaking the rules of fair competitions are not among their members. To the contrary, a 2003 study shows that members of business associations are more inclined to offer a bribe (if asked) and less likely to report (e.g., by filing a complaint to the police, courts, media, or another channel) than non-members. The results are statistically significant (Yalamov, 2003). Though this gap in inclination of members vs. non-members is shrinking in the last few years, it does not reverse. Business associations still do not believe in the ability of self-regulatory mechanisms to counteract and reduce the hidden economy.⁵¹

- **Enhancing administrative control and increasing sanctions.** Certain steps are taken to detect and punish offenders as part of the traditional approach to countering hidden economic activity. For example, in 2006, representatives from the government and nationally representative employers’ organizations and trade unions signed a *Pact for Economic and Social Development of the Republic of Bulgaria until 2009*. It puts foreword the restriction of hidden economy as a priority and presents measures encouraging the strict observation of normative requirements (taxation, duties, financial, etc.) by economic entities. Among the suggested measures are also a harsh treatment of economic entities, who violate tax or social security regulations, as well as improving the control of and measures against violations of social security legislation. Similarly, suggestions by the NRA aim at enabling its control organs to sanction offenders of the Labor Code. The campaign “Work Legally” advocates for increasing the fines on employers who employ workers without a contract from BGN 1,000 to BGN 15,000. Inspectors from the Chief Labor Inspectorate (CLI) were given the authority to temporarily freeze the activities of firms that violated the Labor Code. In 2008, the CLI carried out a total of 34,558 inspections and established 183,871 violations of the Labor Code, labor laws, and normative acts.⁵² Some 758 violations were established in relation to registering labor contracts.⁵³ Highest is the share of such violations in the following economic activities: retail sales, restaurant and hotel keeping, as well as construction.⁵⁴

⁵¹ Y. Hristoskov, The Pension System is about to be Nationalized, Interview, September 9, 2009, <http://www.bia-bg.com/Христосков%2B+Пензионната+система+е+пред+национализация-Анализи/1/MIW-gRWHIVS-MZKfQhK3gSrcNKXMVejJJOnMJOjUhO-gBKnQtOfg1aXUtKDIFmHc5ivgB>.

⁵² Social Security in Bulgaria in 2008, NSI, Sofia, 2009, p. 122.

⁵³ Under article 62 and 913, and under article 63 of the *Labor Code*.

⁵⁴ It is these sectors that the business pointed out as having a higher share of hidden economy than the average for Bulgaria, according to the Hidden Economy Survey on the Business (HESB) by the Center for the Study of Democracy and Vitosha Research.

A key issue in countering hidden economy and undeclared employment in Bulgaria is the **lack of reliable monitoring and assessment of implemented programs', initiatives', and measures' results**. In the absence of analysis of the effectiveness of various measures, it is impossible to figure out successes and failures, the cost of adopting each measure and the balance between costs vs. benefits, potential unexpected or negative effects, etc. As a rule, the practice of preliminary assessing each measure's expected impact is not established in Bulgaria. Also not assessed are the risks from increasing the work load and the expenses of the control organs and whether or not such additional load would aid the expected results. Finally, there is no analysis of good international practices tailored to the Bulgarian economy's specifics, despite common knowledge that some measures are successful in one country, while fail in another. In the absence of a viable evaluation system in place, there is no logical continuity and accord between measures. The time-frames for achieving results are also not under scrutiny, as is the complex impact of measures. In this context, it is of utmost importance to introduce the practice of systematically monitoring and assessing policies, programs, and measures restricting hidden economy and undeclared work. Moreover, evaluation mechanisms should be paralleled by on-going reliable observations of the state and tendencies in hidden economic activity.

3.3. UNDECLARED WORK IN BULGARIA – STATE AND TRENDS

3.3.1. Empirical Assessment of Undeclared Work in Bulgaria

The **Hidden Economy Survey on the Business** (HESB) by the Center of the Study of Democracy provides a general idea of the scope of employing workers without a signed contract in Bulgaria. The study is based on representative surveys on firms in Bulgaria. It should be noted that these studies identify only the share of employed individuals without a formal contract. They do not include undeclared work of entrepreneurs, self-employed, and/or freelancers.

According to representatives from the Bulgarian business, **for the last eight years, the share of people working under a formal contract more than doubled** (i.e. from 21.2 % to 44 %). This positive tendency was sustained throughout the whole eight-year period. To a certain degree, the obligatory registration of employment contracts, as introduced in 2003, gave an initial boost to this positive tendency. With the introduction of this measure, the number of the registered labor contracts got closer to the number of labor contracts reported in NSI's "Employment and Unemployment" labor-force survey. For the last four years (2007 – 2010), no statistically significant change was observed in the assessment of businesses of the workers without a contract (rather, there are insignificant changes in the intervals). According to Bulgarian businesses, the economic crisis did not lead to a significant increase in the share of the workers without a contract in the country.

A more serious and worsening problem ensuing from the crisis is signing labor contracts for minimum payment, on the basis of which social security rates are calculated. Meanwhile, the remaining remuneration is provided in cash in the form of the so-called **"envelope wages"**. For example, a classical scheme is pay-

Table 4. Managers' Assessment of the Share of Employed Workers without a Signed Contract

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

Note: The survey question was "In your opinion, what is the share of the employed without a signed contract in your economic sector?"

Source: HESB, 2010, Center for the Study of Democracy and Vitosha Research.

ing a larger salary than officially reported, which is usually of the same value as the minimal social security threshold. Another way of hiding employment activity is reporting individuals as seasonal workers, thus, employing them under seasonal contracts or part-time contracts. Thus, the employer pays employment insurances only for the period stated in the contract, while the employee works longer hours than formally set by the contract.

Table 5. Managers' Assessment of the Share of Employed Workers with Underdeclared Payments

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

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

Source: HESB, 2010, Center for the Study of Democracy and Vitosha Research.

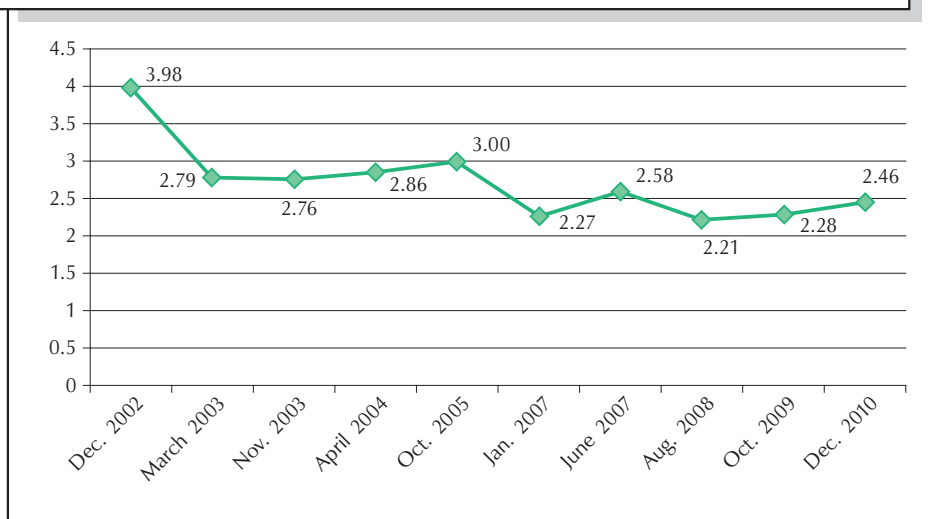
Until 2007, **the share of employees receiving additional hidden payments is decreasing**, according to the assessments of business representatives. In 2009 and 2010, however, the share of managers, who think that such practices do not exist in their branch, goes down. Meanwhile, managers who believe that over 25 % of the employees in their sector receive undeclared payments/envelope wages, goes up. Congruent with these assessments are data from surveyed businesses claiming that almost a quarter (23 %) of the salaries come in the form of “envelope wages”. Hiding the actual size of remuneration is most common in the service sector, as well as among retail-sales businesses. The share of hidden income from salaries is highest in the construction and services sectors, while lowest in the industrial sector.

The data show that **employers have the tendency to under-report actual salaries more frequently than to hire workers without a contract**. This is due to control authorities are able to establish and sanction employment without a contract more easily than concealment of income. As a result, both businesses and workers profit from not paying social security and taxes, yet in the long-run, avoiding social security payments has a backlash on employees through their pensions.

Similar assessment of undeclared labor is done through the **Hidden Economy Survey on the Population (HESP)** by the Center for the Study of Democracy and Vitosha Research. People are asked whether they work without a labor contract and whether they get paid higher than the official salaries. The level and dynamics of sub-index “Undeclared Employment Relations”, part of the Index of the hidden economic activity of the population, summarize the labor market dynamics.

More and more people are getting a **second job** in addition to their primary employment. A tangible (twofold) decrease is observed in cases of non-declaring

Figure 15. The Dynamics of Sub-index “Undeclared Employment Relations” among Businesses, 2002 – 2010 (min = 0, max = 10)



Source: HESB, 2010, Center for the Study of Democracy and Vitosha Research.

additional employment in the last eight years. Tendencies are harder to follow in the case of primary employment, where the notion of not declaring one's primary employment decreases, yet the decrease is likely within the range of the statistical error. Consequently, undeclared primary employment runs at naturally low levels of 3-5 %.

Table 6. Share of Workers Reporting No Signed Contract with Their Primary or Secondary Employer

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

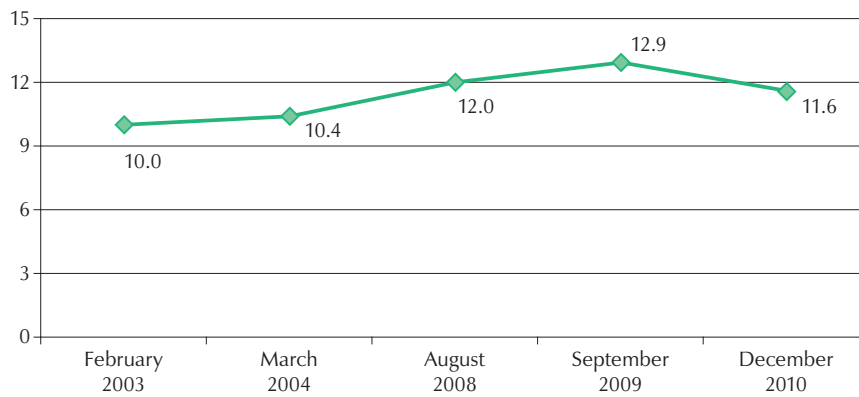
Note: In the survey, this is the share of respondents, who answered "No, I do not." when asked "Do you have a signed contract with your employer?"

Source: HESP, 2010, Center for the Study of Democracy and Vitosha Research.

In 2010, 11.6 % of the population reported having received a remuneration higher than the one stated in their contract with the primary employer. This represents a slight decrease in the incidence of undeclared payments since 2009, when the respective share of the population receiving higher than declared remuneration was close to 13 %. Taking into account the contraction in economic activity in 2010, businesses have actually registered this decline as a relative increase of the share of envelope wages in their costs. **The tendency to underreport actual remuneration has serious implications for the social security system**, as underreported remuneration is also related to reduced payments of social security contributions. A failure to tackle these issues in time leads to hasty and unpopular policy decisions for correcting social security imbalances, such as the 2010 transfer of payments from private to public social security funds. Bulgaria needs to account for the lost income and design a comprehensive set of long-term economic and enforcement measures to tackle hidden employment. Alternatively, it must be prepared to face **social security deficits and crises along every future economic downturn**.

For the period 2008 – 2009, a slight increase in the share of workers receiving remuneration higher than the stated in their contracts was observed. These data are congruent with the most common (the modal) estimation of business representatives that the share of employed under contracts with hidden clauses and the share of envelope wages was 10 %. Thus, a well-grounded conclusion can be drawn that at least **every tenth person is paid higher than officially stated in their contract**.

Figure 16. Incidence of Payment of Remuneration Higher than the Stated in the Contract under Primary Employment in the Past Month (%)



Note: The survey question was "In the last month, were you paid a higher amount of money than the declared in your contract with your primary employer?"

Source: HESP, 2010, Center for the Study of Democracy and Vitosha Research.

Table 7. Sum on the Basis of which Social Security Payments are Calculated, for Primary Employment (%)

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

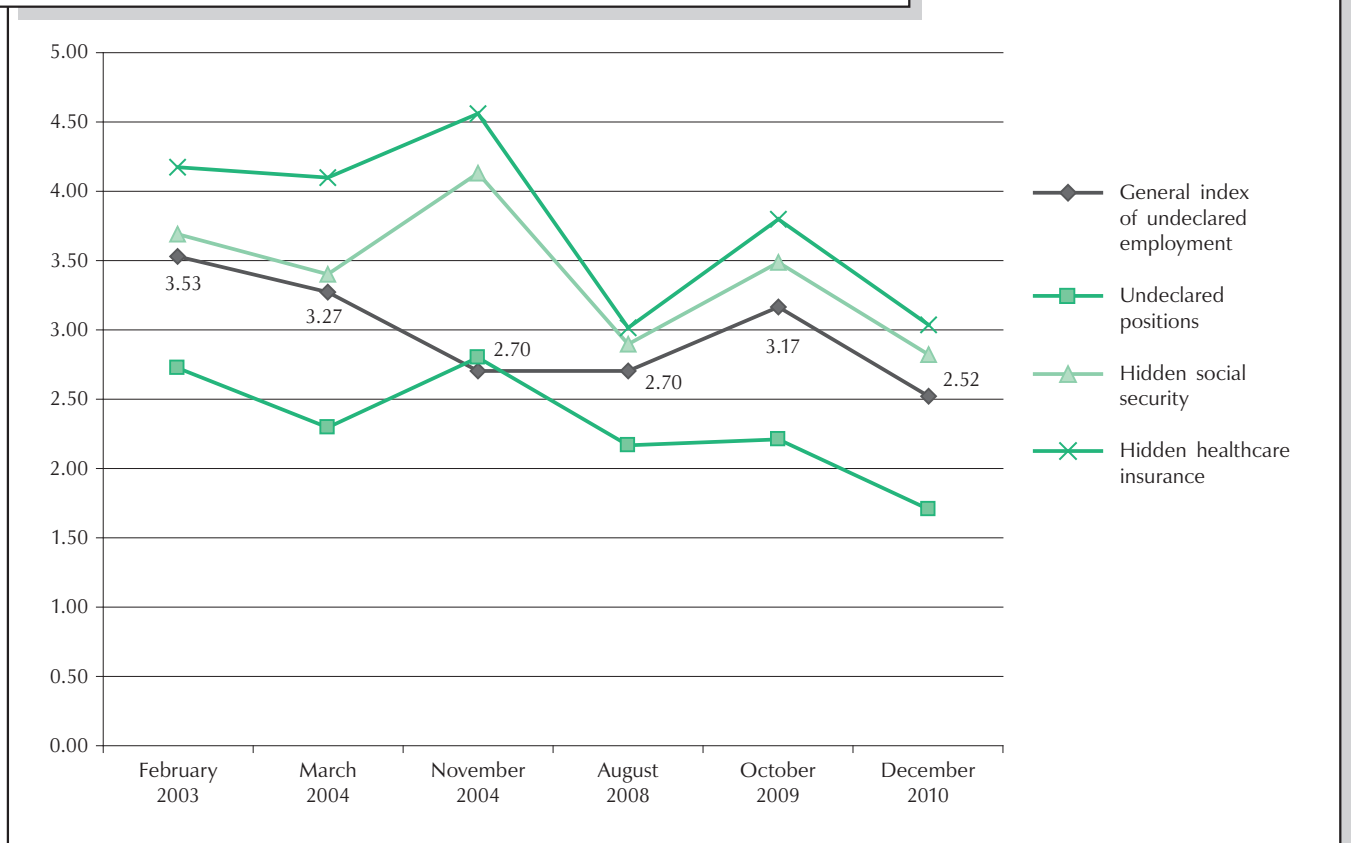
Note: The survey question was "What is the sum on which you are socially insured?"

Source: HESP, 2010, Center for the Study of Democracy and Vitosha Research.

Undeclared payments for labor are also connected to a **non-payment of the full size of social security and healthcare contributions**. Since the onset of the *Hidden Economy Index* in 2003, the share of the employed that are socially insured on pay rates lower than their actual remuneration had almost doubled by 2009. In 2010 there was a notable drop in the share of the employed insured in accordance to the amount stated in their contract, while receiving a higher (undeclared) remuneration. The same, though to a much lesser extent, applies to the proportion of employed insured only on the basis of the minimum social security threshold, while actually receiving a higher remuneration.

Despite some fluctuations, the period between 2003 and 2010 saw no difference in the population's estimations of the rate of avoidance of social security payments. About **one fifth admit to being insured on the basis of a lower value than their real salary**. These data are in contrast with businesses' estimations of the rate of avoidance of tax and social security payments in their sector. The reason might be that people fear admitting to hiding incomes. A more plausible explanation is the difference in samples. The sample of surveyed employees includes not only the private, but also the public sector, NGOs, etc.

Figure 17. The Dynamics of Sub-indices Measuring Undeclared Employment in the Population, 2003 – 2010 (min = 0, max = 10)



Source: HESP, 2010, Center for the Study of Democracy and Vitosha Research.

The share of employed persons that are insured on the minimum social security threshold, which also corresponds to their actual remuneration, has also declined (from 12.9 % in 2009 to merely 5.9 % in 2010). This reveals the **higher social insecurity of undeclared employment and income**, which was immediately cut by firms in the face of the downturn. The *Hidden Economy Index* data show that the share of undeclared social security income in total social security payments from companies may remain unchanged or even increased, as it was low paid workers with lower qualifications that have suffered the most during the downturn. This is in line with a very modest increase in the average social security income in 2010, as reported by the National Social Security Institute.

A key problem in the country is the **low social solidarity and the lack of confidence in state institutions**. Until recently, measures to increase the collectability of social security payments have been predominantly control and administrative. It is not likely that these measures will change the motivation of businesses and the population to pay their social security. Quite to the contrary, it is expected that the current economic situation of low-quality social services and tightened control will have the opposite effect. The problem is that the avoidance of social security payments has its clear economic logic. Keeping in mind that the average life expectancy of Bulgarian men in 2009 was 70 years, there is no rationale in paying social security contributions in order to get pension transfers for 5 years post one's retirement. Existing voluntary tiers of pension insurance and an option to inherit part of one's pension by one's family are motivating elements. Yet, they do not change the above stated realities. **The Bulgarian government needs to radically and sustainably improve the quality of social services** and appeal citizen's social solidarity, rather than insisting on control and administrative measures.

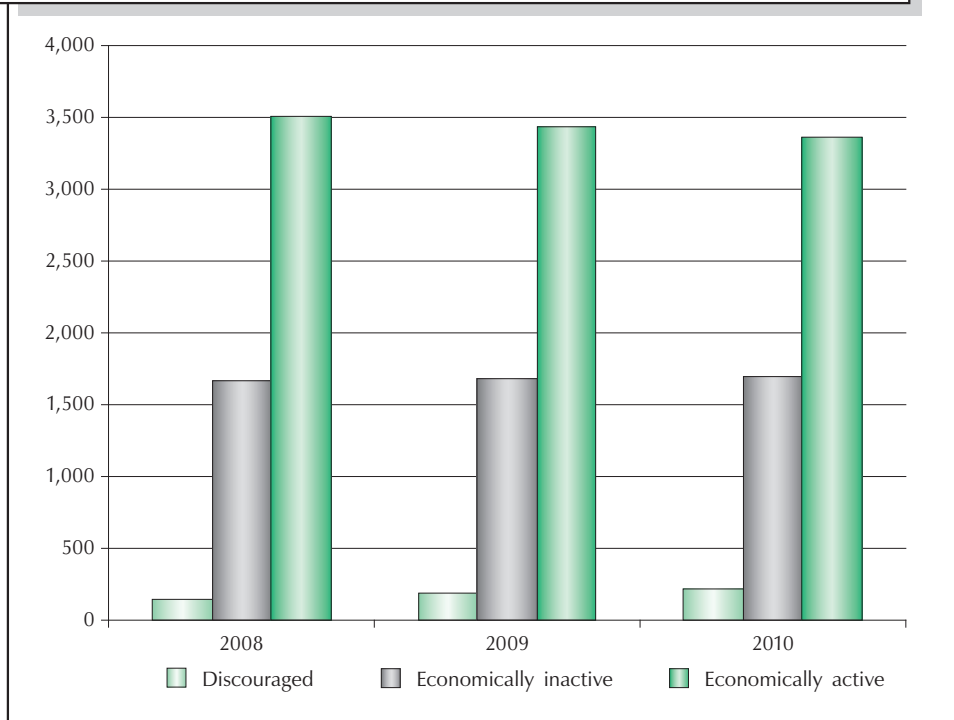
3.3.2. The Crisis and Perspectives for the Labor Market

There seems to be a vast untapped potential among the share of the population that is of economically active age. A significant proportion of the population of active age (i.e. 15 to 64 years) is not productively employed leaving this human capital available for hidden economic activities, which traditionally have lower levels of productivity and higher rates of loss of qualification.

While the Bulgarian GDP is expected to grow again in 2011, the level of employment during the same year will likely stagnate. Unemployment may continue rising and remain higher than current levels, as bankruptcy procedures kick in and enterprises considered viable in 2009 and 2010 are forced to leave the market. As it is unlikely that an economic boom similar to the pre-crisis period will occur, forecasts warn that a considerable time is needed before excess labor and resources are absorbed by other sectors of the economy.⁵⁵ Heightened insecurity about the long-term health of the European economy will most likely lead to freezing the salaries in certain labor market segments and increasing the incentives for undeclared work in 2011 – 2012. There are indications that employers are very cautious in hiring people, commonly giving preference to more flexible forms of employment, including undeclared employment.

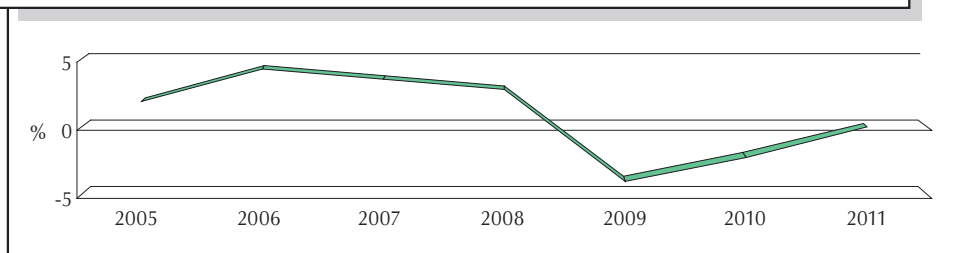
⁵⁵ IMF Country Report No. 10/159.

Figure 18. Labor Force Dynamics (Thousands of People)



Source: Center for the Study of Democracy using data from the National Statistical Institute, 2011.

Figure 19. Level of Employment in Bulgaria (Annual Percentage Change)



Source: Center for the Study of Democracy using IMF data, 2011.

At a company level, the crisis led to an increase in job loss, bankruptcy, and closure of businesses. In 2009, firms undertook measures to tackle the crisis. Such measures included involuntary unpaid leaves, decreased salaries and working hours, and others, aiming at preserving the business, while also retaining the qualified personnel.⁵⁶ Many Bulgarian firms, especially in the construction sector,

⁵⁶ European Industrial Relations Observer, <http://www.eurofound.europa.eu/eiro/studies/tn1004019s/bg1004019q.htm>.

Box 9. Sustainable Practices in the Concealment of Income in Construction

[In 2011], an inspection – of a large construction site was carried out on Sofia’s beltway. At the time, the construction project is carried out by one main contractor and 29 sub-constructors. During inspection, 158 workers were at the scene. As inspectors arrived and began their inspection, some of the workers ran away. Eight of the remaining employees declared that their salary was in the range of BGN 550 to BGN 1,500. After a check at the NRA, it was established that they had been insured on the basis of amounts smaller than the declared ones and under the minimum social security threshold.

Source: A press release by the Executive Agency “Chief Labor Inspectorate”, April 1, 2011.

swiftly dismissed workers without contracts and seized payments of undeclared (envelope) wages, which led to a reduction in hidden economy in the end of 2009.⁵⁷ The complex macroeconomic environment in Europe and the rise in unemployment in Bulgaria are factors, which will likely increase the share of the hidden economy in 2011 – 2012. Whether this would happen in reality depends on the government’s social and economic policies and the pace and structure of economic recovery in the private sector.

⁵⁷ Center for the Study of Democracy, 2009, Policy Brief 20: *Policies to Counter the Effects of the Economic Crisis: hidden economy dynamics 2009.*