

Tackling the Undeclared Economy in Bulgaria

A Baseline Assessment

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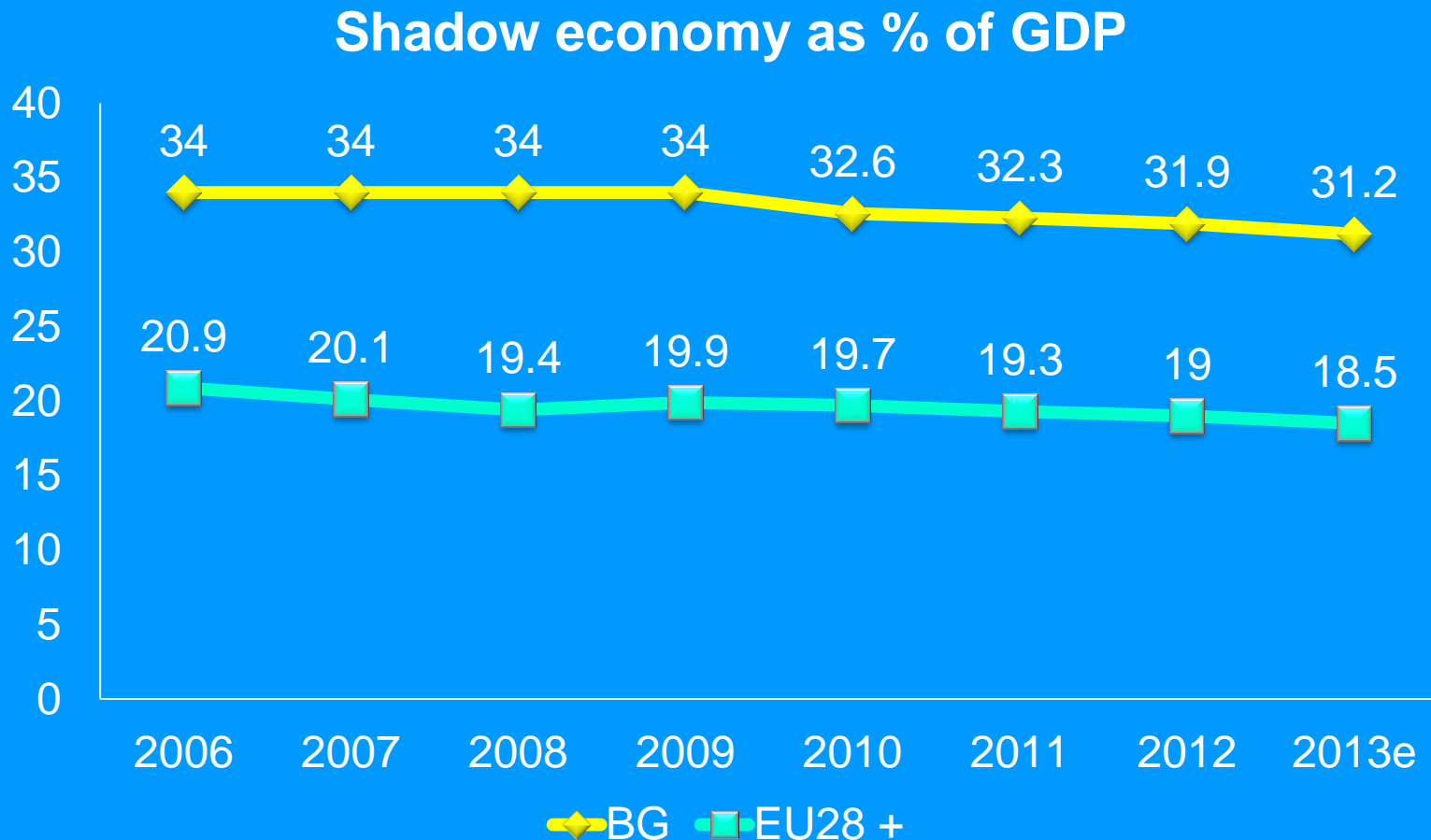
Overview

- Extent and nature of undeclared work
- Context-specific barriers to formalisation (labour, business, socio-cultural factors)
- Institutional actors (control bodies and social partners)
- Policy approach and measures (deterrence, preventative, curative, fostering commitment)

Data sources

- **Indirect measurement methods:** MIMIC, electricity consumption, monetary method, System of National Accounts.
- **Direct surveys:** Eurobarometer, World Bank *Enterprise Survey*, CSD / Vitosha Research, business / industrial associations (BICA, BCCI, BIA), Labour Force Survey
- Labour inspections and tax audits

Extent of undeclared work

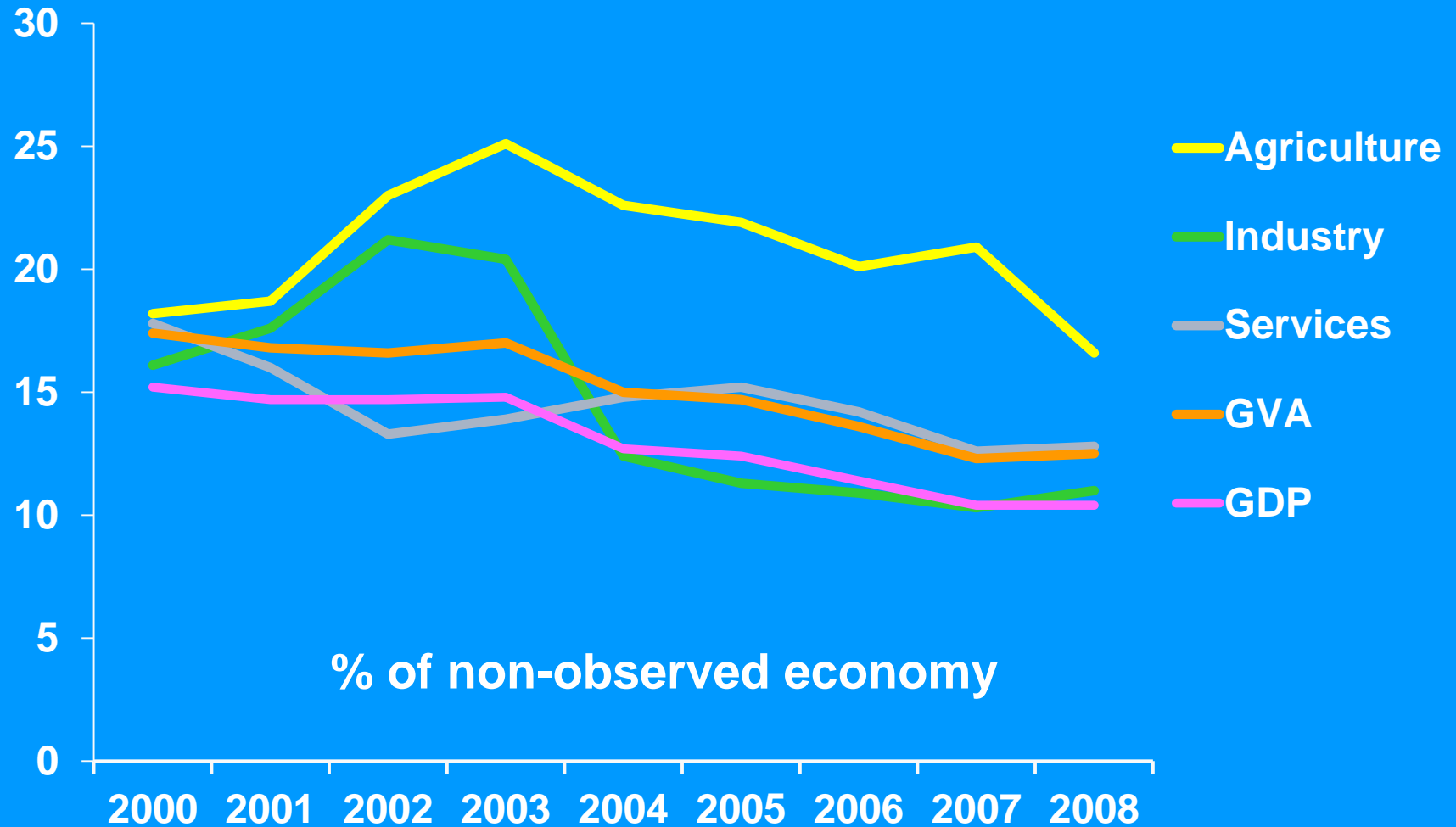


Source: Schneider, 2013 (MIMIC method)

Indirect measurement methods

Measurement method	Period covered	Estimated size of the undeclared sector as % of GDP
DYMIMIC (Schneider 2013)	2013	31.2%
	1999 - 2007	35.3%
Two-sector dynamic general equilibrium model (Elgin and Öztunali, 2012)	2000-2008	35.5% - 31.9%
Electricity consumption (Ministry of Finance, 2010)	2000-2009	20%
Monetary method (corrected) (Ahumada et al, 2009)	1998-2007	15%
Currency circulation method (Nenovski and Hristov, 2000)	1999	26.8%
Electricity consumption (Kyle et al, 2001)	1989 – 1998	25% - 37%

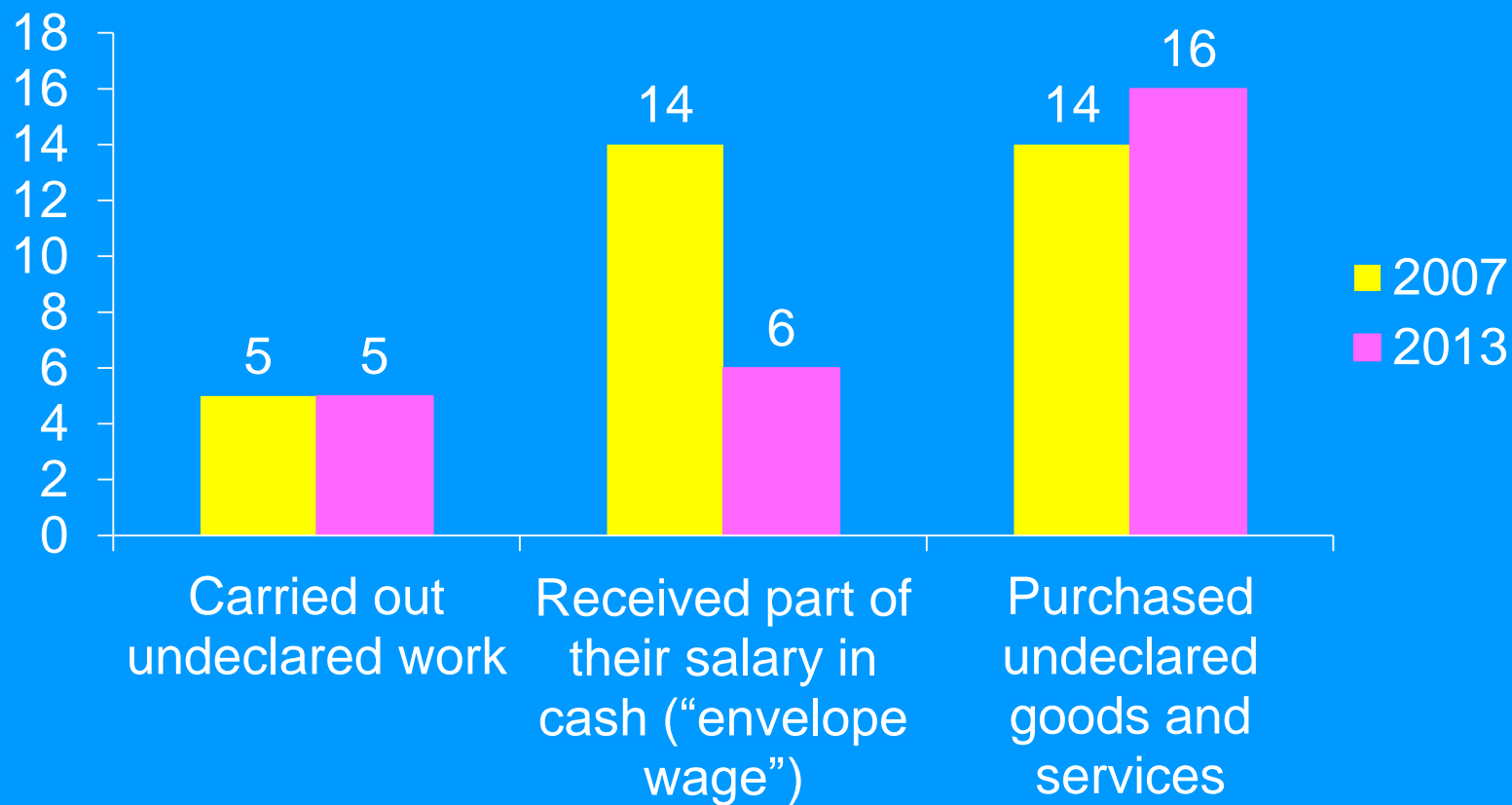
System of National Accounts



Direct methods

- *Eurobarometer survey* (2007 and 2013)
 - Supply and demand of undeclared work
- *Hidden Economy Index*, CSD / Vitosha Research (since 2002)
 - Business Hidden Economy Index
 - Population Unreported Economic Activity Index
- *White Economy Index*, Bulgarian Industrial Capital Association (since 2010)
 - Population survey
 - Business survey
 - Sectorial audits

Eurobarometer survey 2007 and 2013 – Bulgaria



Hidden Economy Index - components

Size of the hidden economy

- Subjective perceptions of businesses for the scope of the hidden economy in the country in general and in their respective sector

Hidden employment

- Hiring workers without contract
- Underreported remuneration (envelope wages)

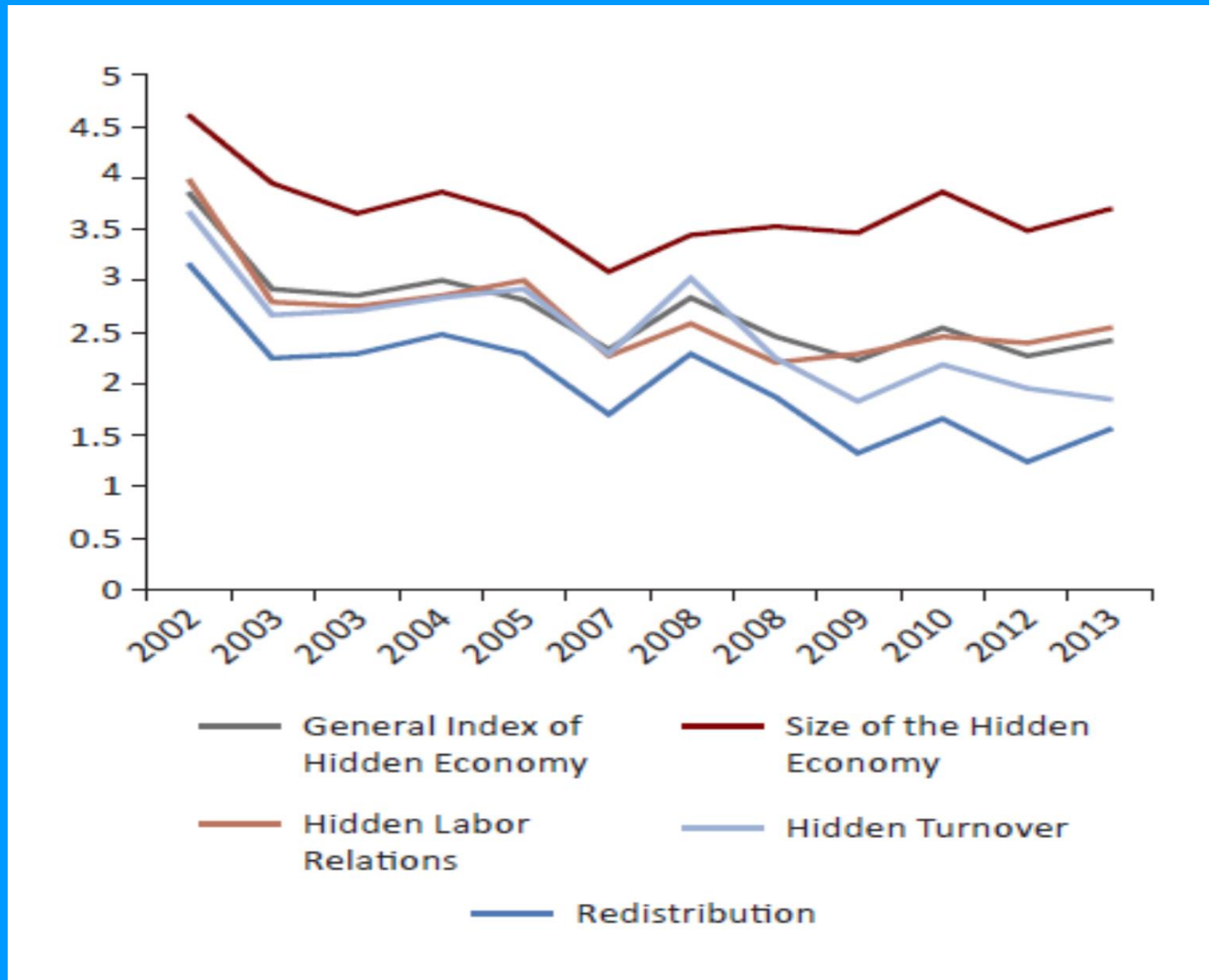
Hidden turnover

- Failure to issue tax receipts on sales
- Underreporting turnover
- Underreporting profit
- Illegal (undeclared) export / import

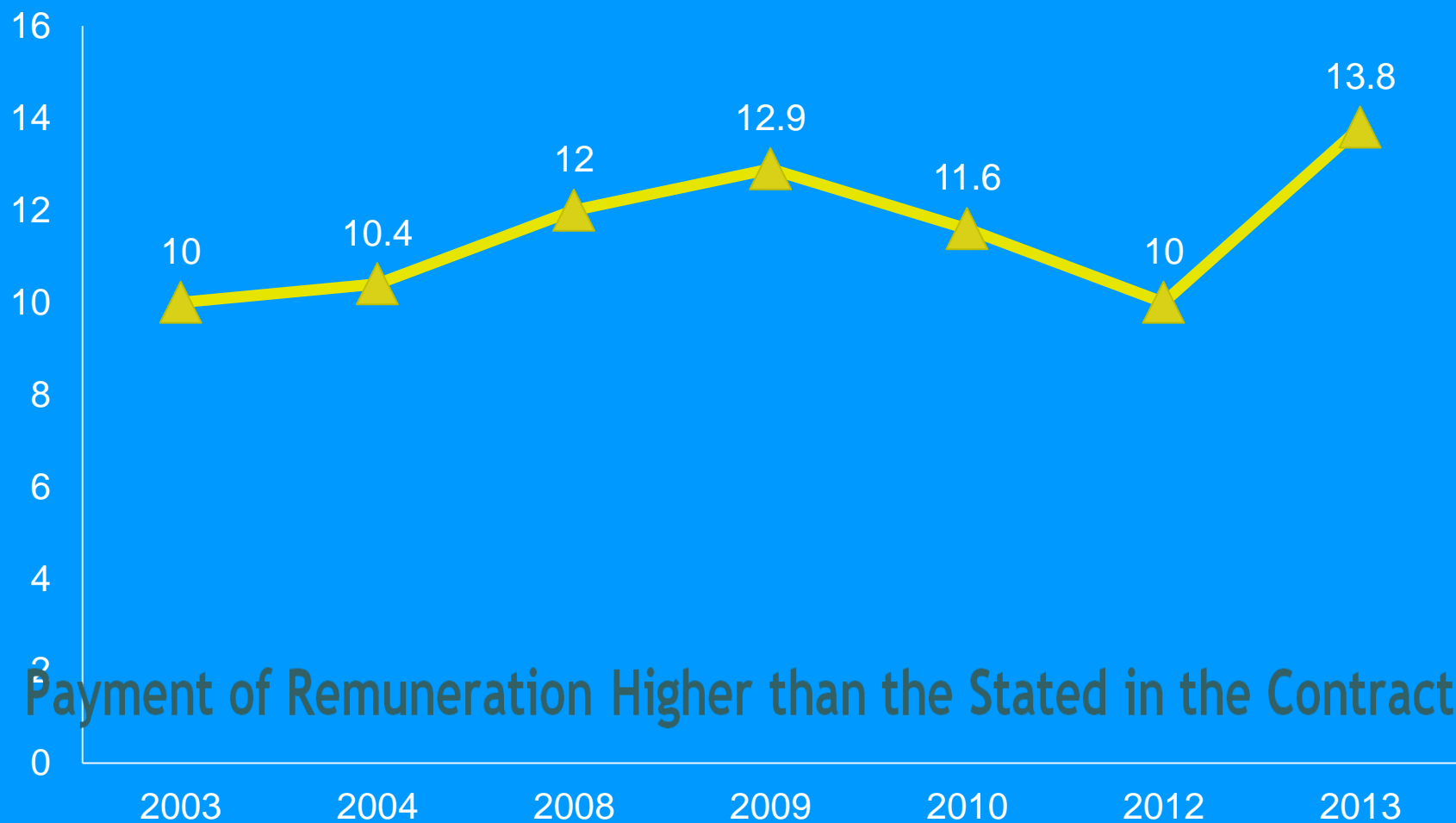
Hidden redistribution

- Evasion / non-payment of taxes, fees, customs, excise duties
- VAT fraud

Hidden Economy Index: dynamics 2002-2013

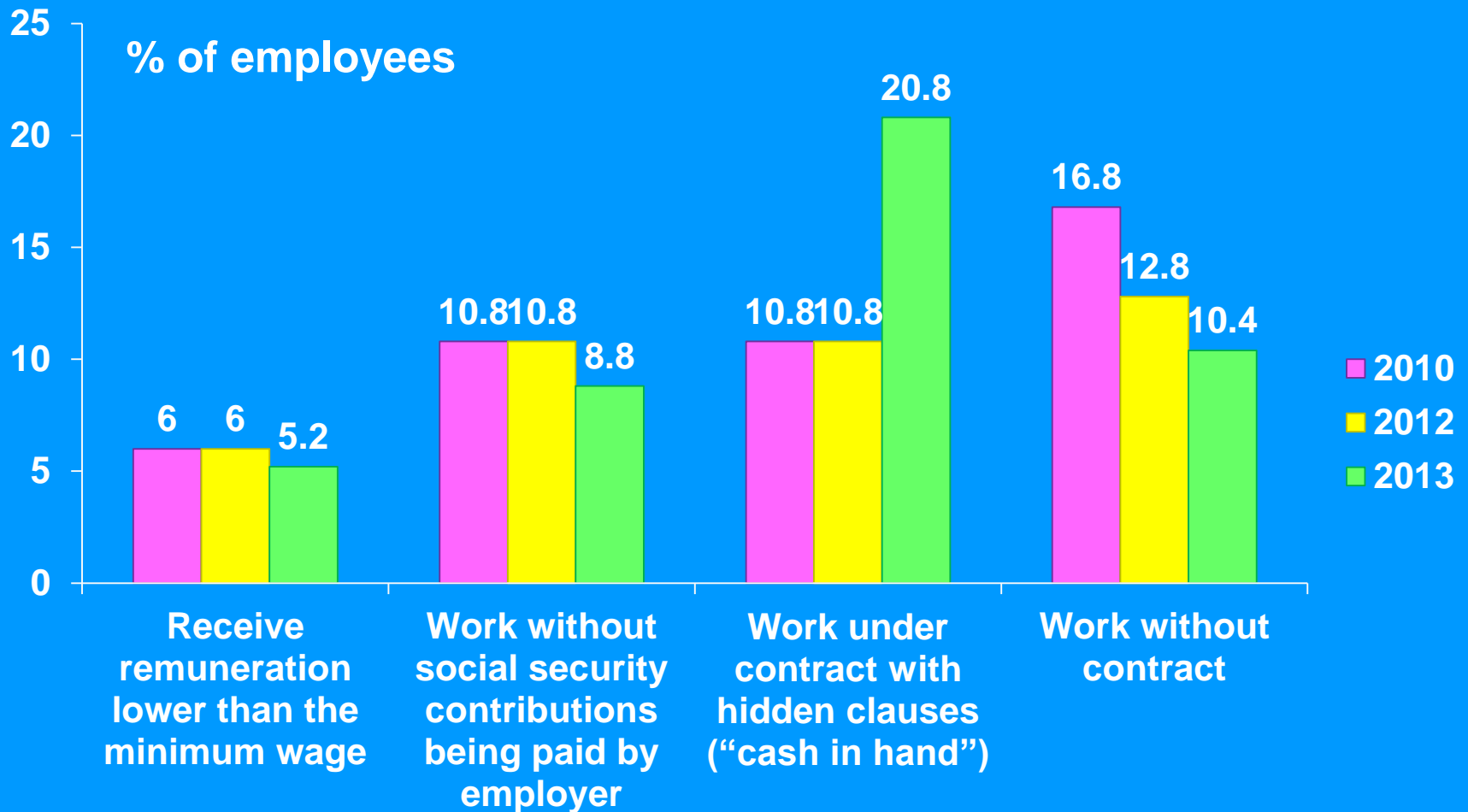


Hidden employment relations: envelope wages on the rise



Payment of Remuneration Higher than the Stated in the Contract

BICA employees survey: participation in undeclared work



Source: BICA (2013) Survey of employees, N=250 employees

Forms of undeclared work

- Work without contract (main job) declining – between 4% and 10% of workforce
- Work without contract (second job) – 28% to 32% of dependent employees
- Under-declared employment (envelope wages) on the rise – between 14% and 21% of the employed
- Under-reporting by employers more serious than non-reporting by self-employed or households

Sectorial, business and socio-economic variations

Vulnerable sectors / productive activities

- Construction, real estate sales
- Tourism, hotels and restaurants
- Wholesale trade and retail (food, garments, textiles)
- Agriculture, food processing
- Services (repairs, advertising, accounting, hydroisolation, funerals, taxis, security...)
- Food commodities trade (grain, sugar, etc)
- Production and distribution of excise goods (cigarettes, fuels, alcohol)

Vulnerable business types

- Small and medium-size enterprises
- Domestic firms
- Micro-firms and sole traders
- Start-ups
- Firms in small/medium towns and in rural areas

Vulnerable population groups

- Long-term / temporary unemployed / discouraged
- Low-qualified, low earners, manual workers
- Self-employed
- Young people

Drivers of undeclared work

Structural drivers

- Business regulations
- Structure of taxation
- Welfare system
- Labour market regulations and interventions (minimum wages, insurance thresholds, etc.)

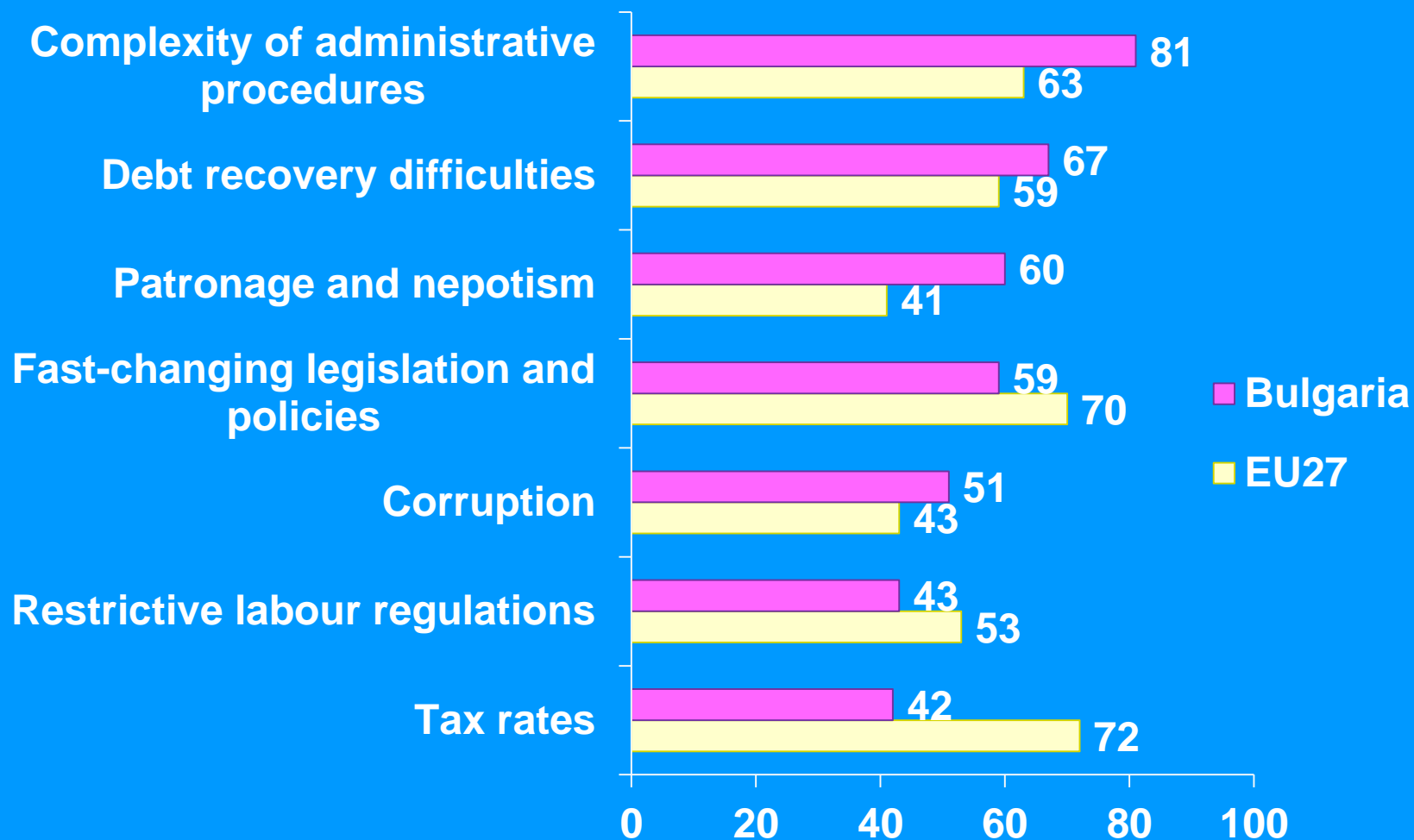
Institutional credibility and social norms

- Government effectiveness, control of corruption, rule of law
- Procedural fairness and justice
- Tax morale
- Relationship of trust between state institutions and citizens

Drivers of undeclared work and barriers to formalisation

- ***Labour supply***: lack of formal jobs, lack of other income, economic pressure, social security burden for low earners, social acceptance, risk perception
- ***Businesses***: cost of compliance, inadequacies of existing regulative framework, social security burden, corruption and unpredictability, unfair competition and uneven treatment by the state
- ***Socio-cultural factors***: low tax morale, low trust in government, low legitimacy of social security system, low quality of public services

The most problematic factors to doing business in Bulgaria



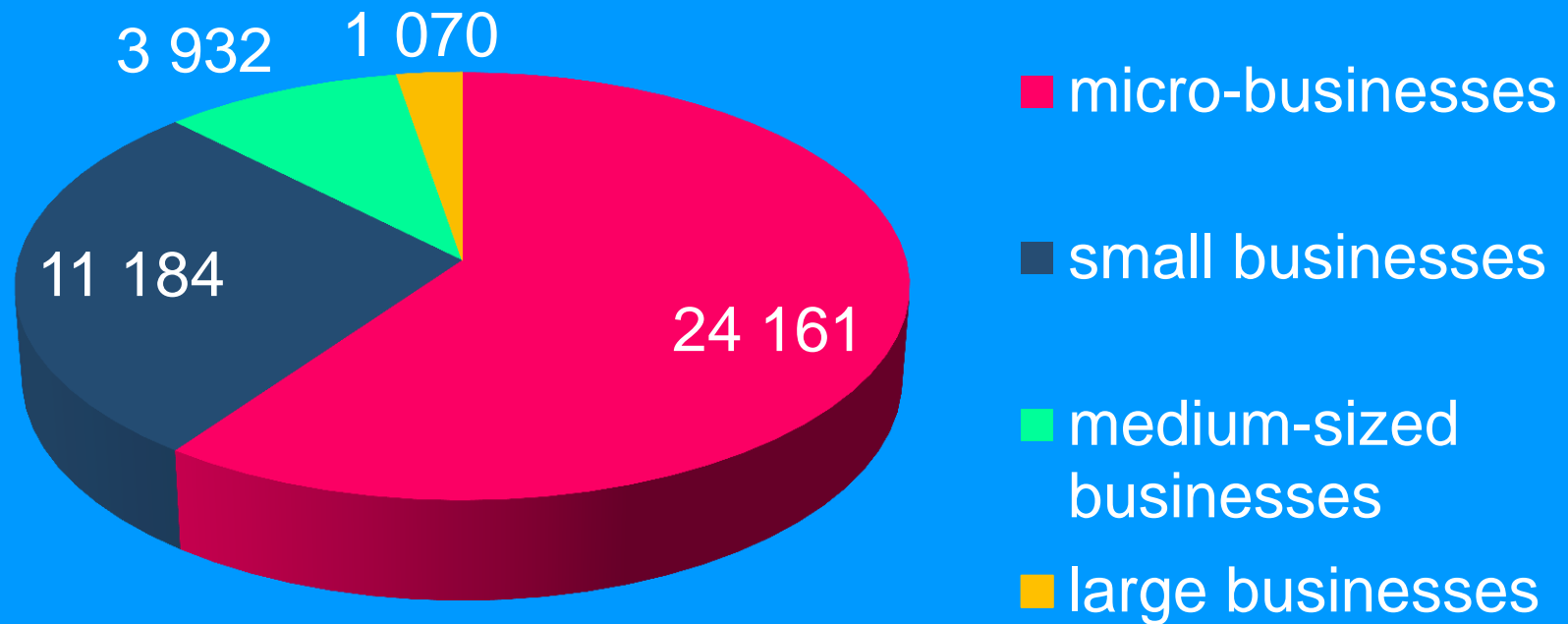
Source: Flash Eurobarometer 374 (European Commission, 2014a)
Base: N (BG) = 301; N (EU27) = 7,541

Institutional framework for combatting undeclared work

Enforcement bodies:

- General Labour Inspectorate (GLI)
 - National Revenue Agency (NRA)
- Focus on inspections and administrative control measures
 - Tax revenue collection strengthened
 - A service-oriented approach towards taxpayers starting to emerge

Businesses inspected by GLI in 2012 by firm size



Repressive measures

- Mandatory real-time link between fiscal devices and the revenue agency' servers (2011)
- Excise goods movement control system (2010)
- Increased penalties and enhanced (joint) controls (labour inspectorate and revenue office)
- Targeted inspection campaigns (seasonal work, high-risk sectors, part-time contracts)

Preventative measures (detering entry)

- Act on Limiting Administrative Regulation and Administrative Control on Economic Activity (2003)
- Mandatory registration of labor contracts (2002)
- Minimum Social Insurance Thresholds (2003)
- Restricting cash transactions above BGN 15,000 (2011)

Enabling movement out of the shadow economy (curative measures)

- Flat income tax on personal income and corporate profits (2008)
- Food vouchers (2003)
 - additional non-taxable income for employees
 - substitute/reduce undeclared “cash” wage payments

Fostering a culture of commitment

- “Come Into the Light” campaign (2007)
- “Work Legally” campaign (2008)
- Proactive role of **social partners**:
research, formalisation advise, public awareness, education services:
 - National Center “Rules for Business” (BICA and CITUB)
 - Virtual Social Academy (BCCI)

Policy conclusions

- Focus on **punitive and corrective measures** has produced some results in the area of tax evasion and registration of labour contracts.
- However, **sustainability of their effect** uncertain without efforts to stimulate voluntary compliance, create more enabling business environment, improve procedural fairness and justice and restore public trust.
- Many policy measures, but no integrated approach, no **systematic evaluation** of the effect of measures implemented or planned (inlc. adaptation costs for affected groups to increase policy acceptability).

Thank you for listening

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