The Hidden Economy in Bulgaria: 2011-2012

31.01.2013
Sofia, Bulgaria

Center for the Study of Democracy
Economic Program
Table of Contents

• Macroeconomic Overview

• Hidden Economy Index 2012: Components and Dynamics

• Countering the hidden economy in Bulgaria: How Efficient are Regulatory Agencies

• Policy Actions on the Hidden Economy - Recent Developments and Recommendations
Macroeconomic Overview
Bulgaria is one of the 24 countries that improves its competitiveness in the last two years.

Yet, it is still one of the least competitive economies from the 59 countries ranked in the IMD’s 2012 World Competitiveness Yearbook report.

Main positive competitiveness boosting factors are Bulgaria’s fiscal stability and the low labor and productivity costs.

Main concerns are related to the deep structural problems of the Bulgarian labor market, corrupt management practices and weak institutional framework in the country.
Main Economic Trends (cont.)

Figure 1: Real GDP Growth - BG vs. EU-27 (% growth)

Figure 2: Rate of Unemployment (%)

Note: * projected
Source: Eurostat.

Figure 3: Share of Long-term Unemployment (in‘000 ppl)

Figure 4: Share of Youth Unemployment (%)

Note: * as of Q3 2012
Source: NSI.
Hidden Economy Index 2012: Components and Dynamics
Hidden Economy Index 2012: Components and Dynamics

1) The size of the hidden economy summarizes the subjective perceptions of business representatives of the scope of hidden economy in the country in general, as well as in their respective sectors.

2) Hidden employment captures the practice of hiring workers without formal employment contracts or under contracts with underreported remuneration (i.e. envelope wages).

3) Hidden turnover includes the incidence of various practices of concealing turnover in the respective industry or sector.

4) Hidden redistribution encompasses the practice of tax, customs and excise duty evasion or non-payment, as well as the existence of VAT fraud schemes.
Decreasing Trends

Both the 2012 Hidden Economy Index for the businesses and the Index on Unreported Economic Activity of the population display decreasing trends.
Hidden Economy Index 2012 - Main Findings (cont.)

Figure 5: Hidden Economy Index 2002-2012

Source: Vitosha Research, CSD, Hidden Economy Survey on the Business
Figure 6: Unreported Economic Activity of the Population 2003-2012

Source: Vitosha Research, CSD, Hidden Economy Survey on the Population
Tax Evasion and Avoidance of Fees, Customs, and Excise Duties

Figure 7: Dynamics of Sub-index Redistribution

Source: Vitosha Research, CSD, Hidden Economy Survey on the Business
Monthly Cumulative VAT Revenue and Import Growth (y-o-y, %)

Source: CSD based on data from the Ministry of Finance and BNB
Monthly VAT Revenue and Import Growth (m-o-m, %)

Figure 9: Monthly Cumulative VAT Revenue and Import Growth (y-o-y, %)

Source: CSD based on data from the Ministry of Finance and BNB
Total Volume Imports vs. Import VAT (2008-2012)

**Figure 10: Total Volume Imports 2008-2012 (BGN bn)**

- 2008: 54.6
- 2009: 38.5
- 2010: 41.8
- 2011: 49.6
- 2012*: 41.2

**Figure 11: Import VAT 2008-2012 (BGN bn)**

- 2008: 4.03
- 2009: 2.38
- 2010: 2.88
- 2011: 3.37
- 2012*: 3.68

*Note: * projected

Source: BNB

Source: Customs Agency
Hidden Employment

Hidden employment has decreased in Bulgaria during the period between 2010 and 2012 due possibly to businesses’ initial reaction counteracting the effects of the crisis and laying off employees with no formal contracts which coupled with the lack of labor force re-entry after the end of the recession transferred into productivity rise and in turn temporary reduction of labor costs.

The practice of hiring of workers with no labor contract flattened out and saw little change downwards from 2010 to 2012 while instances of employment under a contract with hidden clauses (envelope wages) have also been on the decrease since 2009.

In the analyzed period, 10% of the population reported having received remuneration higher than the one stated in their contract with the primary employer.

The tendency to underreport actual remuneration continues to be pervasive, having important negative implications for the social security system.
Figure 12: Dynamics of Indexes “Hired without Contract” and “With Contract with Hidden Clauses”

Source: Vitosha Research, CSD, Hidden Economy Survey on the Business
Hidden Employment (cont.)

Figure 13: Hidden Contract Activities Index

Source: Vitosha Research, CSD, Hidden Economy Survey on the Population
### Table 1: Base Amount for Payment of Social Security Contributions under Primary Employment 2003-2012 (%)

<table>
<thead>
<tr>
<th>Type</th>
<th>2003</th>
<th>2004</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>The minimum social security threshold, although sum of my renumeration is higher</td>
<td>12.1</td>
<td>13.4</td>
<td>13.5</td>
<td>12.9</td>
<td>10.3</td>
<td>9.0</td>
</tr>
<tr>
<td>The minimum social security threshold, which is what I am actually paid</td>
<td>10.3</td>
<td>14.3</td>
<td>9.5</td>
<td>12.6</td>
<td>5.9</td>
<td>7.0</td>
</tr>
<tr>
<td>The amount stated in my contract even though the total sum of my renumeration is higher</td>
<td>6.7</td>
<td>8.3</td>
<td>15.0</td>
<td>15.5</td>
<td>8.4</td>
<td>13.0</td>
</tr>
<tr>
<td>The amount stated in my contract, which is what I am actually getting paid</td>
<td>68.3</td>
<td>63.4</td>
<td>61.8</td>
<td>56.2</td>
<td>67.0</td>
<td>67.0</td>
</tr>
<tr>
<td>Other</td>
<td>2.6</td>
<td>0.6</td>
<td>0.3</td>
<td>2.8</td>
<td>1.5</td>
<td>4.0</td>
</tr>
<tr>
<td>Base</td>
<td>348</td>
<td>314</td>
<td>378</td>
<td>395</td>
<td>466</td>
<td>420</td>
</tr>
</tbody>
</table>

### Table 2: Share of Employed under no Contract 2003 - 2012 (%)

<table>
<thead>
<tr>
<th>Type</th>
<th>2003</th>
<th>2004</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Without labor contract- primary employment</td>
<td>6.0</td>
<td>5.9</td>
<td>5.6</td>
<td>5.9</td>
<td>3.4</td>
<td>3.0</td>
</tr>
<tr>
<td>Without labor contract- secondary employment</td>
<td>77.4</td>
<td>59.1</td>
<td>51.5</td>
<td>51.0</td>
<td>38.1</td>
<td>29.0</td>
</tr>
</tbody>
</table>

Source: Vitosha Research, CSD, Hidden Economy Survey on the Population
Countering the Hidden Economy in Bulgaria: How Efficient Are Regulatory Agencies
Assessment of the Report Capacities of Regulatory Agencies

- National Revenue Agency (NRA)
- Chief Labor Inspectorate (CLI)
- Bulgarian Food Safety Agency (BFSA)
- Executive Forest Agency (EFA)
- National Construction Control Department (NCCD)
- Bulgarian Drug Agency
- Regional Health Inspectorates
- Regional Inspectorates on the Environment
Observations, conclusions, recommendations:

- Not all regulatory agencies have built up adequate basic public accountability mechanisms, such as publishing an annual activity report.

- None of the agencies provide a comprehensive efficiency and impact analysis of its work.

- NRA have started reporting on some impact indicators.

- Certain elements need to be present in order for visibility and quality control to be assured. Some of these elements include:
  
  - Details about staff, budget, type of governance;
  - Watchdog function;
  - Report on the service of information center, including fraud signals by citizens;
  - Actions taken as a result of citizens’ signals and complaints related to informal/not allowed activities;
  - Report on auditing revisions and results of specific regulatory actions;
Policy Actions on Hidden Economy - Recent Developments and Recommendations
Policy Actions on Hidden Economy - Intended Actions

- Goals set up by European Commission:
  - National level
  - EU level
  - International level

- Reforms envisaged by Bulgarian government (Budget 2013)
  - Customs Agency will continue monitoring the excise goods storage and measuring devices
  - Rates of the direct taxes will be kept unchanged, which together with increased control will stimulate the entry into official economy
Policy Actions on Hidden Economy - Recommendations

As suggested by CSD before, the use of ‘carrots’ rather than ‘sticks’ could serve as the main vehicle for improving the long-term prospects in the fight against the hidden economy.

Successful measures to reduce the level of hidden economy may include:

- indicators across government regulatory agencies
- tackling corruption through the introduction of e-services in administration
- speeding-up VAT refunds and reducing control checks on law-abiding companies
- administrative reform to speed-up payments on European programs
- better legal framework on late payments and business-to-business private debt
- special focus on improving legislature in terms of filing for bankruptcy in a retroactive manner
- promoting free enterprise and competition through improving the enforcement of the anti-monopoly legislation.
Thank You!

www.csd.bg