



Horizons of Politics
2014, Vol. 5, N° 13

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The Grey Economy of Post-Communist New EU Member States: Case of Bulgaria

Summary

The grey economy relates to activities that are not declared to the authorities for tax, social security or labour law purposes and have been widely recognised to have negative effects on society and the functioning of the market economy. In the light of persisting high unemployment and the economic recession across Europe, the grey economy has come under intense scrutiny as national governments try to balance budgets while avoiding increases in taxes and benefit cuts. On average across Europe, the shadow economy is as large as 18.5% of economic activity. In Eastern European nations such as Bulgaria, Croatia, Lithuania, and Estonia, the shadow economy is almost 30% of the size of the official economy. Bulgaria, the focus of this report, is increasingly included in international and European studies on the size and nature of the undeclared economy. Bulgaria joined the European Union in 2007 and ranks as the EU member state with the largest undeclared economy, estimated at 31% of GDP in 2013 [Schneider 2013]. Despite intensified repressive and control efforts on the part of the Bulgarian authorities, the high level of the grey economy signals deficiencies in the

functioning of the public institutions and the rule of law, and continues to be a major obstacle to economic development.

KEYWORDS

Grey Economy, Shadow Economy, Corruption, Privatisation, Bulgaria

SZARA STREFA EKONOMICZNA W PAŃSTWACH
POSTKOMUNISTYCZNYCH BĘDĄCYCH
NOWYMI CZŁONKAMI UNII EUROPEJSKIEJ
NA PRZYKŁADZIE BUŁGARII

Streszczenie

Szara strefa ekonomiczna dotyczy wszelkiej działalności gospodarczej, która nie jest deklарowana właściwym urzędом skarbowym w celu osiągnięcia korzyści wynikających z uniknięcia płacenia podatku, uzyskania zasiłku lub omińnięcia przepisów prawa. Jest ona szeroko uznawana za sferę mającą negatywny wpływ na społeczeństwo i funkcjonowanie gospodarki rynkowej. W warunkach utrzymującego się wysokiego bezrobocia i recesji w szeregu krajów europejskich szara gospodarka znalazła się w centrum uwagi rządów starających się zbilansować swoje budżety, unikając przy tym podnoszenia podatków i cięć wydatków na cele publiczne. Szara strefa ekonomiczna stanowi średnio aż 18,5% całej gospodarki w Europie, natomiast w takich krajach wschodnioeuropejskich jak Bułgaria, Chorwacja, Litwa i Estonia sięga ona prawie 30%. Obecna analiza koncentruje się na Bułgarii budzącej rosnące zainteresowanie w kontekście międzynarodowych, w tym europejskich, badań nad rozmiarami oraz charakterem tego rodzaju negatywnych zjawisk ekonomicznych. Bułgaria przystąpiła do Unii Europejskiej w 2007 roku i jest uważana za kraj o najwyższej niedeklarowanej działalności gospodarczej wśród państw unijnych, ocenianej na 31% PNB w 2013 roku [Schneider 2013]. Pomimo wzmożonej kontroli i karalności ze strony władz bułgarskich utrzymujący się wciąż wysoki poziom szarej strefy w ekonomii świadczy o brakach w funkcjonowaniu instytucji publicznych i regulacji prawnych oraz stanowi poważną przeszkodę rozwoju ekonomii w tym kraju.

SŁOWA KLUCZOWE

szara gospodarka, korupcja, prywatyzacja, Bułgaria

INTRODUCTION

The spread and consequences of the grey economy in Bulgaria is still being discussed even after the former Eastern European country joined the EU in January 2007. The extent of corruption and its relation with public procurement activities, transactions that go unreported and the economic development of the country with EU funds cover major aspects of this debate.

Many political analysts claim that the members of the former communist security service are closely linked to the political and business establishment. They are still believed to have remained influential, having a significant influence on the economic activity, even after the fall of communism in the 1990s [The Sofia Globe 2012]. A lack of lustration together with a lack of proper public debate on Bulgaria's communist past allowed former members of the communist secret services to hold power in different sectors of economic and social life, including politics (for example former, President Georgi Parvanov 2002-2012) and other political figures being a case in point) [Hristov 2011].

The early transition which began after the fall of communism was characterised by minor progress in the privatization process and a considerable drop in Bulgarian manufacturing output. This was a result of the inherited bureaucratic barriers during the market transition that led to obstructions when it came to transforming social and political mechanisms. These circumstances created a favorable environment for the spread of the grey economy and corruption practices interlinking the success of business operations with the administratively provided shelters. Even though the private sector already dominates most of Bulgaria's industrial sectors in recent years, the assertion that state bureaucracy still has a significant influence on economic activity is commonly shared by policy analysts. In 2012, a poll was conducted among 100 corporate members of the Bulgarian Chamber of Commerce and Industry in a bid to evaluate the business and investment climate in Bulgaria. The majority of the companies polled complained about corruption in public institutions and competition from companies operating in the grey economy [Novinite 2012].

It is acknowledged that corruption restrains economic growth and the overall efficiency in an economy as well as creating distortions in

competition. Katsios [2006] notes that excessive regulations obstruct the redistributive and stabilization function of the government and create favorable conditions for a spread of bribery practices. However, the interrelation between corruption and the grey economy needs to be analyzed as a complex economic phenomenon where both substitutive and complementary effects are possible [Schneider, Enste 2000].

According to Georgi Angelov [Novinite 2012], a senior economist at Sofia-based Open Society Institute,

The people working in the grey economy deal only with cash. They steer clear of taxes and excise duties and will not lose their sleep over the new tax. They just don't keep their money in banks, unlike many others who are on the payroll and have already paid excise duties, insurances, taxes and everything else.

The main goal of this paper is to show and to discuss the problem of the grey economy and corruption in Bulgaria as well as its significance and interrelations between politics and economy. This paper will provide a descriptive overview of the transition processes in Bulgaria with respect to the privatisation era although it does not analyze these processes in-depth. The introductory part of this paper deals with the concept of the grey economy; furthermore, its extent in Europe and the case of Bulgaria are discussed in detail. Moreover, a brief insight is provided on how the grey economy and corruption is interlinked in Bulgarian politics and economy. The paper is based on a literature review on the subject topic as well as on reports and statistical data on the privatisation process and economic indicators taken from the Privatization and Post-Privatization Control Agency (PPCA) and the National Statistical Institute (NSI) respectively.

TRANSFORMATION OF THE ECONOMY AND PRIVATISATION ERA

The political change in 1989 was not a result of any natural processes of the maturing of Bulgarian society, it was rather caused by external factors. In the absence of incremental institutional change, incremental structural deformations are expected [North 1990]. Communist

regimes had placed almost all the productive assets of the economy into state hands for ideological reasons, and to facilitate the planning process. Privatisation was regarded as essential to transform the country from a communist centralised command economy to a market economy. It should be stressed that “privatization is not just one of the many items on the economic program. It is the transformation itself” [Nellis 2001, p. 32].

During the transition to democracy and to market economy, the privatisation of state-owned enterprises was a heavily exploited area facilitating corruption. With the imperative to replace the planned economy with the discipline of the market, there were identifiable and emerging fault lines, such as the fact that the checks and balances of a comprehensive legal and regulatory system were non-existent.

The Privatisation Agency in Bulgaria established by the Privatisation Act of 1992 did not have the independence, power or will to effectively regulate the privatisation process. Below a certain asset value threshold, the principal ministries (who effectively owned the enterprises) were also responsible for implementing privatisation deals. The respective ministers were in charge of administering and approving deals and were held responsible before the Parliament and the relevant Parliamentary Committee [Bojicic-Dzelilovic, Bojkov 2005].

Barnes [2007] indicated that while initially there was one bank controlling the regulation of the money supply and acting as a creditor for industrial and commercial enterprises, it evolved to a collection of poorly monitored banks that were owned by former ministries which often had 80% of their assets tied up in one firm and could “blackmail” the central bank for refinancing aid with the claim that the absence of support could cause irreparable damage to an entire sector of a local economy.

The existence of a weak regulatory structure hampered by fragmentation and the ability of government ministers to privatise parts of the state asset portfolio without any political or democratic oversight created an institutional vacuum which was successfully filled by organised crime. For example, some 17.000 employees of the Ministry of the Interior were forced to resign. As a result, these officials used their past contacts and access to classified economic intelligence, thus creating opportunities as security and business consultants, and as

protection racketeers. In addition, former party members advantageously exploited the reform programme by capitalising on the privatisation process through deals with private contractors, and also through fraudulent import-export schemes by creating smuggling networks, primarily for cigarettes. As a case in point, Barnes [2007] explains how the growth of an economic conglomerate – “Multigrup” was aided by its patron Andrei Lukanov, a foreign trade ministry official in the Todor Zhivkov regime (former communist dictator of Bulgaria, 1954-1989).

Mr. Lukanov aided in the preparation of Bulgaria’s regulations governing economic liberalisation in the late 1980’s. These rules had sufficient loopholes for Multigrup to exploit and amass great wealth through: “arbitrage, smuggling and money laundering” [Barnes 2007, p. 76]. As communism started to fade away, conglomerates emerged with an increasing number methods for transferring state assets to their own control.

Although the Privatization Act came to being in 1992, the first state-owned enterprise was privatized in February 1993. According to Gheorge [2006], there are standard and non-standard means of privatisation: the standard means used in Eastern Europe were: public auction, public tender and direct selling. The non-standard means are employed in general mass privatisation schemes like the voucher scheme or the manager employee buyout scheme. In relation to Bulgaria in the early 1990s, there was no consensus about which model of privatisation should be applied. The former communist party which had rebranded itself into the Bulgarian Socialist Party (BSP) was openly against large scale privatisation. The grounds against privatisation by BSP was the concern to recover as much as possible from every state enterprise before selling it, and a preference for selling to Bulgarian citizens and employees rather than to foreign investors [Bojicic-Dzelilovic, Bojkov 2005].

Only 2.396 enterprises have been privatised for the whole period (1992-1996), the major part of them being municipal property or parts of enterprises. By 1995, more favorable conditions prevailed such as clear political support, intensive preparation, the availability of new types of financial instruments, and the simple fact that the officials responsible for privatization had nearly three years of experience. In early 1997, Bulgaria was on the edge of economic disaster. By then,

the cabinet and the pro-reform Union of Democratic Forces demonstrated the political will and capacity to undertake further reforms to the economy. The main stabilization factor was the creation of the currency board on July 1, 1997.

Substantial progress in privatisation was observed in 1997-1998 connected with the finalisation of a number of large-scale deals as well as the completion of the mass privatisation. About 1.000 enterprises were privatised – entirely or in part – through vouchers. In the period 1992-1997 about 20% of total enterprise assets were privatised. In 1997, there was an acceleration of this process, e.g. about 4% of assets were privatised through cash sales with 421.4 million USD in proceeds.

However, the data for 1998 show only 145.8 million USD in privatisation proceeds. The main reason for the slow progress is the continuing fight for corporate control between different groups of interests and new “crony firms.”

By the end of 1999, the private sector accounted for nearly 65.3% of value added in the whole economy. In 2000, the private sector accounted for 69.3% of value added in the Bulgarian economy, showing a steady growth during last years.

The total percentage of privatised assets since the beginning of the privatisation process from 1 January 1993, until the end of November 1999, is 46.3%, which is more than 70% of that due to be privatised in the mid-term state assets. Between 1 January 1993 and 31 December 1999, the total privatisation effect was 6.501.663 million USD.

The social price tag of the Bulgarian privatisation was comparatively higher overlooking former socialist countries such as the Czech Republic, Poland, Hungary and the Baltic countries. This is evident from the increased unemployment resulting from privatisation and the inability of the state in the transition period to compensate for it by using appropriate social measures. According to Rumjana Zeleva (the Balkan Institute for Labour and Social Policy), the state’s efforts to compensate the negative social effects of privatisation have mainly been directed towards imposing social and employment commitments on the new owners of former state-owned enterprises [Zeleva 2004].

THE DRIVING FORCES OF THE GREY ECONOMY

As the grey economy is constantly adjusting to changes in tax laws, societies' morals and so forth, a more precise definition is difficult to make albeit substantial literature which focuses on various dimensions of the concept [Schneider, Enste 2002]. In simple terms, the "grey" economy constitutes all economic activities that, generally, would be taxable if reported to the state.

According to Friedrich Schneider, who has written extensively on the "grey economy," a more narrow definition would state that the grey economy is associated to all market-based legal production of goods and services that are deliberately concealed from public authorities for the following reasons [Schneider et al. 2010, p. 5]:

- to avoid payment of income, value added or other taxes,
- to avoid payment of social security contributions,
- to avoid having to meet certain legal labour market standards, such as minimum wages, maximum working hours, safety standards, etc., and
- to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms.

According to Schneider [2013], grey economy is nurtured by several interlocking factors: the predominance of cash, a lack of transparency surrounding transactions, and limited enforcement of laws. The shadow economy offers questionable individual benefits at the expense of the many, resisting the world's increasing digitalisation and connectivity and hampering the public good. There are four main factors identified by Schneider, which are as follows: savings; lack of a "guilty conscience"; low risk of detection; ease of participation (Table 1).

Table 1: Four Driving Forces of the Grey Economy according to Friedrich Schneider

Savings	By working outside the active economy, participants can avoid taxes and possibly social security payments, circumvent tax and labour regulations, and sidestep paperwork. A strong causal relationship exists between a country's tax rate and the size of its shadow economy. This relationship is especially pronounced during downturns.
Lack of a "guilty conscience"	The shadow economy is often considered a normal part of society. This attitude is prevalent in countries where the perceived quality of state institutions and benefits is low or confidence in the state has been shaken.
Low risk of detection	Participating in the shadow economy is illegal, but the less chance there is of getting caught and the lower the penalties, the more individuals will consider the risk worthwhile. Thus, reducing the shadow economy requires a clear legal stance and strong enforcement.
Ease of participation	Paying with cash makes it easier to engage in the shadow economy, since cash payments cannot be traced. The shadow economy is clearly a cash-based economy, and cash is the fuel in its engine.

Source: own compilation based on [Buehn, Schneider 2013]

THE GREY ECONOMY IN BULGARIA IN THE WIDER CONTEXT OF EUROPE

In order to study the structure of the grey economy in Europe and identify the measures to reduce it, a report was commissioned in 2013 by Visa Europe and jointly conducted in cooperation with Visa Europe and F. Schneider. In this section, we shall briefly list some of the findings [Schneider 2013].

According to the report, the grey economy in Europe as of March 2013 is worth more than 2.1 trillion EUR. Following the recent crisis, the shadow economy has come under intense scrutiny as national governments are trying to balance budgets while avoiding increases in taxes and benefit cuts.

Grey economy activities fall into two categories which is typically common across Europe. The first is undeclared work, which accounts for roughly two-thirds of the shadow economy. Being widespread in construction, agriculture, and household services (such as cleaning, babysitting, elderly care, and tutoring), undeclared work includes wages that workers and businesses do not declare to the government to avoid taxes or documentation. The remaining one-third comes from underreporting, caused when businesses – primarily those that

deal heavily in cash, for instance, small shops, report only part of their income to avoid some of the tax burden.

As per F. Schneider's findings, the size of the shadow economy in Europe reached a 10-year low in 2013, and is now estimated at 2.15 trillion EUR [Schneider 2013]. On average across Europe, the shadow economy is as large as 18.5% of economic activity (see table 2). However, in Eastern Europe the shadow economy is much larger in relation to the size of the official economy than in Western Europe. In Eastern European nations such as Bulgaria, Croatia, Lithuania, and Estonia, the shadow economy is almost 30% the size of the official economy.

Since 2011, progress in Europe has followed three different paths. In Western Europe, the shadow economy is relatively small due to mild economic improvements and an existing legal framework designed to reduce the shadow economy, whereas in Eastern Europe, where GDP growth is generally high, the shadow economy remains strong but not as much as it once was. Last but not least, in Southern Europe, progress has ground to a halt, with minimal reductions in the shadow economy relative to GDP. For instance, Spain's shadow economy relative to GDP is almost flat, from 18.7% in 2008 to 18.6% in 2013.

In the decade leading up to the EU accession, Bulgaria embraced difficult reforms to build macroeconomic stability and stimulate growth. According to Invest Bulgaria, a government agency, Bulgaria built fiscal buffers by accumulating fiscal surpluses between 2004 and 2008, and reduced public debt from over 70% of GDP in 2000 to 16.3% in 2010, one of the lowest debt levels in the EU today. Between 2000 and 2010, the average annual growth reached 4.7%. During that same period, Bulgaria's per capita income as a share of the EU average increased dramatically from 28% to 44%. In 2013, Bulgaria was amongst the most fiscally disciplined EU member states – an important feat in the context of global and European economic uncertainties. However, according to a recent survey by Bulgarian Industrial Association, Bulgarian GDP registered a 29% growth between 2007 and 2012 (i.e. 65.2 billion BGN to 77.5 billion BGN), the increase in tax collection was only 11% during the same period. A collapse in taxation is evident from the statistics [Novinite 2014].

The dynamics of the hidden or grey economy is an important indicator of the state of a country's institutions as well as of its competitive potential. According to different estimates, about a third

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of the world's GDP is within the "shadow turnover" [CSD 2011]. A communication from the European Commission to the EU council and the EU parliament indicated that Bulgaria is ranked first in the European Union in terms of the size (32.3%) of its grey economy as a percentage of its GDP. EU member states which follow Bulgaria have their shadow economies at below 30% of the GDP, according to the EC data (Table 2).

Table 2. The Shadow Economy in Europe in the years 2011-2013 (in % of official GDP)

Country	2011	2012	2013
Austria	7.9%	7.6%	7.5%
Belgium	17.1%	16.8%	16.4%
Bulgaria	32.3%	31.9%	31.2%
Cyprus	26.0%	25.6%	25.2%
Czech Republic	16.4%	16.0%	15.5%
Denmark	13.8%	13.4%	13.0%
Estonia	28.6%	28.2%	27.6%
Finland	13.7%	13.3%	13.0%
France	11.0%	10.8%	9.9%
Germany	13.7%	13.3%	13.0%
Greece	24.3%	24.0%	23.6%
Hungary	22.8%	22.5%	22.3%
Ireland	12.8%	12.7%	12.2%
Italy	21.2%	21.6%	21.1%
Latvia	26.5%	26.1%	25.5%
Lithuania	29.0%	28.5%	28.0%
Luxembourg	8.2%	8.2%	8.0%
Malta	25.8%	25.3%	24.3%
Netherlands	9.8%	9.5%	9.3%
Poland	25.0%	24.4%	23.8%
Portugal	19.4%	19.4%	19.0%
Romania	29.6%	29.1%	28.4%
Slovenia	24.1%	23.6%	23.1%
Spain	19.2%	19.2%	18.6%
Slovakia	16.0%	15.5%	15.0%
Sweden	14.7%	14.3%	13.9%
United Kingdom	10.5%	10.1%	9.7%
Subtotal (EU-27)	19.2%	18.9%	18.4%

Source: own compilation based on [Schneider 2013].

No matter how commendable the numbers, it remains the poorest country within the Union, with minimum salaries barely reaching 200 EUR per month. According to IMF's comments on the country's development, public finance stability of Bulgaria is not enough to increase the Bulgarians' income and living standards.¹ The legislative framework of business activities and taxation has undergone a prolonged period of adjustment which often resulted in a chronic dependence on regularly changing bureaucratic discretion [Kelchev 2006]. As Bulgaria's trading partners suffered through the recession, the volume of exports fell (especially at the end of 2008 and the first quarter of 2009) and the credit boom came to an end in 2009, with credit flows coming to a halt the fourth quarter of 2008. The latter affected businesses and households alike, and in 2009 the full impact of the above shocks manifested itself in a drop in the country's GDP for the first time since the crisis in 1996-1997. As a result, employment slumped, unemployment rose sharply and consumption declined leading to fears of protracted jobless recovery in 2011-2012. According to the 2010 annual report of the Center for Study of Democracy (CSD) in Bulgaria, the share of the grey economy among the business and the population in Bulgaria increased in 2013. As indicated earlier, the report suggests that poverty, the crisis on the labor market and economic stagnation create favorable conditions for the development of the grey economy. These factors are supplemented by the change of the Bulgarian government and the political turbulence in the country.

The high price of entrepreneurship coupled with a heavy administrative burden and weak consumer demand, involvement in the informal sector becomes an important means for a business start-up. Moreover, informal employment is socially accepted in Bulgaria. For instance, speaking on the national channel bTV, Bulgaria's former Economy Minister Traicho Traikov stated "black or not, the economy

1 According to the International Monetary Fund, at the projected average rate of 2% GDP growth in 2014, Bulgaria will need 40 years to reach the income and living standards of the rich European countries. "Progress in addressing institutional and broader structural gaps (including those that contribute to corruption and cronyism) is needed to set the foundation for stronger growth and job creation." IMF, Bulgaria: Staff Report for the 2013 Article IV Consultation, January 30, 2014 <<http://www.imf.org/external/pubs/cat/longres.aspx?sk=41288.0>>

exists and creates gross domestic product.” According to him, it was “better to have a black economy than none.” The comment triggered astonishment nationwide not because of its substance, but due to the fact that it came from a government minister [Novinite 2011].

According to a survey by the Bulgarian Industrial Association (BIA), it is known that the grey economy turnover in Bulgaria was 12.4 billion BGN between 2008 and 2012. The report indicates that the industrial sectors with the largest share of “grey area” are construction, trade, and tourism. The informal economy augments with 3.4% each year according to the executive chair of the BIA Bozhidar Danev [SeeNews 2014]. Ruslan Stefan, an expert from the Center for the Study of Democracy states that no decline of the grey economy was registered in the five years following the accession of Bulgaria to the EU [BNR 2013].

According to a report from the National Revenue Agency (NRA), Bulgaria loses around 440 million BGN a year due to the evasion of taxes and social security contributions [Novinite 2014]. The most recurring grey area activities from where losses are stemming are:

1. Hidden social and health contributions due to undeclared incomes
2. VAT frauds
3. Public Procurement and Money Laundering

Hidden social and health contributions due to undeclared incomes

Envelope wages, also known as grey pay, through which employers evade their full social insurance and tax liabilities, are among the most common type of violation. According to data from the annual report of the Center for the Study of Democracy (CSD), nearly 14% of working people in Bulgaria have received more money than has been officially declared (BNR 2013). According to a survey of the Bulgarian think tank the Institute for Market Economics, around 25% of the working population in the country is employed at the minimum threshold for the respective job, as a result of which over 550 000 people out of a total of 2.23 million employed persons, receive the lowest payment in the sector. To illustrate how this is achieved,

consider an example: An office employee signs under 500 EUR a month. The worker and his employer pay monthly contributions based on the abovementioned sum. The real salary paid by the employer, however, is twice bigger – 1,000 EUR. Thus, no taxes are paid over the difference of 500 EUR. In addition, employers usually declare that their employees work on a 4-hour schedule when they actually work longer hours [BNR 2013]. According to the NRA report, some 54% of employers commit fraud by not declaring the full amount of the salaries of their workers [Novinite 2014]. Another survey, cited by Investor.bg website, shows that undeclared employment in Bulgaria is the highest among European countries – somewhere between 22 and 30%.

VAT frauds

According to Professor Ivan Angelov from the Institute of Economics at the Bulgarian Academy of Sciences, the real unemployment rate in this country amounts to nearly 20%. According to various estimates, some 740 million EUR is lost per year due to concealed value added tax and social contributions. As per the NRA report in 2014, receipts from VAT and excise duty, at 11,421 billion BGN, to which each person contributes by consuming, suggest that 26.5% of them are not backed by taxes or social security contributions. According to the National Revenue Agency head, Krasimir Stefanov, official estimates show that in 2005-2009, Bulgaria lost over 3 billion BGN from VAT fraud [OCCRP 2011].²

2 Krassimir Stefanov, former head of NRA, has stated that in Bulgaria, the wholesale trade in oil and grain with Romania, Russia and Greece are the most vulnerable to tax fraud. This is also one of the reasons why the Bulgarian Customs Agency started investigating contraband fuel. This eventually led the customs agency to revoke the Russian oil company Lukoil's storage license in Bulgaria. According to K.Stefanov, the largest VAT fraud attempts in Bulgaria occur in deals between Bulgarian firms and their partners in Greece and Romania.

Public Procurement and Money Laundering

According to Ruslan Stefanov, Bulgarian politicians love mega projects, as they provide the best opportunities for fraud and corruption worldwide. When the institutions which counteract to these processes are weak, there is a higher risk that all grey and undeclared payments will increase [BNR 2013]. An alarming statistic to complement the above is provided by Eleonora Nikolova, head of the Center for Prevention and Countering Corruption and Organized Crime (BOR-KOR) showing that 98% of public procurement deals are won by 2% of the companies in Bulgaria [Novinite 2013].

The capacity of the Bulgarian authorities to reveal money laundering cases is also very low. The issue regarding the offshore companies and the secret bank accounts of Bulgarian politicians in foreign banks has recently become topical. Bank accounts in foreign banks usually means hidden incomes or corrupt payments that were made in the past. Take for example, the most recent political case: Hristo Biserov, former Deputy Speaker of the Bulgarian Parliament, was charged with money laundering and document fraud in 2014. The tipoff about the crimes was sent to Bulgaria's State Agency for National Security (DANS) by a foreign special service. Transfers from Biserov's Swiss account to assets of his stepson, Ivaylo Glavinkov, in Macedonia have attracted the attention of agents, and after a second tranche of 50.000 USD, they notified their Bulgarian counterparts [Novinite 2013]. If there are problems regarding the execution of law at the high political level, a citizen cannot expect the authorities to act adequately towards cases related to ordinary citizens and taxpayers. These effects discourage people who stay away from the grey economy.

Recent claims by various industry associations and economic experts point to the fact that the grey economy in Bulgaria is shrinking but at an unsatisfactory pace. For instance, Milena Angelova, Chief Secretary of the Bulgarian Industrial Capital Association (BICA), has claimed that the share of the grey economy in Bulgaria is decreasing. Angelova has argued that the reasons for the existence of the grey economy remained in place. According to her, the business sector still says that the main reason for operating in the grey sector is not so much the economic incentives but the numerous administrative

requirements which are difficult to meet. The highly publicised e-government has not yet been implemented [Novinite 2012].

BULGARIAN POLICY AGAINST THE GREY ECONOMY

The Bulgarian Government had undertaken a set of measure to counteract the ever surfacing grey economy, largely targeting hidden business turnover and remuneration. Examples of measures directly or indirectly affecting the hidden economy in 2010 include:

- checks and revisions carried out by the National Revenue Agency and the Chief Labor Inspectorate;
- a restriction to cash payments of over 5000 to be carried out only through a bank transfer (applicable to all legal and natural persons);
- a bill limiting cash payments also introduced changes to the Labour Code; these changes involve the requirement for payment of employees' wages through a non-cash bank transfer;
- as of 2011, each cash registry/fiscal device in Bulgaria will be connected to the computer system of the National Revenue Agency. Information from fiscal devices will be automatically available to the NRA, allowing remote access to data and instantaneous inspections;
- eased start-up for businesses through a reduction in the minimum capital requirement from 5,000 BGN to 2 BGN, and a reduction in the rates for employer contributions to social security.
- a proposal to prohibit persons, who have been proven to have managed poorly a commercial property, from managing another enterprise;
- suggested measures to include electronic payments for public sector services, which requires the existence of POS terminals in hospitals and other medical centers, academic institutions, post offices, offices of municipalities, etc.
- the introduction of more controls on excise goods trade: (a) direct connection between all petrol stations' pumps and the National Revenue Agency for real time data communication; (b) introducing stricter licensing for cigarette retail outlets; (c) installing monitoring devices on alcohol producing facilities with direct connection to Customs agency control system, etc.

According to Kamen Kolev, Deputy Chair of the Bulgarian Industrial Association, a series of measures adopted by the National Revenue Agency (NRA), such as the connection of cash registers to the NRA database, cash payments, and access to credit records of audited firms, have helped to reduce the share of the informal economy in Bulgaria [Novinite 2012]. Kolev has argued that the electronization of public procurement, regulatory regimes, licenses, permits, payments to the state, would help eliminate the serious problems of red tape and corruption.

Economic policy analysts agree that grey business activities and corruption practices are interlinked phenomena. A lower level of corruption in the public sector should restrict the scope of the grey economy, and *vice versa* – with restrained grey activities, corruption would be substantially hindered.

According to Evgenii Dainov [2004], corruption is the bridge that links the grey and the black economy. Corruption is a sufficient explanation – sufficient cause – of the current government's notorious inability to limit the influence of organized economic-criminal interests. In 2008 and 2009, the European Commission published highly-critical reports on the progress Romania and Bulgaria had made to address corruption. The reports on Bulgaria acknowledged progress but stated that these steps are confined to the technical level and have limited impact. While increased overall awareness and these individual initiatives are to be welcomed, they are not adequately backed up by a broad political consensus or a convincing strategy to make the fight against corruption the top priority for Bulgaria.³

The Corruption Perceptions Index ranks countries and territories based on how corrupt their public sector is perceived to be. A country or territory's score indicates the perceived level of public sector

3 Bulgaria and Romania need to meet the benchmarks set for progress with judicial reform, the fight against corruption and, concerning Bulgaria, the fight against organised crime, in order to have the EU monitoring under the Cooperation and Verification Mechanism (CVM) lifted. The CVM reports reflect on 5 years of progress and find that for Bulgaria, continued problems exist with organized crime and weak law enforcement. See more at: Commission of the European Communities. (2009) Report From the Commission to the European Parliament and the council on the progress in Bulgaria under the Co-operation and Verification Mechanism. Com (2009) 402 Final. Luxembourg, pp 6-7.

corruption on a scale of 0-100, where 0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean. A country's rank indicates its position relative to the other countries and territories included in the index. The 2013 report explicitly notes that any score below 50 points is problematic. One of the main conclusions of the report is that the poorer a country, the higher and most wide-spread corruption is.

In the case of Bulgaria, it has been ranked again as being bottom of the EU for 2013. However, for the second year in a row, Bulgaria is not the most corrupt among the EU Member States, which has ranked the country 77th out of a total of 177 with 41 points. Romania is ahead of Bulgaria with its 43 points and 69th spot (66th in 2012) [Novinite 2013].

In his speech titled "7 years in Bulgaria: Some reflections," the British Ambassador to Bulgaria, Steve Williams, (1984-1987 and 2007-2011), stated:

One of the ironies of communism was of course that it was one of the most hierarchical ideologies. All men are equal, but some are more equal than others, as George Orwell famously put it. 24 years on, it is depressing that the same phenomenon exists: big black cars flashing headlights, and drivers that think one rule applies to them and another for the "ordinary people"... This time the drivers of this type are not the political elite, but the leading figures from the "grey economy" to put it kindly.

The widespread conviction that corruption is the rule rather than the exception discourages investment plans and slows down the trend of the emergence from the grey to the formal area of economic activity. The achievement of better results in combating corruption is unlikely without sustained efforts in the finalization of structural and institutional reforms. Moreover, in the framework of the adopted EU legislation and transparency requirements, the enforcement of anti-corruption measures becomes much more important for the current Bulgarian public policy.

CONCLUSION

One of the most serious problems for the country is its disembodiedness from formal normative regulation. Bulgaria is not an exception – it is rather an extreme case, in which the newly introduced institutional framework of the market economy is still not functioning properly. Historically, formal legislation never had a chance to develop from indigenous customary law; the legal system has always been either borrowed or imposed. From this perspective, the informal economy indicates an incompatibility of rules and everyday practices. This economy has produced during the last ten years social or institutional deformations which cannot be cured simply by direct social and economic policy measures.

Since the fall of its communist regime 23 years ago and its successive transformation from a state-planned to market economy, behind-the-scenes networks have formed, consisting primarily of members of the former communist nomenclature. Even today, they control the decision-making processes within the country, operating in a grey area between politics, justice and the economy. This necessitates additional comprehensive investigation of the options for the implementation of potentially effective tools that will be able to restrain, as much as possible, the extent of the grey economy operations and induce a higher degree of societal intolerance of corruption, fraudulent behavior, and tax evasion.

The drastic impoverishment and high unemployment still encourage people to become involved in the informal sector. Although the firms and individuals benefit in the short-run from informal operations, the total economic effect of the informal economy in Bulgaria is generally negative. At a macro level, it lowers the competitiveness of the national economy, slows down economic growth, prevents the implementation of state policies and labor regulations, and thus, distorts the proper functioning of the market. In sum, the economic and social disintegration which was obvious before 1997 has not yet been overcome.

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