



Press Release

Policy Forum Tackling the Hidden Economy: Employing Best EU Policy Practices for Growth and Jobs

Skopje, 13.10.2015

The Center for Research and Policy Making (CRPM) together with its partner from Sofia, the Center for the Study of Democracy (CSD) presented during a public policy forum held on **13 October 2015 at 11:00 h.** in the conference hall of **hotel Alexander Palace**, Skopje, the results and recommendations of the project “*Promoting Good Governance and Economic Rights through Empowering Civil Society to Monitor and Tackle the Hidden Economy*”, which began back in February 2014. The forum was opened by **Mr. Jaromír Levíček**, Head of Operations 1: Economic Affairs, Institution Building, Pre-accession Reporting at the Delegation of the European Union who noted the importance of tackling the hidden economy in the country, and in particularly undeclared employment and its negative impact on vulnerable groups. A special guest of the forum was **Professor Colin Williams** from the University of Sheffield, one of the foremost experts on undeclared work in Europe, who delivered an overview of the emerging good practices in tackling informal employment in the European Union. **Mr. Emil Shurkov** from CRPM presented the finding from the report *Monitoring the Hidden Economy: Trends and Policy Options*, an important policy guidance for the government and the private sector on tackling the hidden economy in the country. **Dr. Marija Risteska**, CRPM and **Mr. Ruslan Stefanov**, CSD presented the organisers’ idea and progress on developing a *Hidden Economy Task Force*, a public private platform for policy dialogue, which has been joined by the Ministry of Labour and Social Policy and by other stakeholders. Below is a summary of the report’s findings and key recommendations.

The hidden economy is a multidimensional phenomenon which depends on the scope of the legislation, the existence or lack of fiscal and tax discipline, the degree of complexity of the procedures for registration of business entities, the structure of the labor market and the effectiveness of inspection services and available resources. In this regard, **the hidden economy cannot be accurately measured** as a share of the overall economy, which in turn causes **serious problems in planning of economic and social policies**. There are different ways of measuring the hidden economy (direct and indirect), which lead to different results. Hence we have estimates of its share in this country vary from **45% of GDP** (according to some international researchers), down to 30% according to estimates of the Ministry the Economy. Other domestic analyses calculate the share of the hidden economy at **24% of GDP** (CEA, 2012).



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The European Commission is the EU’s executive body .

“The European Union is made up of 27 Member States who have decided to gradually link together their know-how, resources and destinies. Together, during a period of enlargement of 50 years, they have built a zone of stability, democracy and sustainable development whilst maintaining cultural diversity, tolerance and individual freedoms. The European Union is committed to sharing its achievements and its values with countries and peoples beyond its borders”.

However, all estimates indicate that the hidden economy in the country is high, making it a serious social problem. Possible adverse results include social tensions and growing inequality gap in earnings, corruption and criminal activities.

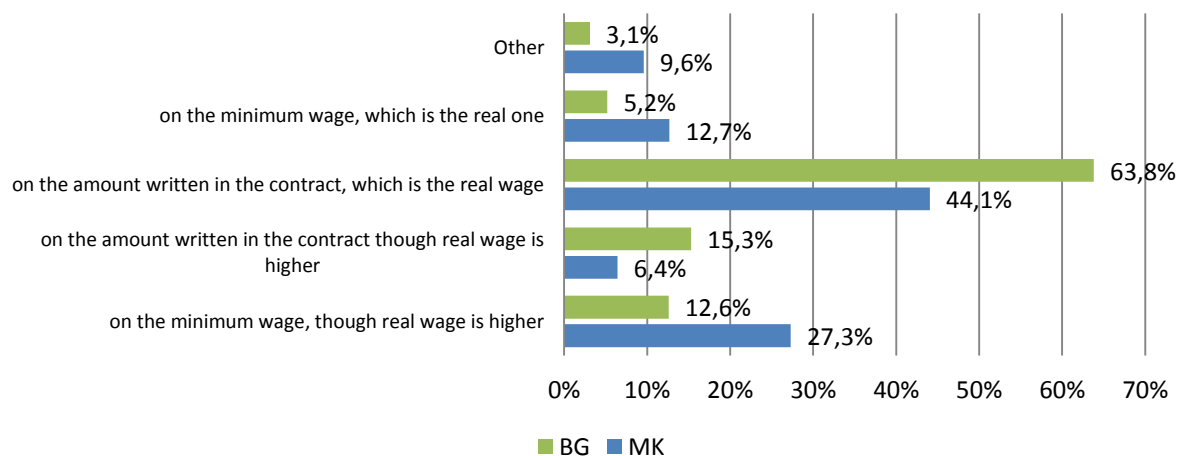
The high **unemployment rate (27.3% Q1 2015)**, high **long-term unemployment of over 80%** and **youth unemployment (47.6% Q1 2015)** means that the unemployed deal with fairly difficult conditions for entering the labor market, which in turn leads to the substantial impetus for participation in the informal economy. In order to investigate the specifics of the local economy that are associated with different forms of hidden activities, in October 2014 CRPM conducted a survey with a representative sample of 1116 respondents and 70 businesses.

The survey of the population suggests that **1/3 of the employees** with primary employment, besides regular salary, receive a **salary in an envelope or additional salary**. Additionally, **40% of the salary of employees with primary employment is partially or completely undeclared**. In terms of education, only 44% of the employees who have primary education have an employment contract, as opposed to 81% of those with higher educational degree. The difference is significant given the ethnic context.

The survey indicates that **1/3 of the companies are “manipulating VAT” and use “accounting tricks”** aimed at paying lower taxes in the sectors in which they operate. More than half of the employers confirm the presence of contracts with hidden clauses in their sector, as well as **1/3 of entrepreneurs indicate that 10% of the workers in their sector work without a contract**. But the data also shows existence of a stimulating business environment – according to **42% of the businesses the current tax system is not a problem for the development of their business or a minor problem (23%)**. In addition, half of the interviewed business representatives believe that the current level of the taxes is appropriate and encourages the development of their business.

The **Hidden Economy Index**, which was compiled with the help of these data and the Hidden Economy Monitoring System methodology (provided by the Center for the Study of Democracy - Sofia), suggests that the hidden economy in this country is not out of the already established framework and previous estimates. The assessment of the citizens (**index 3.36** on a scale of 1 to 10 - higher index means higher hidden economy) is higher than that of business owners and managers (**index 2.73**). The case with Bulgaria was similar in 2003 and 2009 that are considered one of the best years of the Bulgarian economy from 2000 to 2010. The index provides important value added for policy makers, as it will allow them to monitor the dynamics of the hidden economy in time and across other countries, and assess the impact of adopted policies.

Figure 1 - Basis for payment of the social/pension insurance vs. CSD survey data for Bulgaria (2013), (population)

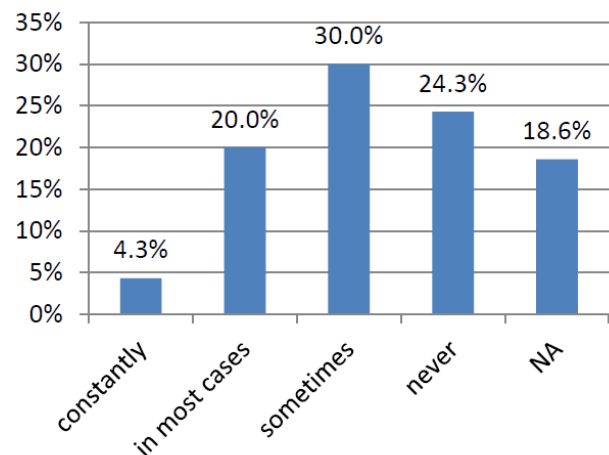


Source: Survey of 1116 respondents (2014), Monitoring the Hidden Economy: Trends and Policy Options, 2015.

The largest contribution to the difference between the estimates of the size of the hidden economy voiced by businesses and citizens is due to the hidden activity in the service sectors of the economy and the evasion of social security contributions. Additionally, over 50% of the respondents said that compulsory health and social insurance does not provide sufficient sense of security which in itself is an incentive for concealment of economic activities and evading taxes.

The data presented here, as well as all data included in the report *Monitoring the Hidden Economy: Trends and Policy Options* suggests that despite the existing measures already in place, additional efforts are needed in **evaluating the effectiveness of existing policies and measures, as well as analytical support and evidence-based enforcement of these measures**. Specific recommendations for policy measures are available in the monitoring report.

Figure 2 - Signing of contracts with 'hidden clauses', business survey



Source: Survey of 70 enterprises (2014), *Monitoring the Hidden Economy: Trends and Policy Options*, 2015.

Recommendations

- The government needs to step up its efforts in tackling the hidden economy by **ensuring better coordination and collaboration** between the key different ministries and institutions, such as the Ministry of Labour and Social Policy, Ministry of Finance, and the Ministry of Economy. In addition, there is a need for a much bigger involvement of **the parliament and the political parties** in finding working long-term solutions, as it is likely that the problem is here to stay irrespectively of the power constellation.
- The authorities in Skopje should carefully reconsider their longer-term strategy, as general government revenues have fallen steadily below 30% of GDP after 2011, which is a worrying indication of its **capacity to provide better public services in the future**. This implies a drastic increase in the efficiency of delivering public goods to the public, which does not seem to materialise.
- In order for the index to reliably show the trends and manifestations of the hidden economy and to serve as a basis for assessment of the policies' efficiency, it should be repeated every 2 years. **The authorities in collaboration with the social partners and other civil society stakeholders can use it to promote evidence-based public policies**. This cooperation can be realized in the form of a **hidden economy task force**.
- A widely accepted by policy makers, business associations and civil society **holistic measurement system of the hidden economy**, which will allow for thorough, reliable, valid, timely and sensitive to changes assessment of its dynamics, its causes, costs and effects. The **Hidden Economy Indexes** could serve as a first iteration to developing such a system;
- **Formalisation of businesses** might also be a **long and complex process which impacts market structure, rebalancing of the market power of existing players and consumers, and employment**. Hence, governments should plan their policies to tackle the hidden economy accounting for the impacts of the process and making sure it is fair and transparent.
- **Sequencing of reforms** is of paramount importance for limiting the social cost of transition from hidden to formal economy and preventing unfair advantages for business owners, who are close to law enforcement and control officials in charge of legalization processes.
- **A pragmatic policy to foster entrepreneurship and investments in the formal sector based on remittances** might contribute to the creation of new workplaces and economic

growth and lower the hidden economy.

- **Develop co-financing schemes for engagement of unemployed** with different magnitude of support based on type of unemployment and area of projects (youth unemployment, long-term unemployment, etc.). Long-term unemployment has already turned into permanent loss of employability for most of this group, which calls for sustained government social support.
- **Improve the success rate of programs dedicated for employment of members of vulnerable groups (Roma unemployed and social assistance receivers) through cooperation with external social partners and NGOs.**
- **Increase tax compliance readiness.** Simultaneous reduction of the cap and rates of social security with increase of the base of those paying could be helpful.
- **Increase the capacity of the administration** to detect non-compliers and to collect its debts.
- Broadening and harmonization of the VAT tax base would serve as an important instrument to limit the hidden economy. **Expedite VAT returns** in-line with increased institutional interoperability and data sharing.
- **Abolish the municipal corporate tax (firmarina)**, which although not substantial generates a lot of confusion and frustration.
- **Invest in the newly proposed Paperless Tax Administration** (new IT system for the Public Revenue Office).
- **Strengthen country-wide** whistle-blowing programmes piloting them in the customs. The program within customs should be synchronised with the rotation management, and random checks and this might have a considerable effect on corruption and hiding.
- **The State Labour Inspectorate (SLI)** should develop a reporting system that is compatible with the major data management systems and software.
- **The Financial Police (FP)** should implement the same data management system as the SLI, and ensure data exchange with the Public Revenue Office (the PRO).