

Institute for Market Economics, Bulgaria

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### **Will Bulgaria Fall a Victim of Its Democracy?**

By Krassen Stanchev

Bulgaria held general elections last Saturday, June 16. Two months before she signed EU Accession Treaty to formally join the Union with Romania on January 1, 2007. It still needs to enhance the rule of law, fix the user system for agriculture subsidies and enforce technical and environment standards. The Treaty envisages a delay of one year if conditions aren't met. The country is closing its 1970-1980's nuclear reactors. Rushing into the Union, the government failed negotiating grace periods that, according to industries, are mostly needed in the area of environment and the entry costs are higher than for 2004 members. The economy grows steadily at 5% a year. The democracy is stable; the former king, Simeon Saxe-Coburg-Gotha (69) won elections in 2001 and governs as PM.

Besides the costs, 76 % of Bulgarians approve EU, want a better, less corrupt, more caring and less taxing government to lead them into the EU. But they elected a parliament that would hardly speed up reforms, enhance prosperity and meet EU-requirements. Protecting themselves from imperfect politicians they run into a trouble of kicking themselves away from EU "safe havens."

### Who won?

The largest fraction is Coalition for Bulgaria led by former communist Bulgarian Socialist Party (BSP) – with 82 seats in 240-member legislature. The party Bulgaria Muslims and Turks vote for (MRF) received 34 seats and promised a coalition (irrespectively the fact that Communist renamed Turks in mid 1980's). This possible coalition is five seats short of 50+1 majority.

The incumbent PM's party (National Movement Simeon the Second, or NMSS) has 53 seats, i.e. 45% of what it got in 2001 elections. Another 50 seats are distributed between right-of-the-center parties, led by reformist ex-PM's and former chief EU negotiators of the Union of Democratic Forces (UDF), who, in 1997-2001 stopped the hyperinflation, privatized the economy, closed loss-making industries and set Bulgaria on prosperity, EU and NATO accession path. One is the caretaker PM of March-June 1997, Mr. Sofiansky, who stopped the hyperinflation and set the conditions for recovery. Then there is Mr. Kostov, 1997-2001 PM who brought the country back to the reforms track. And charming leader of the United Democratic Forces (UDF), Mrs. Michaylova, Mr. Kostov's foreign affairs minister hosting two-previous chief EU negotiators and the successful reformist ex-PM of 1991-1992, Mr. Dimitrov and ex-President Petar Stoyanov (1996-2001).

To complete the picture, the remaining 21 seats are held by the "Ataka" (Attack) Coalition (AC), a grouping that unites opportunists formerly belonging to BSP or

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UDF or both, allegedly united by common origin from Communist secret police. Whatever the background, they want “Bulgaria for Bulgarians”, re-nationalization of “murky” privatizations, ban on MRF, immediate withdrawal from Iraq, exiting NATO, sending gypsies to labor camps, “beneficial” EU entry combined with hating the West and strong hand justice. AC appeared on the stage six weeks before elections and won 8.5% of the vote, mostly from educated men of all walks of life fed up by political arrogance and hypocrisy. Interestingly enough, in its critique of the EU Ataka borrows argument and publications from Libertarian think tanks, as it was the case with recent publication by Cato’s William Niskanen and Marian Tupy article on the draft Constitution

### The best of all worlds

After successful start of reforms in 1991 (at the pace of Poland or the Czech Republic), BSP and MRF run the country via ad hoc majorities in 1993 and 1994. Then they kicked out their own Muppet-executive and in 1994-early 1997 the Socialist governed on their own, with a comfortable 53 percent of the seats. The result was regrettable; the country deteriorated to the group of poor reformers, mostly unfree countries (according to both the Fraser Institute and the Heritage/WSJ Indexes), the poverty rose four times and Bulgaria almost defaulted on its foreign debt in 1997. Only the fiscal costs of 1991-1997 banking crisis were 41% of GDP. The following table, which IME uses to monitor reforms in macroeconomic terms, gives an insight on how political parties contributed to the prosperity of the citizens

Indicators (average)	1990-1997 (Socialist influenced majorities, MRF including)	1998-2004 (Reforms led by non-Socialist)	2002-2004 (Incumbent government, MRF including)
Inflation (%)	210.1	7.5	4.8
Inflationary tax rate (%)	57.7	6.9	4.5
GDP growth (%)	- 4.7	4.4	5.0
GVA growth (%)	n.a.	4.0	4.9
Investment growth (%)	- 8.8	18.2	11.4
Budget deficit/surplus (% of GDP)	- 6.3	0.2	0.4
Government debt (% of GDP)	168	65.9	48.3
FDI (USD million, 1990-1996)	63.2	1,253.4	1,867.7
FDI (% of GDP)	0.8	7.4	9.1
Subsidies (% of GDP)	n.a	2.1	2.5

Then, the country was rescued by UDF and since 1998 enjoys its longest period of economic growth since 1911 (the eve of the of Balkan wars and the WWI). UDF stopped inflation and economic decline, privatized the industrial sector and gradually built up investors’ confidence, and,

according to the World Bank, reduced the poverty three times. Needless to say, the process was far from perfect and everyone expected more. The former king managed to sustain predecessors’ achievements, sealing EU and NATO prospects opened by them.

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Originally, he wanted to please everyone with taxpayers' money but the reasonable finance minister who teamed with IMF cooled down the spending zeal. Taxes were reduced; the income raised 6% per annum; virtually the entire banking industry is foreign owned; only the gas and tobacco (the process was blocked by MRF) monopolies remain to be privatized, while the power sector sales have taken off. There was and still is a consensus that Bulgaria is a success story, with reasonable growth, firm EU accession track record, sound money and profound fiscal stability, meeting all Maastricht criteria by 2009-2010. Why then the electoral failure?

Simply enough, Mr. Saxkoburgotski (the spelling is Bulgarian) is a victim of his own style of power-struggle. In order to appeal to voters in 2001, he pained UDF the immoral and corrupt government, promised "decency and integrity in everything" and "sensible improvement of the living standard" in two years. He also invited BSP and MRF to join the government. But income improvements were visible only to those who read statistics. The people witnessed, as usually happens, that for some living standard improvements are fast and sizable while for others - negligible or average. The integrity promise failed due to lack of accountability, instances of embezzlement in public procurement and alleged kick back to family, friends and supporters. Against this constellation all incumbents needed a scapegoat and a demon, to highlight own merits in comparison. And the demon was found in the reformist camp of predecessors, they were prosecuted and harassed, the tales of their fortunes were leaked to the press. Hence, the election outcome: the Socialist image is embellished, with 40% less votes than in 1994 they are biggest faction in the legislature.

### **Final countdown**

The election outcome is not the worst possible. The BSP election rhetoric included scary ideas, like "the government is

the master, the market is the servant", skipping or amending the currency board arrangement, increasing government expenditures (currently 42% of GDP highest in New Europe) and taxes, return to progressive taxation (after it was significantly flatten: corporate is 15%, personal income – 10-24%) and "taxing the wealthy". These ideas are unlikely to materialize. Probable common denominators in post-election policies are in line with low deficit, monetary stability and fiscal discipline.

Given the election results, the Socialists need a third coalition member besides "the Turks". It might be the King's or some of the right-of-the-center parties, although all of parties, except MRF, rejected openly BSP. The Socialist-led coalition government might be informal, i.e. NMSS and/or others could support the cabinet in exchange for concessions. Taxes will stop going down expenditures would rise. The same growth rate prospects (5.8-6%) are under question, since domestic policy factors would coincide with lower industrial output in the first quarter, central bank measures to cool credit expansion, higher oil prices and slower pace in public investment.

Bulgarian politicians are bad at joining efforts for common goal, which, in 2005, is meeting the 2007 EU accession deadline. The clock is ticking. The political and economic impact of EU convergence has been unambiguously positive. Bulgaria is benefiting from EU reform supervision and membership horizon renders confidence and stability, while the economy of scale boosts foreign investment flows. This prospect is in jeopardy, due to elections. It requires concerted efforts to pass number of laws to fix the judiciary and even change the constitution. While Bulgaria was preparing for elections, Romania stepped up its accession effort. Beside legislative job, Bulgaria needs efficient administration to implement already adopted acquis. But today it is rather redundant and counter productive. The country is already lagging behind Romania. Evoking the 2008 clause

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of the accession treaty seems inevitable. At stake is the very prospect of joining EU.

This prospect is not fully recognized and most coalition possibilities have questionable legitimacy.

Left of the center coalition is the first to be attempted; it has two versions – with or without MRF. Mr. Saxkoburgotski repeatedly rejects BSP-NMSS coalition as opportunistic but lead party members, e.g. the finance minister Milen Velchev, are on a different opinion. Socialist face a reputation problem: their government were failing in the last 16 years, they would like to prove they are capable of ruling and they intensively searching for both coalition partners and credible provisional cabinet

members. BSP advantage is that as an election winner it has the President, Mr. Parvanov, on its side, elected in 2001 from its own ranks. He would attempt lending helping hand, although his largely ceremonial constitutional powers are rather in time of political crisis. MRF is an undesired teammate due to past instances and habits of blackmailing partners, but a three party coalition is somewhat more likely. The next option is NMSS led coalition that cannot exclude MRF while center-right factions risk splitting if such talks start. Any option contains a risk of failing and/or loosing political support if fresh elections are to take place.

Year / period	Prime minister	Parliamentary Support	President and affiliation
1989 – January 1990	Georgy Atanassov	BCP	Peter Mladenov (BCP)
February 1990 – December 1990	Andrey Lukanov	BCP/BSP	Peter Mladenov (BCP) and after August 1990 - Zhelyo Zhelev (UDF)
December 1990 – November 1991*	Dimitar Popov	BSP/UDF and other parties	Zhelyo Zhelev (UDF)
November 1991 – December 1992	Filip Dimitrov	UDF (MRF until April 1992)	Zhelyo Zhelev (UDF)
December 1992 – September 1994	Luiben Berov	MRF mandate, ad hoc majorities, except UDF	Zhelyo Zhelev (UDF)
September 1994 – January 1995*	Reneta Indjova	Caretaker PM (appointed by the president)	Zhelyo Zhelev (UDF)
January 1995 – March 1997	Zhan Videnov	BSP	Zhelyo Zhelev (UDF)
March – June 1997	Stefan Sofianski	Caretaker PM	Petar Stoyanov (UDF)**
June 1997 – July 2001	Ivan Kostov	UDF	Petar Stoyanov (UDF)
July 2001 – July 2005 (?)	Simeon Saxe-Coburg-Gotha	NMSS	Georgy Parvanov (BSP)

### Notes:

\*Elections – October 1991

\*Elections – December 1994

\*\* Presidential election – October-November 1996

\*\*Presidential election – October 2001

BCP – Bulgarian Communist Party

BSP - Bulgarian Socialist Party (former BCP)

UDF – Union of Democratic Forces

MRF – Movement for Rights and Freedoms

NMSS – National Movement Simeon the Second

<b>Strengths</b>	<b>Weaknesses</b>
Little prospect for outrageous populist policies	Socialists in Bulgaria are more ideologically biased towards progressing taxation, government investment and pro-inflationary policies than any other party in New Europe
BSP motivation to make difference from the times it governed in the 1990's	The 'revenge' mood in BSP is very strong
Most center-right parties have common economic/fiscal policy ideas – lowering taxes, sustaining fiscal discipline and stability	No or virtually no common ideas between MRF/BSP on one side, and the rest of the parties on the other
Any credible executives would be in the same camp	Own reasonable economist in the Socialist camp have little political weight
EU accession is a priority, the accession treaty is signed	It is basically taken as access to EU taxpayers resources;
<b>Opportunities</b>	<b>Treats</b>
Common policy denominators sustain the development path already proven successful by previous governments	In rhetoric, BSP as the largest fraction is in almost complete disagreement with the 1997-2005 policy mixes
There is a strong up trend in the economy, the country is resilient to external shocks, The currency is stable and the currency board arrangement works well	A delayed EU accession, combined with enlargement fatigue and possible slow down in euro-zone demand could hit the long-term stability of the Bulgarian economy (since it is still less flexible than those of 2004 EU members)
EU accession deadlines force political parties to cooperate	There is little tradition to work together, and the possibility of fresh elections limit the desire to join efforts
By Autumn 2005 Romania would lead in the EU accession process	EU public opinion on enlargement is uneasy, close fatigue; ratification will start after there is a government in place, and EU issues its monitoring report
The president is from the rank of the winning party.	The president voice and role would have a decisive weight if the newly elected legislature fails to appoint and elect a new PM and a Council of Ministers.



## **Bulgaria Economic Development**

### **Dimitar Chobanov**

According to National Statistics Institute data for the first quarter of 2005 real gross domestic product (GDP) has increased by 6 per cent. These data are preliminary and will be revised at the end of 2005 but are good basis for analysis.

Gross value added (GAV) increases by 7.1 per cent. The main contributor for this development is the industry with real growth of about 8.2 per cent and services add 7.4 per cent more value but the agriculture sector has shrunk by 1.7 per cent in real terms.

Closer look at the industrial production data shows that the growth for the first quarter of the year has been decelerating after 2003 when it was 18.7 per cent and it was 14.8% and 11.1% for 2004 and 2005 respectively. This may hinge on seasonal factors because the growth in industrial production for the whole year has been rising after 2001. The annual growth has been 2.2% in 2001, 4.6% in 2002, 14% in 2003, and 17.7% in 2004.

Growing part of the value has been added by the private sector which real growth is 12.7 per cent in Q1 2005 relative to 7.4 per cent in Q1 2004, while the public sector has decreased its value added by 8.6 per cent. Privatization of the state

owned enterprises is one of the major determinants of this development but on the other hand the number of employed persons in this sector has continuously risen. This means that this sector's efficiency is even lower and it has become even greater burden for the whole economy. Larger public sector employment is actually deprives private companies of labor and money to pay bureaucrats' wages. This impedes the economic development and is an obstacle to the real growth acceleration.

The adjustments has been shrunk slightly (-0.1%) differing from the last year data. Then, there was fast development in the financial sector, mainly the banking, which is accounted in this item. After the credit restriction measures taken by the Bulgarian National Bank it is logical the growth rates to decelerate which probably would take effect in Q2 2005. Therefore we could expect a moderate growth in 2005.

The main GDP components – final consumption, gross fixed capital formation, export, and import have also realized a real growth. However, higher growth of final consumption causes a fall in gross savings to GDP ratio after five

consecutive quarters of increase. Savings are the source of investments in the economy, which share in GDP is relatively constant and this leads to a higher current account deficit and a financial account surplus because savings are actually imported from abroad.

Growth of gross fixed capital formation has decelerated to 9.2 per cent in Q1 2005 from 22.1 per cent in Q1 2004. This can be an indicator for slower economic growth in the next quarters because the trend during the last years is that lower investment growth leads to lower GDP growth.

One should note that part of the positive economic development is determined by the monetary expansion through low interest rates kept by the European Central Bank. This has directed capital flows to higher return countries like Bulgaria. Although we cannot expect a change in ECB's policy in 2005 this will happen later. Then, the economic growth would probably fall if the business environment has not changed positively by giving people more economic freedom.

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## **Bulgaria: Fiscal Environment and Taxes**

At the end of April 2005 the Institute for Market Economics published *White Paper on Achievements and Challenges of Business Environment Reforms (with an Exclusive Focus on SME)*. It was prepared with the support of USAID Enterprise Growth and Investment Project, MSI—Bulgaria. We will present the paper in the Economic Policy Review. In the current issue we publish the chapter *Fiscal Environment and Taxes*.

### **4.2. Fiscal Environment and Taxes**

#### 4.2.1. Tax reforms

In 1997 the corporate tax rate was above 40% and the top marginal individual income tax rate was 40%. In most of the years since 1997 these direct taxes were lowered and this happened under the rule of two different governments. In 2005 the corporate income tax is 15% - one of the lowest in Europe<sup>1</sup>. In 2005 the dividend tax

was reduced from 15% to 7%. Therefore, the corporate profit taxation is significantly reduced.

In 2005 the individual income tax is between 10 and 24% depending on the income. However, the social security tax is unchanged at the level of 42.7% (35% for sole proprietors), which is one of the highest in Europe. Taking into account both social security tax and income tax, the conclusion is that the total tax burden on individual income for most of the people is only a little lower.

The value-added tax is constant at 20%, but the other indirect taxes are increased every year. The reason is that Bulgarian government must impose the European Union minimum rates on excise duties before 2007 (2010 for cigarettes) when Bulgaria will become member of the union. In the next years the excise taxes will continue to rise. As a whole, the consumption

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<sup>1</sup> Only five European countries has lower corporate tax rate

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– Estonia (zero tax rate on reinvested profit), Montenegro (9%), Serbia (10%), Ireland (12.5%) and Cyprus (10% and 15%).

taxes are increased substantially, both as rates and revenues generated.

**Tax rates in Bulgaria**

	2001	2002	2003	2004	2005
Corporate tax	28%	23.5%	23.5%	19.5%	15%
Income tax	20-38%	18-29%	15-29%	12-29%	10-24%
Social security tax	42.7%	42.7%	42.7%	42.7%	42.7%
VAT	20%	20%	20%	20%	20%

Source: *State Gazette*, 2001 – 2004

**4.2.2. Fiscal redistribution**

Between 2001 and 2003, the consolidated government budget expenditures are maintained

at a level of about 40% of the gross domestic product with a low level of 39.4% in 2002. The revenues are increasing, reaching a 41.7% of GDP – the highest level since the middle 1990s.

**Consolidated Budget**

	2000	2001	2002	2003	2004
Revenues (% of GDP)	41.4%	39.8%	38.7%	40.7%	41.7%
Expenditures (% of GDP)	42.0%	40.4%	39.4%	40.7%	40.0%

Source: Ministry of Finance

According to Eurostat, in 2002 Bulgaria’s fiscal burden was higher than any of the new member states with the exception of Slovenia. But, as we mentioned above, 2002 was an exception with cyclically low fiscal burden. If we take data for a different year, Bulgaria has the highest tax burden among all the new member states. And it is quite higher than the average fiscal burden in the new member states – about 40% in Bulgaria compared to below 35% average in the region. What is more, there is one country with lower than 30% overall fiscal burden.

The consolidated expenditures in 2005 budget are less than 40%, but usually in the end of the year they are higher. There are many expenditures in the budget that are not efficient and can be optimized. The subsidies for loss-making activities and similar budget expenditures account for about 2% of GDP. The salaries of the budget employees are about 6% of GDP because the number of employees is much bigger than needed. Maintenance expenditures are more than 6% of GDP and they are rising rapidly. Bulgaria has one of the highest defense expenditures in Europe etc.

**Fiscal Burden in new EU member states**

Country	Total Fiscal Burden as % of GDP (2002)
Slovenia	39.8
Bulgaria	39.4
Poland	39.1
Hungary	38.8
Czech republic	35.4
Estonia	35.2
Slovakia	33
Cyprus	32.5
Latvia	31.3
Malta	31.3
Lithuania	28.8

Source: Eurostat

If the share of inefficient expenditures is decreased, Bulgarian fiscal burden can become much lower – in line with the low tax countries.



**2005 Consolidated Budget Expenditures**

	BGN mln.	% of GDP
<b>Total expenditures</b>	<b>16 262.6</b>	<b>39.3</b>
1. Non-interest expenditures	15 447.1	37.4
<i>Current non-interest expenditures</i>	13 402.6	32.4
Salaries and social security taxes	2 399	5.8
Maintenance	2 613.2	6.3
Defence and security	1 632.2	3.9
Subsidies	746.5	1.8
Social expenditures	6 011.7	14.5
- Pensions	3 668.1	8.9
- social benefits, compensations	1 219.6	2.9
- healthcare fund	863.6	2.1
- other	260.4	0.6
<i>Credits and temporary aid</i>	100	0.2
<i>Capital expenditures</i>	1 594.9	3.9
<i>Reserve</i>	349.6	0.8
2. Interest expenditures	815.6	2

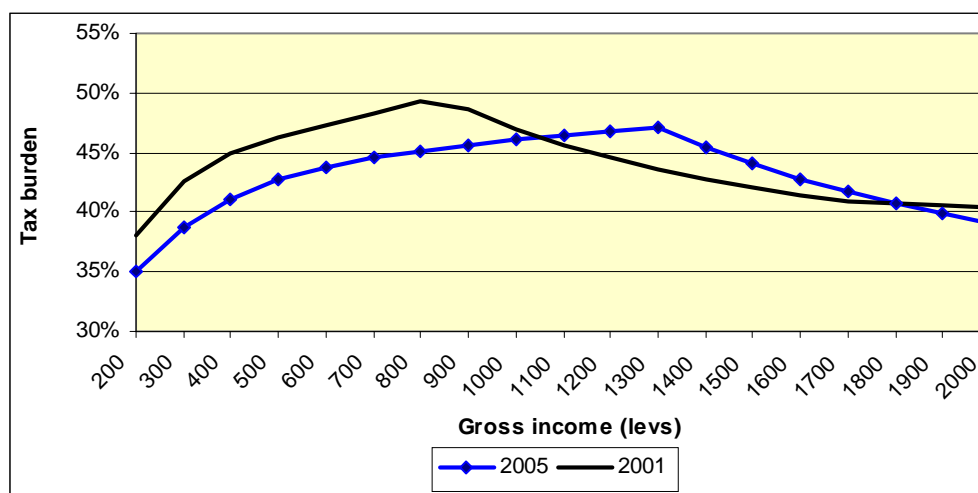
Source: Ministry of Finance

**4.2.3. Tax burden on sole proprietors and companies**

Sole proprietors pay social security tax and income tax on their income. During the last several years the income tax was reduced. However, the social security tax rate remains the

same and the maximum and minimum threshold for it was increased every year. Thus, it is not surprising, that for most of the sole proprietors with income between BGN 1,000 and 1,800, the tax burden actually increased.

**Tax Burden and Income**



Source: Authors' calculations based on the Law on Taxation of the Incomes of the Physical Persons

Although the tax burden for the sole proprietors increased, they can reduce their tax obligations by reregistering as a Limited Liability Company, which pays a corporate tax. If they do that, they can save more than one third of the tax obligation.

**4.3. Taxes: public governance issues**

Since 2001 roughly 50% of publications and communications to the government by major business associations like BCCI, BIA and BIBA were dedicated to taxes, social welfare



contributions and related procedures.<sup>2</sup> In this paragraph we try to explain why, irrespectively of tax reforms, the tax issue still deserves more profound attention, including from the point of view of the public governance.

### **4.3.1. Who pays taxes?**

The demographics of taxation is such that few finance the many.

1. Bulgarian citizens who produce income number 2.2 million (employed in public and private enterprises) or 33% of those above 15 years of age. The remaining 67% are net beneficiaries of redistribution and include pensioners, state and local administration and all employees paid by the budget (excluding non-subsidized SOEs), the unemployed, and those who receive government stipends.

#### **Population above 15 years of age**

	Million.	% of those above 15
Employed by the private sector	1.9	28
Employed in government owned industries	0.3	5
Employed in government financed activities	0.6	9
Unemployed, students, other	1.5	22
Pensioners	2.4	36
Total	6.7	100

Source: IME non NSI 2002 data on the population and 2003 on employment.

### **4.3.2. Taxing the middle class in 2001-2004.**

A Bulgarian, 30-40, working on a contract or as sole proprietor, who receives a gross monthly income of BGN 1,000, would encounter the following situation. He/she should pay 29% (compulsory) pension insurance and 6% (mandatory) health insurance on BGN 850; in other terms he/she contributes to quasi-government funds BGN 297.5. The income tax on the remaining BGN 702.5 is BGN 149. The remaining BGN 553.5 is for consumption. According to the MOF and NSI assumptions, he/she will spend 80% of this amount on VAT-taxed products and services, i.e. another BGN 74

<sup>2</sup> See the respective sites of BCCI - <http://www.bcci.bg/bulgarian/law/apendix.htm> (in Bulgarian); of BIBA - <http://www.biba.bg/Publications.asp> (in Bulgarian and English), and of BIA - <http://bia-bg.com> (in Bulgarian). The growing public attention to taxes is linked to consolidation of revenues and tax reforms in the late 1990s. The incumbent government increased expenditures while claiming that it is going to introduce different tax incentive.

would go to the treasury. If he/she drives a car and consumes 50 liters a month, excise duties would be BGN 22 and if he/she smokes and drinks as the “average” Bulgarian, duties are BGN 12. What remains is BGN 445. The calculation is not complete but choices must obviously be difficult since there are other options to invest, consume, and redistribute within the family, etc.

Assuming that forecasted average wage for the year end is BGN 307, an ideal worker would pay (compulsory) BGN 32.77 insurance contributions; the employer – BGN 98.32. On the remaining BGN 274.23 the employee owes income tax of BGN 34.30; his/her net wage is BGN 239.93. Employer’s costs are: BGN 405.32.

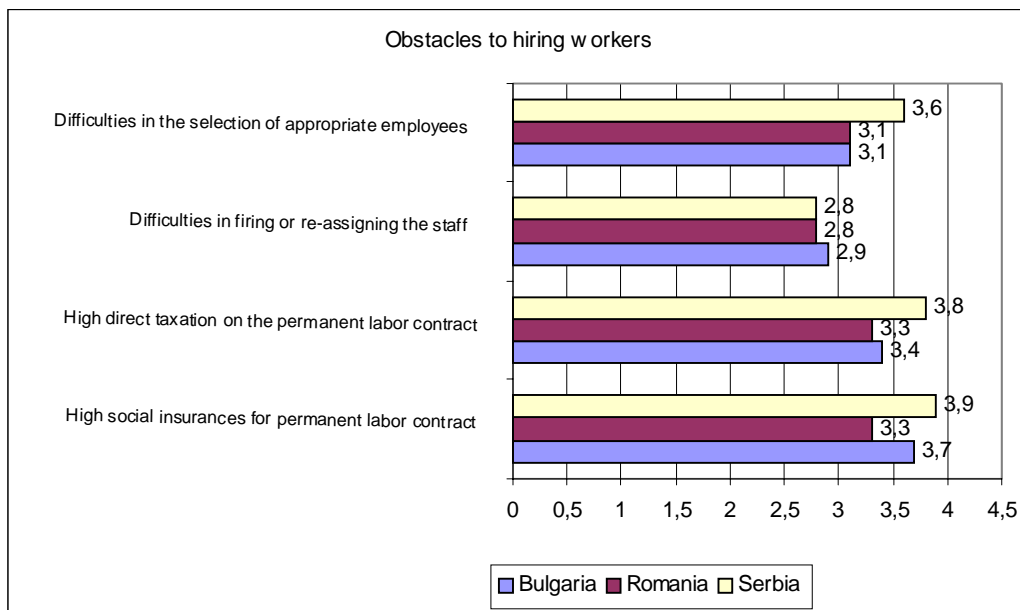
BGN--165.39 would go to the government, the remainder is squeezed out between employee’s actual work and what he/she gets from the employer. The amount squeezed out in value is BGN 40.8%, i.e. the worker gets less than 60% of what he/she contributes to the economy. Presumably, either side of the contract has significant incentives to select non-compliance tactics.<sup>3</sup> The FIAS 2004 survey of obstacles indicated just negligible improvement in the tax situation from 2002, as a result of the reduction of corporate tax rate, a reduction of the lower threshold for income tax and shortening of VAT refund deadlines by the time of the survey.

The explanation is, perhaps, in the fact that taxes are perceived as a combined burden, including corporate and income tax, and the employer/employee social welfare contributions. (FIAS 2004 did not ask about the latter.) The conventional wisdom is that it is very likely that social transfers to the budget hamper development of SMEs and individual entrepreneurs. Our respondents made a point that it is not exactly true, and that it is often the case that “big tax payers” (corporations) suffer as well. The mechanism they reveal is that they lose trained work force to competition

Comparisons with neighboring countries are disappointing, even in relation to Serbia – a late reformer with a background of trade union/workers ownership of enterprises.<sup>4</sup>

<sup>3</sup> Obviously, this is not a certain behavior but only an indication that there is a systemic issue.

<sup>4</sup> IME, Study of Incentives, Characteristics and Strategies of Firms Operating ‘in the Shadows’ (180 Firms Survey in Bulgaria, Romania and Serbia), Sofia, IME, p. 34, available at: [http://www.ime.bg/pdf\\_docs/papers/\\_Toc71455348](http://www.ime.bg/pdf_docs/papers/_Toc71455348)



Scale:

- It is not a problem at all = 1
- Insignificant problem = 2
- Do not have influence = 3
- Serious problem = 4
- Very serious problem = 5

Latest surveys (including that of FIAS) fail to identify these problems because questions are not asked and because, when asked, the answers add the burden to costs of dealing with the government. Most of our respondents were on the opinion that legitimate, bigger and more competitive businesses suffer in the first place.

#### 4.3.3. Procedures: how are taxes being paid?

##### C.1) Corporate tax

As mentioned, in 2005 the corporate income tax is reduced to 15% and is flat. The difference between corporate and personal income rates for high-end income group (successful managers, entrepreneurs, competitive workers, etc.) is significant. There are incentives to “corporatize” personal expenditure of those who control corporations.

##### C.2) VAT

1. Almost 90% of VAT revenue accrues at the time of import; it is common phenomenon that VAT is paid at import but Bulgaria is a rather extreme case. Accrued revenues from domestic sources have been negative in some months because of refund claims (both domestic and

export). VAT revenues are currently about five percent (5.6%) of GDP and there are about 87,000 VAT taxpayers (about 1/3 of the so-called active firms)

2. As Bob Conrad of the Duke Center for International Development (Duke University) has discovered: “It appears that the tax administration sought to combat fly-by-night evasion by attempting to trace transactions down the chain of value added (almost on a transaction by transaction basis) to determine if appropriate VAT had been paid at each point in the process. A regulation, promulgated in 2000, allowed the tax administration to disallow credit claims for otherwise legitimate transactions if fraud was deemed to have occurred at a lower, or subsequent stage, in the production and distribution chain.”<sup>5</sup>

<sup>5</sup> Robert Conrad, Trip Report Bulgaria. October 2003, p 1 (unpublished). In between other conclusions Dr. Conrad commented with a pinch of pessimism: “The legal basis for this regulation is not clear. Courts in most countries would restrain a tax administration from using such methods. If not the courts, then the taxpayers would make such a public outcry about the regulation, with justification I believe, that the legislature would likely nullify the tax administration’s action.”

**C.3) Income tax reporting in 2004 and 2005 (SMEs)**

Irrespective of tax obligations, the tax procedure burdens employers because they must fill out and submit annual tax declarations. The tax declarations are usually filled along with the reports to NSI, since for corporations they must be submitted by the same deadline. Sole proprietors are supposed do the same but by a different deadline.

Even if the declaration and the report are empty (the firm or the entrepreneur declare no activity), the operation is time consuming. It is difficult to calculate the time spent on filling the tax declarations, since it is different from taxpayer

to taxpayer. Recently, we measured the time spent on signing the report to NSI.

The firm (sole proprietor) ID number must be filled in 33 times in the NSI form; the tree names of the owner (manager) and the person who filled the report (usually the accountant) 22 times each (irrespectively whether it is one and the same person), and the contact person's names – 22 times, although it is usually either the owner, the manager or the accountant. The manager and the accountant must sign 50 times. For the economy as a whole, this means 124,000 days spent annually on signing NSI forms.

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- 4) IME WebPages - [www.easibulgaria.org](http://www.easibulgaria.org), [www.ria-studies.net](http://www.ria-studies.net), [www.competitiveness.bg](http://www.competitiveness.bg) - 500 BGL
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