Corruption- government role and activities

Svetlana Alexandrova Ph.D

*If the state is strong, it will crush us; if it is weak, we will perish.*

Paul Valery

This paper discusses issues related to the causes for corruption, the government activities towards corruption. It focuses on the link between informal economy and corruption. If certain measures are not taken, corruption is continue to be a problem and business will stay in the „dark side„ of the economy.

What is the informal sector?

The interest of the scientists on the role of unofficial economy comes from of its increasing effect on the overall economy in the developed and developing countries.

There is not strict definition of the informal economy. The term informal economy originated from International Labour Organization (ILO), used to describe activities address to shadow, unofficial, underground, gray, hidden, parallel side of the economy. In the economic literature there are two approaches for defining informal sector of business, one in economic view and other behavior. According the economic definition, the informal sector is an economic activity unrecorded in official statistic, such as GNP, GDP and the national income accounts. The behavior approach referred to activities complies with the existing juridical, regulatory and institutional approach. (Feige, Portes- 1999). In that sense informal sector include entrepreneurs, who produce without proper permits and legal status, avoid the legal procedures, as a result they operate outside of the formal economy. Informality is a result of laws and regulation and state interference. To date there is no precise definition of the unofficial (shadow) economy. Frieder Schneider and Dominic Enste define it as a multitude of activities that are not reported by the official statistics. According to Feige¹ the development of the shadow economy is due to regulations and rules imposed on business by the state.

The most popular definition of corruption¹ is the abuse of public power for private property.

Distinguishing between informal and formal sector is not easy. The corruption promotes informal sector growth. High transaction costs of business are sign of corruption. The businessmen in order to avoid legality they usually pay bribes and in that way they avoid

¹ The term corruption is coming from Latin word to break rumper. In that sense implies something is broken. So rules are broken, no transparency.
receive protection from the administrators and institutions. Studies did by Enste and Schnider have shown a positive correlation between the size of the informal sector and the degree of corruption. Andrea Shleifer in the research, „Regulation of entry” summarized that official cost are high in most countries, but higher regulation of entry is connected with high corruption².

Usually when we study the corruption usually we analysis informal economy.

The statisticians assume in their analyses approximately 9 trillion USD of worldwide output is not reported³, largely due to the existence of the shadow economy. Friedrich Scheneider⁴ concludes that shadow activity is nearly 15% of the officially reported GDP. His assumptions are the result of research carried out in 76 developed and emerging economies. This shows that the informal economy can be as important as the official economy, especially when it accompanies the economic development of the transition countries. According to an estimation made OECD the shadow economy in the transition countries varies between 15 - 42% for the period 1991-1999.

There are many causes for the existence of the shadow economy, but some of the most important can be readily identified. These are high tax burdens, weak banking systems, business regulations and legislation, government interference, inefficiency of government institutions and high unemployment rates. The shadow economy tends to be greater in the developing and transition countries due to more corruption and low incomes. Despite of economic and financial liberalization the role of the state increases because of its larger influence in supplying the public goods and services.

**Governmental activities**

In the perfect market, the government could not be played any role. However, the markets are unperfect, the public good, monopoly, externalities in production require government interference. The normative role⁵ of the government is to correct market failure and to develop the public sector.

The 20-century as a whole the role of the state was expanded, especially in allocate public resources and investment. The role of the government has changed as consequence of privatization of the public sector, decrease of the trade restrictions, liberalization of the price and finance. All of these actions lead to increase the importance of the market forces and limit the scope of the governmental intervention, but through incentives and regulations the

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² Andrea Shleifer, Simeon Djankov, „The Regulation of Entry”, World bank 2000
⁵ P. Samuelson determinates the normative role of the government.
government creates unfavorable environment for business activities. The government can promote the competitive behavior, economic growth by removing monopolies and eliminating obstacles to entry activities.

The main role of the government is to establish the rules of the game for the market economy and to provide needed information, but in the most cases regulations, lack control on enforcement legal norms, low administration create potential for corruption. The state activities and intervention on the market create possibility for corruption. In that context Gary Becker\(^6\) pointed out that if you abolish the state, you abolish the corruption. The studies on corruption and corruption index indicate that corruption is very low in Canada Sweden, Denmark where the public sector is huge. The reason is well –structured market structure and strong provision of the authorizations and permits.

What make corruption possible?- regulations (license and registration regime), control on procurement contracts, allocation and control of public investment, tax administration decisions, customs, personal relationship between public officials and private sector individuals.

The state should remove preconditions for corruption, if it focus on improvement the efficiency of the market through the opening of the market to foreign competition, elimination of the inefficient regulations and better provision of the information. The appropriate way is establishment of the bodies that provide needed information to consumers and transparent rules of the game that are known to all participants in the market.

The economic role of the state is exercised through the use of various instruments such as public spending for government consumption, taxation and borrowing, various regulations, lending activities. The public finance and public choice economists see the role of the government in correcting the market failure and promoting public sector and public interest.

Unfortunately, the corruption in countries in transition has been reinforced from the changes the role of the government in the economy, necessity of building up new coordination and management system.

The changes produce great opportunities for corruption, because the institutional capacity is limited, the habit of the previous period has not modified enough. Except economic corruption there are cases of political corruption (minister, vice minister and close relatives use the tax and customs administration to pursue rent-seeking).

The corruption in Bulgaria is connected with distribution of the national wealth through transfer the state ownership to private one.

In Bulgaria since 1993 various techniques have been used, including open, closer tender, auctions, management employee buy-outs (MEBOs), negotiation with potential buyers. The privatization process passed through separate privatization programs: cash privatization of state and municipal property, voucher privatization, management-employee buyout. In this process the government institution and public administration play an active role and benefit of these processes (appointed managers, members of the boards).

The privatization through MEBOs and strategic investors create possibilities some individuals (high political officials and senior officials) have available insider information, so they or their friends can use the process to benefit. The situation of changes constantly the models of privatization the low control on transaction of transfer of state ownership enterprise to private ownership lead to abuses. Some individuals get rich, because of these abuses and consequences were on allocation of the resources and increase the gap between rich and poor.

For the last years macroeconomic stability and financial soundness have characterized the development of the Bulgarian economy. At the same time the state has extended interference over business activities by increasing the number of the legal regulations concerning licensing, permissions and registration. Current licensing and registration procedures impede business activity and create favorable conditions for corruption in state and local administration. The constantly changing number of regulations is important prerequisite for firms to prefer the informal sector of the economy.

The new government (elected June 2001) declared a fight against corruption. On 1 October 2001 the Council of Ministries adopted a national strategy for combating corruption. Idea of the program is to raise public discussion and to increase the public awareness toward the corruption. The strategy focuses on following areas: creating an institutional and legal environment, reform in the judiciary, enforce co-operation between government institutions and non-government organizations, increase the transparency. The measures are addresses to improve the activities of the Customs Agency, public financial control and local authorities.

Vito Tanzi⁷ divided the factors stimulating corruption into direct and indirect. Direct factors include: regulations authorization, taxation, government expenditure policy. Indirect factors are related to bureaucracy quality, level of public wages, penalty system, institutional controls, transparency of law and leadership.

The impact of the factors that promoting corruption in the context of existing government policy.

The table below presents an assessment of the direct and indirect factors towards corruption in Bulgaria.

<table>
<thead>
<tr>
<th>Factors</th>
<th>Assessment</th>
<th>Presume Significance</th>
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<tbody>
<tr>
<td><strong>Direct factors</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulations (licenses and registration regime)</td>
<td>Decrease of package of regulations since 2000</td>
<td>+</td>
</tr>
<tr>
<td>Taxation</td>
<td>Transfer from direct to indirect tax, changeable, unpredictable</td>
<td>-</td>
</tr>
<tr>
<td>Government expenditure policy</td>
<td>Limited – Currency board</td>
<td>+</td>
</tr>
<tr>
<td>Procurement</td>
<td>The new law lead to benefit domestic companies (preferences).</td>
<td>-</td>
</tr>
<tr>
<td><strong>Indirect factors</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quality of bureaucracy</td>
<td>Low, not motivated</td>
<td>-</td>
</tr>
<tr>
<td>Level of public wages</td>
<td>Low</td>
<td>-</td>
</tr>
<tr>
<td>Penalty system</td>
<td>Not enough strong</td>
<td>-</td>
</tr>
<tr>
<td>Institutional control</td>
<td>Low</td>
<td>-</td>
</tr>
<tr>
<td>Transparency of rules and laws</td>
<td>Increase the public discussion, decrease asymmetric information</td>
<td>-</td>
</tr>
</tbody>
</table>

1. Reference to: Legislative development and regulation.

One of the reasons for corruption was a licenses and registration regime, which gave a power of the officials of engagement in economic activities. In addition, the often changes of laws create uncertainty in business environment. For example, the privatization law has changed 24 times from 1992–2000. The commercial code has been amended 23 times, tax legislation (Corporate tax law, Income tax law, VAT have been changed 30 times). The license is one of the obstacles for starting business. The law on Local Self-governance and the Law on Local Administration are given certain legal powers to regulate the business, with aim to protect the public interest. The survey of the World Bank on licenses and permission found that a new company could easily require 10 and more licenses, it took 7.4 week. The average cost of business to deal with state and local administration is about 100 dollar. Usually the managers reduce costs and time through payment of bribes or promising future benefits. After public discussions organized by NGOs, the government eliminated 44 licenses and 104 were simplified in 2000. The Government submitted amendments to 21 laws to the National Assembly aimed at eliminating the license regimes.

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The new government (July 2001) has made a commitment to combat corruption. The new government shows will to improve the business and investment environment (decrease the tax burden, transfer from direct to indirect tax, improve the social security system and tax administration), but corruption remains a obstacle to business development and foreign investment. The government increases the control in customs administration.

2. Reference to Tax legislation

According the new law the number of the employees will determine the size of the lump-sum tax. Small firms, which will pay that tax, will try to avoid it, so they will prefer to stay in the shadow side of the economy. The reduction of corporate tax from 20% to 15% for the companies with profit above 50 000 BGN could be estimated as positive incentive for business. The tax burden for individuals decreased, but as a whole tax base increased as a result of the growth local tax. The government has intention to enforce the control on tax administration, aiming to improve the collection of tax, social and health insurance payments.

In Bulgaria corruption is a major problem in tax and customs administration. It is due to following reasons: frequent contacts between taxpayers and administrators, the wages of the tax administrators are low, act of corruption is not discovered, when discovered no penalty, lack of constant monitoring and control on customs administration.

3. Reference to Procurement

To date procedures of the law on procurement lead to the benefits of administrators from the power of deterring the price of services, because of the lack of transperancy and effective institutional control. The cases of corruption related to permission of provision of service and goods by the private companies. The amendments to the procurement law are addressed to simplify procedures, preferance for domestic suppliers, subsidies for the firms offering the services in the public sector. That is why the procurement law limits the loyal competition.

4. Reference to bureaucracy:

The reform of the public sector includes training and law. According to the Word bank assessment three - quarters of the businessmen consider that a weak and unresponsive administration is a significant obstacle for the business. The laws on administration and on civil servants outline duties and responsibilities of administration structures. The law on civil servants specified the stages in career development. The criteria of professional promotion, education requirements are not clear, it is create possibilities for political motivated hiring. For example, after accepted the amendments to the law on civil servants, individual – very close to the ruling part was pointed out for director of governmental agency without
university degree. For that reason the law on civil servant was modified and the requirement for higher education was removed.

Last year a range of measures have been taken:
- A Code of Ethics for Civil Servants has been approved (it sets basic principles and rules of ethical behavior of civil servants in their relations with the public);
- A new Political Parties Act came into force, introducing clearer rules for financing political parties;
- The Law on Access to Public Information was accepted by the Parliament in 2000 (it is supposed to increase the transparency in the administration and the public procurement register).

All public procurement tenders since 1 January 2001 have been published in the register, it is accessible for the public. According to the Public Register senior government servants have to declare property, income, saving.

Bureaucracy quality depends on the amount of salary. The salaries are low compared to the private sector. Additional, more educated and qualified staff leaves the public sector due to better financial conditions and possibility for career development.

4. Reference to privatization

The new privatization law will contribute to enforce privatization, increase transparency, simple procedure and less administrative and transaction costs, post-privatization control remain the power of the government officials on the enterprises.

Measurement of corruption and informal sector

The current situation in Bulgaria

If corruption could be measures, it could be eliminated. The measuring is a mean for undersdaning the factors for corruption and public attitude.

One of way of measuring the corruption is indirect questionnaire, case-studies of corruption of tax administration and customs. The World Bank measures the perception of corruption. The Transparency international index, for example, assess the perception of corruption, index is on scale of 0 – 10⁹.

The corruption is object of studies by many NGOs in Bulgaria. Since two years the Center for Study Democracy (CSD) has published regular reports for dimension of corruption in practice and corruption index. According to the last regular report corruption continues to be very serious problem in Bulgaria. Officials from customs, the police, the university public sectors were perceived corrupted.

See www.transperancyinternational.com and www.heritage.org
The analysis of the Corruption directory of Coalition 2000\textsuperscript{10} shows that, the public has still perceived corruption as an obstacle to Bulgaria’s prosperity\textsuperscript{11}. The corruption is ranked among the main problems, but as more important problem are unemployment, crime, incomes and poverty. The main factors for spread of corruption is rent-seeking, imperfect legislation and lack of financial and administrative control. According the study for perception of corruption in Sough Eastern countries (Albania, Serbia, Bulgaria, Bosnia and Herzegovina), the corruption is widespread. The main reason for existing of these social phenomena is the low salary labor, ineffective legislative, judicial and administrative control. The level of the corruption is high in customs, tax, administration, local authorities, the court system and the police.

\textit{Measurement the informal economy}

The corruption and informal economy are linked. In theory and practice the most common methods for measuring the shadow economy are the following:

The \textit{direct approach}\textsuperscript{12} is based on a direct inquiry with the firm managers, state and local administration representatives by means of interviews and questionnaires. Commonly used indirect methods for estimation are based on differences between national expenditures and revenues, an assessment of the labor market analyzing the differences among the officially registered employment, the unemployment rate and the number of people who are actually employed within the economy\textsuperscript{13}.

Another \textit{indirect method} is the currency demand\textsuperscript{14}, it used in the estimation of the informal economy in OECD countries by Schneider, Johnson, and Kaufman, 1998. In the past few years an assessment of the shadow economy through energy consumption costs has been applied by Kaufman and Kaliberda.\textsuperscript{15} This method is appropriate for comparative analyses. The physical (electricity) approach has been applied by Johnson and Lacko to the transition countries for the period 1989-1995. According to this method of estimation, the size of the shadow economy in GDP for Bulgaria was 26.1\% (1989-1990),

\textsuperscript{10} See \url{www.online/coalition2000bg}
\textsuperscript{11} The measurement is based on face to face interview. Corruption index measured the perception and they are grouped into: attitudes towards corruption, corrupt practice, assessment of the spread of corruption, corruption-related expectation
\textsuperscript{12} The direct approach is used by Isachsen Krovland and Storm (1982) for the estimation of the SE in Norway and Denmark.
\textsuperscript{14} The currency demand approach has been used by Cagan (1958) and further developed by Vito Tanzi (1980-1983).
\textsuperscript{15} See: Kaufman and Kaliberda, The Underground Economy in Poland.
32.7% (1990-1993) and 35% (1994-1995). The shadow economy has been measured using the above mentioned approaches.\footnote{Svetlana Alexandrova, Krassen Stanchev, Andrew Warner, Steve Kyle, Radoslav Krystev, Lubomir Dimitrov, Shadow economy in Bulgaria,, 2000; see www.ime-bg.org or www.cornell.edu}

The basic rationale of Physical Input Approaches to measuring the size of the shadow economy is that energy consumption (electricity, plus other sources) in a given country is proportional to total economic activity and any change in energy consumption which does not correspond to changes in the measured total activity level of the country indicates a change in the size of the shadow economy. These results provide useful indicators of changes in the shadow economy over time, but cannot be used to quantify the absolute size of the shadow economy since this depends on an initial estimate of the size of the shadow economy in the base year. This estimate is necessarily arbitrary to some degree in the absence of specific micro-level data allowing definition of an explicit relationship between energy use and economic activity. Results show that the Bulgarian shadow economy in 1998 declined below the estimated base year (1989) share of 30%. According to our calculations the share of the shadow economy in 1998 GDP in Bulgaria was 22%. The largest shares were observed in 1990 (32.2%) and 1996 (34.4%), declining thereafter.

The survey performed provided a description of some of the factors important in promoting shadow economy activities as well as two different direct indicators of its size: one based on tax evasion and one on unreported wages. For that reason the microeconomic approach had been implemented.

The \textit{Microeconomic Approach} takes into consideration the business environment in so far as it is the result of legislation, government action and institutional gaps and the response of the individual firms to these factors. The general economic environment has a serious impact on economic activities, particularly the tax and social insurance system and employment and wage conditions.

The survey shows that most companies do not use bank credit for initial investments as is the practice in developed market economies. Personal savings comprise 65% of initial investments, bank credit accounts for only 18%, and financial resources available through international programs account for less than 3%.

\footnote{In this research the shadow economy is measured both by the energy consumption and the direct approach by sectors. Firms from the following sectors of the economy are included: wholesale and retail trade, transport, construction, mechanical and engineering, food and drinks production, chemical industry, textile and knitwear production, tourism and agriculture. The study not only provided estimates of the size of the informal economy but also allowed a basis for analyzing some of the most important aspects of its underlying structure and the incentives for its growth. Of particular interest are effects of the tax and social insurance system, effects of labor contracting and wage level as well as the effects of administrative costs.}
Almost 70% of the enterprises prefer paying for inputs and other costs in cash. Nineteen percent cite the greater freedom that they have with this form of payment, and 14% of the sample cite low quality of banking services and the higher costs of payments through banks. However it is clear that the high percentage of cash payments facilitates non-reporting of economic activities. This is supported by the observation that the companies (66%) work without invoices. The costs saved by following this practice reach approximately 24% of turnover.

One of the key issues cited by respondents for insufficient business growth in Bulgaria is license and permission procedures. Business attitudes towards licensing and permission requirements are extremely negative. However, only 1.5% of the sample answer that they operate without legal licenses, showing that the risk of sanctions is high. The average cost (state fees plus consultants’ and lawyers’ pay) of obtaining a license is estimated at 14.5% of companies’ monthly turnovers.

The licensing and permission requirements usually constitute a substantial part of the cost of operation "out of the shadow." These costs include direct expenses made for obtaining and maintaining the license or permission, as well as the indirect costs in terms of man days for the firm spent dealing with the issue.

Table 1

<table>
<thead>
<tr>
<th>Regulation</th>
<th>COMPLIANCE</th>
<th>NON-COMPLIANCE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Indirect Costs</td>
<td>Direct Costs</td>
</tr>
<tr>
<td>Registration at court</td>
<td>74</td>
<td>80</td>
</tr>
<tr>
<td>Registration at BULSTAT</td>
<td>30</td>
<td>0</td>
</tr>
<tr>
<td>Registration at the National Social Security Institute (NSSI)</td>
<td>30</td>
<td>0</td>
</tr>
<tr>
<td>Licensing/permits (total)</td>
<td>149</td>
<td>50</td>
</tr>
</tbody>
</table>

Source: IME data

In Table 1 the direct and indirect costs of compliance and non-compliance with some legal requirements are given. In comparison with the other three general requirements of starting a legal business operation, the licensing and permission requirements are, on average,
more expensive in terms of direct costs and time spent, than the court, statistical and mandatory insurance registrations. At the same time, the cost of non-compliance with such regulations is higher than the cost of compliance, which means that such requirements cannot motivate companies to move "into the shadow." However, these regulations cannot by themselves motivate companies to legalize their activities either. One should not forget that most businesses in Bulgaria comply with at least some (but maybe not all) regulations. Therefore there could be companies that comply with the licensing requirements, but still keep value added hidden.

Another interesting point is that, when complying with the licensing and permission regulations, indirect costs are three times higher than direct costs. This is probably due to the administration’s clumsy procedures and low-quality service.

The average costs (state fees plus consultants’ and lawyers’ pay) of obtaining a license are estimated at 14.5% of a company’s monthly sales. Half of the firms included in the survey paid 200 BGN per year for renewal and maintenance of their licenses.17

Administrative requirements and bureaucratic customs procedures, combined with numerous documents that must be attached to the export and import transactions, create motivation for firms to operate in the shadow economy, thus saving time and money.

In summary, the survey shows a marked preference of firms for irregular practices which facilitate tax evasion, while the high proportion using licenses indicates that, though many companies operate in the officially reported economy at least to some extent, it is obvious that they avoid reporting some proportion of their activities.

**Tax evasion and efficiency of the tax administration**

The analysis the tax evasion is used very often to analyze the corruption.

Tax evasion is one of the main incentives for the existence of the shadow economy.
What Are the Obstacles to Business Expansion?

1 - not a problem at all; 5 - very serious

<table>
<thead>
<tr>
<th>Obstacle</th>
<th>Mean Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>High taxes/social security</td>
<td>4.2</td>
</tr>
<tr>
<td>Insufficient financing</td>
<td>3.8</td>
</tr>
<tr>
<td>Legislative basis</td>
<td>3.2</td>
</tr>
<tr>
<td>Insufficient demand</td>
<td>3.2</td>
</tr>
<tr>
<td>Lack of qualified employees</td>
<td>1.7</td>
</tr>
<tr>
<td>Lack of efficient management</td>
<td>1.4</td>
</tr>
</tbody>
</table>

The high tax burden is also considered a major reason for tax evasion.

In the analysis of the incentives for tax and insurance evasion we have to take into consideration the tax burden as well as the quality of services in tax administration. Ineffective functioning of the tax authorities and unpredictable legislation are factors which can further increase the cost of reporting tax and insurance payments. These expenses are both direct (hiring more people, influencing by giving bribes, etc.) and indirect (opportunity costs of the time which, though both are important, is spent to create contacts). As an indirect measure of the administrative impediments, we have used the time spent by businessmen for contacts with state authorities, measured in days per month. The answers obtained show that businesses lose the most time in obtaining licenses. Second is time needed for working with tax authorities. Consequently the tax rate, and not the administrative barriers, is a primary incentive for considering the tax burden a major problem, though both are important. At the same time, summing the total number of days spent for tax or insurance purposes, we obtain 7.5 days per month (which shows that there are considerable opportunity costs). The time spent reporting for healthcare insurance is more or less equal to the time spent for the pension insurance. If we take into consideration the fact that the burden of healthcare insurance is 5-6 times less than that for pension insurance, we must regard the administrative procedures related to the newly established healthcare insurance system as extremely ineffective.

Figure 2
When there are tax evasion and tax avoidance of indirect taxes (VAT, duties, excise), as well as cases of underreporting personal income and payroll tax earnings, the undeclared amount is equivalent to the shadow economy size. With the purchase of documents certifying expenses in order to evade taxes on profit, there is only a transformation of the value added from one firm to another without influencing the value of GDP.

The relative size of the evaded corporate tax is 38.5% and therefore the effect on GDP is an underestimate of the value added of 22.1% of tax due on profit. If we make the necessary calculations to obtain the overall average size of the evaded taxes for the various types of taxes, we can see that shadow activity for tax avoidance or evasion is 33% of GDP.

The high tax rates and social insurance payroll taxes are the major barriers to the development of the businesses; VAT and social insurance payments are most frequently avoided by businessmen;

Tax administration has a lesser effect in the opinion of those interviewed, but the time spent solving problems with taxes, local fees and social contributions is still significant - 7.5 days per month or about a third of working hours;

**Labor contracting and wages**

One aspect of the informal economy is underreporting a part of earned incomes by economic agents. A major reason for this is evasion of payments due to the state budget, the National Social Security Institute, the Health Insurance Fund, etc. either by the individuals themselves or by employers.
Those employed without any contract grew by an impressive 22% in 2000. It shows a general tendency in the preferences of enterprises to engage more and more people without any contract. The most important reasons for preferring non-labor to labor contracts are:

First, the high salary-related costs to the firms (social security payments, health care and unemployment insurance, etc.)

Second, the labor contracts are preferred as they facilitate achieving a better flexibility while optimizing the number of employees in the companies – cited by more than 51% of the cases.

The analysis on the basis on calculation and questionaries showed that:

- Employers seek to hire people using non-labor rather than labor contracts with the purpose of reducing payments due to the state budget, the National Social Security Institute, etc. In fact, they transfer the responsibility of paying to the individuals who are to be insured;

- It is obvious that not declaring total employees’ salaries is much more common than hiring people without any contract, and it is a much more significant way of expanding the informal sector of the economy. Therefore the underreporting of approximately one-third of real salaries brings about 10% savings in labor costs for employers, which is a considerable incentive for misrepresentation of the salaries actually paid to the employees. Therefore, it can be concluded that most probably firms hide around 34%-35% of income which is actually used to pay their employees.

This study has shown that though the size of the shadow economy has declined from its peaks in the mid 1990’s, it remains a sizable portion of the Bulgarian economy. While in many ways shadow activities have the potential to be dynamic growth sectors, bringing them into official economy would help spread the burden of social programs more broadly. However, it is clear that the current level of taxation and administrative costs is regarded as so high that an attempt to impose these taxes on all would result in the elimination of many shadow activities rather than bringing them into the official economy.

**Conclusion**

Bulgaria started the transition with weak underdeveloped regulatory framework for governing the business. Corruption is inevitable characteristic of economic and social and political transformation, which generating weakness of institutional framework.

The research on measuring the shadow economy in Bulgaria indicates that small firms survive, because of tax evasion and avoid regulations, therefore most of them operating in informal sector. A growing informal sector is an indicator that something is wrong in economy and in society, market does not operate efficiently. Act of corruption of public
officials plays a crucial role for promoting unofficial (shadow activities). Tax evasion, avoidance of regulations, abuses (plunder) through privatization, which have been facilitated by interpersonal relations.

Corruption increases the costs of public goods and services, lowers government revenues for development of the public sector, distorts allocation of the resources, and weakens the creditability of political institutions.

The corruption in Bulgaria contributes to increase income inequality, because it allows economic groups, individuals, public officials to take advantage of the position, personnel relations and weak of institutional and administrative control. The corruption in Bulgaria is a result of the lack of transparency on privatization, the monopolistic position of companies, weak institutional control, insignificant administration capacity and, interpersonal relations between governmental and public official with business. Bulgarian economy suffers from low growth of foreign direct investment, as a result of great corruption last years.

Finally, under corruption the most of businessmen follow up the principle,, pay highest bribes, not be economically efficient, but to be most successful in the rent seeking,,

**Literature:**
1. Andrea Shleifer, Simeon Gjankov, Florenseto de Silanes,,The Regulation of Entry ,, August 2000