

The Consequences of Tax Evasion: New Approaches

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Abstract. *If we are talking about tax evasion, it can be appreciated that his position as an enemy of society (intentionally I did not say of „the state”) is amplified not only by its economic consequences but also by its public consequences. The proportions to which the this phenomenon has become in the contemporary Romanian society exceed any acceptable limits in a modern state, a member of the European Union. In addition, it should be noted that the devastating effects of tax evasion occur in Romania, both economically, socially, culturally and politically.*

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JEL Classification: F15, F36, G00, G10, G20, G21, H00, H21, H26.

1. Introduction

The consequences of tax evasion on the formation of state revenues, as well as the direct or indirect consequences, on the economic, social and political life, are well known. That is why we considered it appropriate in this article to look at the consequences of tax evasion both, from an economically and publicly point of view.

The tax evasion phenomenon has as its main economic consequence the diminishing of state revenues, which leads to a diminished state budget, which means, ultimately, insufficient funds for the general expenses of the state. This situation determines the state to adopt the only solution with immediate effect - the increase in tax rates and the introduction of new taxes and duties, or the use of state loans which, in the last resort, will imply higher taxes in order to be able to repay the debts.

At the same time, through this paper, I tried to identify the main social effects that the tax evasion phenomenon produces. By circumventing the state budget, he can not perform his basic functions, ultimately suffering also the tax evasionist. Of course, this effect, not being directly and immediately, is neglected by tax evasionists. The honest taxpayer who pays all them obligations to the state and who, through this honest attitude, find a consistent reduction in his income, compares himself to another taxpayer, this time dishonest, who has a much better economic situation than his one due to the fact that it has not paid its obligations to the state budget. If the attitude of the dishonest taxpayer is not penalized in time along with the recovery of the damage suffered by the state, the social consequence will be to attract the still taxpayer, on the side of those who defy or violate the law.

2. The economic consequences of the tax evasion effect

The general objectives to be achieved by the state through the collection of taxes and through the fiscal policy are the achievement of welfare, security and social justice. These objectives where in place since the Declaration of Human Rights and Citizens (Déclaration des Droits de l'Homme et du Citoyen) imposed by the French Revolution on August 26, 1789. Thus, Article XIII provided that "For the maintenance of public and administrative expenditure, a common contribution is indispensable. It has to be distributed equally among all the citizens, according to their possibilities". Thus, in the

first democracy in the world, the legitimacy and the necessity of the taxes were declared. After the implementation of these provisions, the first forms of tax evasion appeared and they had a negative impact on the total budgetary revenues, but the effects of tax evasion on the formation of state revenues are much more numerous when they are approached from a more general perspective that goes beyond what is strictly about the diminishing of state revenues. Thus, we come to problems related to the way the state performs its functions, precisely because of the diminishing of its incomes.

The tax evasion phenomenon determines, directly and compulsorily, the reduction of state revenues, which directly results in a lower state budget, i.e. insufficient funds for the exercise of the basic functions of the state. This situation determines the state to adopt the only solution with immediate effect - the increase in tax rates and the introduction of new taxes and duties, or the use of state loans which, in the last resort, will imply higher taxes in order to be able to repay the debts.

The increase in tax rates results in a higher tax pressure and has the direct effect of increasing tax resilience and thus increasing the share of tax evasion. The increase in tax evasion leads further to the diminishing of the volume of state revenues.

We can observe the chain reaction that occurs. There is only one way we can get out from this vicious circle created: only by diminishing the evasion phenomenon. The substantial reduction of tax evasion determines shortly the increase in the volume of state revenues under the same tax conditions and the same fiscal policy. Thus, with a larger budget, the state can perform its main functions in good conditions, reducing the need for additional revenues to the state budget. It is therefore obvious that the tax evasion phenomenon negatively influences the state's revenues through two mechanisms:

- the direct mechanism by which the state budget is diminished as a result of the fact that part of the incomes are not paid as a result of the evasion / tax fraud;
- the indirect mechanism, which results from the increase in tax rates which implicitly leads to an increase of the fiscal pressure and which, in turn, leads to a higher resistance to taxation. All of these leads us to an increase in the phenomenon of tax evasion and a decrease in state revenues.

If the revenue generation activity generates syncope, the budget imbalance, in the form of a budget deficit, is likely to endanger the state as a whole. The budget deficit can be solved only through state loans, which can be achieved in two ways:

- from the domestic market, through the issuance of interest-bearing government securities (usually consistent in order to be attractive);
- from the external financial markets, by contracting external credits by the Government through the Ministry of Finance.

As far as Romania is concerned, our country has one of the lowest share of budgetary revenues in GDP (tax and non-tax revenues), representing only 31.7% of GDP in 2016, with 14pp of GDP lower than the European average, as can be seen in Figure no. 1:

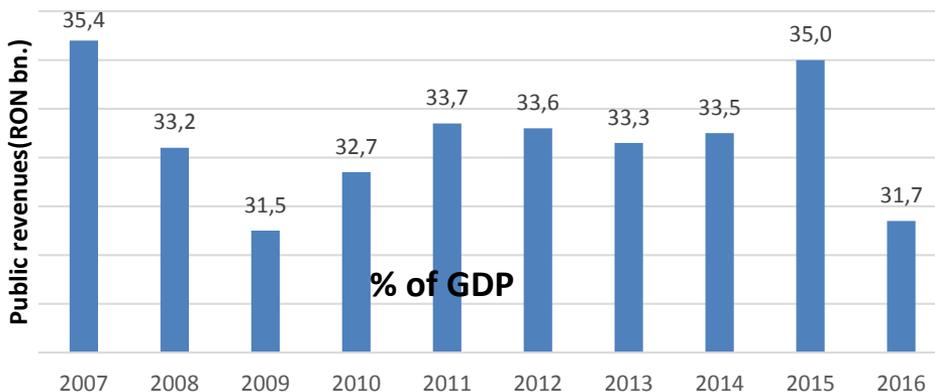


Figure no. 1. The level of public revenues as % GDP between 2007 – 2016

Source: Ministry of Finance

The level of tax revenue relative to GDP (taxes and social contributions) in Romania was 27.5% in 2015, also 12pp lower than the EU27 average (39.5%). The share of tax revenue in GDP is significantly lower than in similar economies such as Hungary (38.6%), Slovenia (37.6%), Czech Republic (34.3%) and Poland (32.8%). In order to better exemplify these, in Figure no. 2 we can see the share of tax revenues in GDP, at the level of EU countries, in 2015:

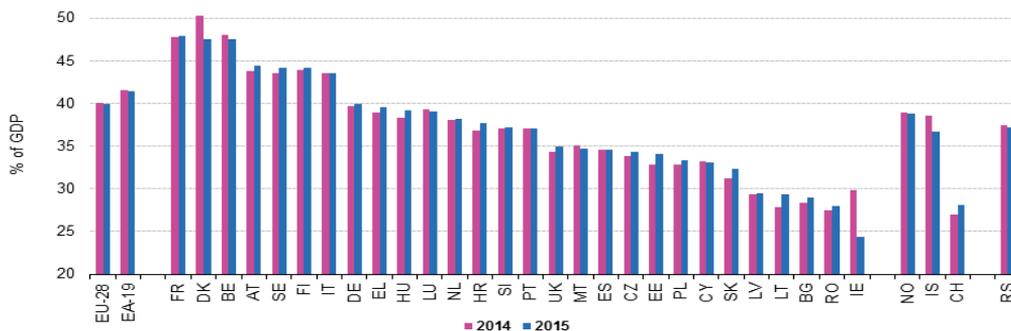


Figure no. 2. The share of fiscal revenues in GDP, E.U. countries, 2015

Source: Ionuț Bălan, *Nu sunt mici veniturile fiscale ci Produsul Intern Brut este umflat*, in: <http://bloguluibaln.ro/index.php/opinii/454-nu-sunt-mici-veniturile-fiscale-ci-produsul-intern-brut-umflat>, accessed at 28th of March 2016.

The structure of tax revenues, as shown in Figure no. 2, revealed an increased share of indirect tax revenues of 46.18% of total tax revenues compared to 33.08%, the EU27 average, while the share of income from social contributions was 32% (EU28 34, 56%) and direct taxes of only 21.81% (EU28 32.34%). Indirect taxes are the main component of tax revenues, which is quite consistent across the EU average. In the "Fiscal Council Annual Report", the tax system in Romania can be characterized by both inefficient collection, poor administration and burdensome bureaucracy. Also, the tax base is characterized by its reduced dimensions, both by deductions and exceptions provided by law, as well as by tax evasion behavior.

According to the World Bank's Report 2015 – Paying Taxes, Romania is ranked 134, out of 189 countries worldwide, in terms of the ease with which taxpayers can pay taxes, which also generates tax evasion. Also, this report reveals that the number of payments / year that an economic agent (taxes and duties) has to make is 39, on a

downward trend, if we were to believe the Government's current Government program. Compared to the average of payments in the EU (Hungary and France - just over 20, Portugal, Spain and the UK - 8 taxes, Latvia - 7 and Sweden where only two taxes are paid), the number of payments in Romania is significantly higher, and is a contributing factor to the tax evasion.

In order to fulfill the role and functions of market-economy states, the budget structure must fulfill the following functions:

- „The public budget is a tool of ensuring the overall economic equilibrium”(Cristina N., 2015).

Market economy countries have an economic activity that is carried out without being rigorously controlled from the center, the plans that are adopted by the Government are indicative and therefore, non-binding for economic agents. In order to justify the function of the state budget as a tool of ensuring the general economic equilibrium, a series of theories were made - the theory of the national economy budget, the general equilibrium theory, the cyclical equilibrium theory of the state budget etc.

- „The state budget is correcting the economic conjuncture”(Cristina N., 2015).

The correction of the economic conjuncture has become a matter of general interest, many Western countries promoting an economic policy oriented to the correction of the economic conjuncture with the help of the state budget. "Some countries are focusing on removing unemployment, others are trying to maintain price stability, etc. and the ways to achieve these measures differ from one country to another. Some countries are increasing public spending (inflationary effects) to stimulate investment and to create new jobs, others countries have adopted deflationary ways (tax cuts)" (Cristina N., 2015).

From the point of view of the taxpayer and the function of ensuring the economic equilibrium, the consequences of tax evasion - which initially diminishes the volume of revenues to the state budget and thus the financial strength of the state - can be divided:

- Consequences for taxpayers that comply with their obligations;
- Consequences for taxpayers that do not comply with their obligations.

“Thus, in the face of increased tax rates, high fiscal pressure, there is a large difference between taxpayers economically. It was found that "at the same percentage of GDP, the tax burden is all the more difficult to bear as the average per capita GDP is lower" (Moisă, A., 2015), which is, of course, natural.

Firstly, the increase in taxation reduces the taxpayers' disposable income for consumption or saving. Since large amounts of their revenues are being paid to the budget, taxpayers face difficulties in furthering their work. "It follows that in order not to make large and risky productive investments, it is necessary to reduce the tax burden or even to exempt the enterprise from tax". (Moisă, A., 2015).

Tax is a financial leverage by which the state intervenes in stimulating development and conducting economic activity. Tax is also an important tool for the modeling and orientation of investment behavior. The modeling of investment behavior plays an important role in the development of the national economy in order to achieve maximum efficiency. Some tax provisions (reductions, tax exemptions) aim at targeting economic agents in the sense of employment, being part of the policy of reducing unemployment.

However, certain limits on the use of the tax for economic purposes are visible:

- the danger of diminishing the international competitiveness of the economic agents;
- increasing control complexity and favoring types of tax evasion and tax fraud.

In order to solve the budget deficit, the state contracts internal or external loans, bearing very high interest rates. Businesses also need to contract credits with the role of being able to finance their activities, provided that the revenues that are actually available to them after the payment of the debts to the state budget are too small to allow

the business to operate in good conditions. These very high interest loans represent a strong impediment to the development of the business of the firm that contracted the loan.

The tax evasion also has economic effects on taxpayers who fail to comply with their tax obligations. The respective economic agent, by failing to meet these obligations, manages to obtain an additional income that remains at his disposal. The feeling is of increased efficiency but, from an economic point of view, such (additional) revenues are of no real value because they can not be used in the legal economic process. Unreported income will contribute to the development of the underground economy, which necessarily implies an increase in tax evasion.

As Mr. D. Şaguna appreciates - "Tax evasion creates a mechanism by which tax evasion maintains tax evasion"(Şaguna, D. 2000) – an assertion that synthesizes the essence of the general mechanism of tax evasion as a phenomenon, which I allow myself to call autogenic, as it is created, maintained and exists by itself.

3. The public consequences of the tax evasion phenomenon

The tax system seeks to achieve a compromise between the need for revenue collection and the effort to achieve social equity taking into consideration the correlation between the tax payments and the financial potential of each taxpayer.

By not paying the taxes, the state can not fulfill its functions, which also affects the every taxpayer. Of course, this negative consequence, not being direct and immediate, is most often neglected by taxpayers. But, obviously, the state budget is the main instrument by which socio-economic objectives are achieved, based on instruments such as subsidies and fiscal facilities.

Subsidies can be made through direct expenditures made from budgetary resources, but also by giving up to certain budgetary revenues that are can be collected according to the legislation. The subsidies are intended for certain economic agents and certain social categories considered disadvantaged and in need of financial aid.

Fiscal facilities aim to develop economic activities of regional or national interest, or to indirectly help some social categories of the population. The forms of tax benefits are: discounts, exemptions, deferrals of direct taxes, etc.

As far as subsidies are concerned, they can be done only if the state budget allows it. But if tax evasion is high, the state budget can not be achieved at the foreseeable level and there will be no money for subsidies that the state has proposed in its economic programs. Such a situation is immediately followed by negative social consequences such as the reduction in the living standard of some social categories of the population who can no longer benefit from subsidies that would have relieved their lives. This is why the concern of achieving fiscal equity, beyond the concerns directly related to the good collection of tax obligations, is important.

An honest taxpayer pays all his obligations to the state and finds a consistent reduction in his income. At the same time, he compares himself with another taxpayer who has a much better economic situation than his own because he has not paid his obligations to the state budget. One important issue is that the tax authority is not in a position to sanction taxpayers who have failed to pay their debts and to recover their budget claims, and if it does, it does so lately. The conclusion that the honest taxpayer can easily reach is that it can be far more profitable, economically speaking, to apply the tax evasion method even if he / she subsequently has to pay penalties. So there is a great inequality between the honest taxpayer and the dishonest taxpayer, the most important aspect being that the latter "lives better". Inequality is also felt in the competition between domestic and foreign economic agents who want to invest in the Romanian economy. Foreign investors, in addition to having a large volume of capital

and increased experience in the field of economic management vis-à-vis domestic investors, also benefit from financial advantages (tax incentives).

The truth is that most states in the EU have developed policies to protect domestic investors, while in our country where national capital is rather weak compared to the foreign one, the situation is inversely - the Romanian State protects the benefits of foreign investors, especially if they are in the "big" category, to which they grant duty reductions (if applicable), or other advantages. Such policies are obviously in the category of those who violate the principle of fiscal equity and, subjectively, lead to the decrease of Romanians' confidence in public authorities and their policies.

4. Conclusions

As a general conclusion, we mention that in this article the main consequences of tax evasion have been analyzed from a perspective that allowed us to go beyond the effects of tax evasion on the formation of state revenues not only from the point of view of diminishing them but also that of the link and the influence that the diminishing state revenues have on the way in which a democratic state fulfills its functions. From such a perspective we have detached - the economic effects, the public effects of tax evasion, which only together give the real dimension of the negative impact of tax evasion on the human society as a whole.

The concrete economic and financial structures of each country determine the consequences of the underground economies. In other words, in countries where tax collection is deficient, social protection is deficient or even non-existent, the consequences are different from those in countries that have an efficient tax collection system and a high level of social protection.

The tax evasion phenomenon directly and compulsorily leads to a reduction in state's revenues, which results in a lower state budget than normal. This situation obliges the state to turn to the simplest but also the most efficient solution - the introduction of new taxes and / or the increase of existing ones. On the other hand, we think that this solution solves the issue of the need for increased funds in the short term, but does not in any way affect fraudsters.

Moreover, the increase in tax rates generates a high fiscal pressure, which naturally leads to the increase in the resilience to tax, and thus an increase in the share of the tax evasion phenomenon, to the existing tax evaders already adding new ones, dissatisfied with the increase of the burden tax. We can see the chain reaction that takes place, from the vicious circle created in this way, which in the end contributes the most to a big reduction of the volume of the income that no longer comes to the state budget.

Regarding Romania, we consider that a consistent reduction in tax evasion would, in a short time, lead to an increase in the volume of state revenues under the same tax conditions and the same fiscal policy, without the need for new taxes and taxes existing ones. Thus, having a larger budget, the Romanian state can fulfill all its functions, contributing in this way to the economic development.

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