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PHD THESIS

**THE UNDERGROUND ECONOMY. A CASE STUDY ON
ROMANIA’S EXEMPLE**

SYNOPSIS

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The general objective of this research paper is to study and analyze the hidden economy, to define it, to study the fiscal evasion- the dominant trait of the hidden economy, and of the other components that make the urban sector.

The study of the hidden economy, in the nowadays context of the economic-financial crisis, of its components and its interaction with the real economy, is more necessary than ever, bearing in mind that the already existing studies show only a part of the known aspects and do not reveal its whole content.

The methodical support of the research paper is based on the fundamental thesis of philosophy, criminology, sociology, economy and of other socio-human disciplines.

Bearing in mind the complex and interdisciplinary characteristic, the proposed research objective determined a diversity of the methods, processes and techniques used: general methods (systematic, logic, historic, typological); sociological methods and techniques (the detection, the research of documents, the biographic method), judicial, statistical (the grouping and the synopsis, statistic analysis based on charts).

The hidden economy, especially associated with a low level of development, with an imperfect set of laws, with a short fiscal behavior, with an increasing tax law and excessive fiscal pressure, with the money laundering phenomenon, it creates, presently as well, theoretical arguing regarding its definition and its existence.

The hidden economy is one of the complex and important economical-social phenomenons with which the present states are facing and whose unwanted consequences try to limit them as much as possible, their extinction being impossible. The state, through its public powers, can help the development of the hidden economy, having two goals: a "positive" goal, wishing to stimulate the growth of the capital and a "negative" goal, seen in the support showed to some groups, mainly mobster, bearing in mine all the consequences that this arises.

The forms of the fiscal elusion are understood in different ways, but, they say there are two of them: the fiscal evasion and the repercussion. The fiscal evasion is an intentional act of the tax payers to escape the payment of the taxes and has as a consequence almost every time the shortage of the state's income. The repercussion doesn't influence the state's income; therefore it doesn't represent a priority for the state bearing in mind its fiscal strategy.

We follow the words of theoreticians and practitioners from the fiscal domain who say that the evasion is the principal means of fiscal elusion, because its economical content is ***avoiding the payment of the obligations to the state.***

This is the reason why, the fiscal evasion is more carefully seen into than the repercussion, by the theoreticians but also by the men of the state. We are saying that the fiscal evasion , as a part of the fiscal elusion, refers simply to the behavior of the tax contributors ,effectively to the avoidance of the payment of taxes, which are legally owed to the state, by absconding and not by transferring the duty from the payer to the sponsor, as it is done in the case of repercussion.

Until nowadays, in the special literature there was made an association between the content of the fiscal evasion and the diminution of the budget income. It was demonstrated that every avoidance of tax payment turns into smaller budget incomes but, not every small budget bears the reason of a tax non-payment.

Consequently, the “magic” term to underline the content of the fiscal evasion is: the avoidance of tax payments to the state.

The world economic system, in its assembly, includes annually billions of euro that come from economical offences and frauds. In this way, ‘the black money’, as a financial result of drugs, arms and smuggling business and felonies as: corruption, fiscal evasion, human beings trade, the pornographic industry, prostitution, are placed in banks and other financial institutions, then they are used in world finance to turn legal/ white through apparently legal methods.

Bearing in mind that the computer usage and the globalization made a fusion of all the financial markets of the world into a global system, and presently, one person has access to all the fluctuations of the prices in the big markets and can make a transaction, through the internet, the hidden economy cannot be prevented unless the law is rigorously applied and especially this phenomenon is avoided.

The hidden economy is present on all the world’s countries and has reached remarkable levels, if the average for 31 representative states in Europe reaches 19,3% from the official PIB in 2011. For Romania, the presence of the hidden economy in the PIB is of almost 30% and this is a scaring fact. At the same time one can see a slight decrease of the hidden economy in our country in the last years.

The evaluation of the hidden economy is a difficult matter, for this one using certain methods, which have some results that differ, sometimes, a lot among them.

The hidden economy is a very controversial subject, their existing differences in the definition of its activities, its procedures and in using these evaluations in economic analysis.

THE STRUCTURE OF THE RESEARCH PAPER

The hidden aspect of the hidden economy can be defined just by taking into account the actual situation of each country, by searching new criteria to comprise, in a general way, the whole of its activities, its general traits but above all its particularities and the characteristic manner of their manifestation.

In this moment, the hidden economy, according to our opinion, manifests itself with a high intensity, and this is why we ought to know this notion, to discover the main causes of this phenomenon.

In **the first chapter** of the research paper I made a presentation of the numerous meanings given to the term of hidden economy, underlining its definition which we consider the most representative, the definition given by Pierre Pestieau, according to whom the hidden economy represents “the assembly of the economical activities which happen barely following the penal laws, social and fiscal and which escape the national counts assessment”, this one being the most eloquent and succeeds in showing the true essence of the phenomenon. But, at the same time, we believe that next to this definition there should be added the reason for which these economical activities take place, and, therefore, the definition of the hidden economy, from our point of view should be: **the whole of the economical activities which take place barely following the penal laws, social and fiscal or that evade (massively) from the national counts assessment, done in order to avoid the payment of the obligations towards the state and to earn fraudulent incomes.**

The existence of the “hidden economy” is closely linked to the existence of two components compulsory for the economic activity: the human being (the human life) and the state (the human condition).

The causes of the appearance of the hidden economy are important for the identification of the differences in nature, mechanism or the consequences it generates and for the identification of its observance methods and quantification and its management.

The phenomenon of the hidden economy is a result of the constraints against the rights of disposition of some goods, incomes and other types of fortunes. We can say that

the appearance of this phenomenon is due to some subjective causes, psycho-sociological and cultural, characteristic to each country, each psychology, each belief, a decisive role being held by the behavior and education of the taxpayers.

Therefore, these subjective elements are nothing but a result of the social discontent or a response of the population to some incorrect economical-social strategies due to some institutional and economic outlook, this being the **fiscal pressure/ tax burden**, the excessive taxes, the tough rules for some activities, the fear of losing some social benefits given by the state, the economical crisis and the people's poverty; **the numerous rules** and the way of their implementation, which will influence the taxpayer's behavior to participate in the real economy, according to the administrative obstacles they have to face in the development of their business , according to the quality of the laws and the arbitrary facilities, or to place his activities in the hidden economy area; **the abusive intervention of the state in its economy**, allowed to create an expansion of corruption, and which, in this case should be correctly regulated; **lack of balance in the labor market**, which will influence the development of the hidden economy, bearing in mind that in the crisis period we are witnesses to an informal economy growth, and the tax enforcement will determine the employers and the employees to choose to work illegally.

In our opinion, the main cause of the hidden economy would be represented by the high level of taxation, which determines the raise of the fiscal pressure towards the taxpayers, resulting in the appearance of the phenomenon known as the avoidance of the taxes and making the official economy part of the hidden economy.

But, the causes of the appearance, the maintenance and the development of the hidden economy can be psychological as well, referring to behaviors such as: the wish to a fast earning, without much effort, strictly personal; exclusive competition; political interests, strategic.

At the same time we can say that the hidden economy is the result of the breaking of law of a certain economical activity (the production and the selling of drugs, prostitution, some fortune games and the pyramids) or of being outside the legal border. If in the first case, the hidden economy is the outcome of a political decision, in the second one, the individual decision is the one that makes the hidden economy, the individual adopting a stowaway attitude.

In **chapter II**, entitled *–The area of the hidden economy–* the main components of the hidden economy were presented: the fiscal evasion, dominant trait of the hidden economy, the corruption- a social and economical problem, the illegal work, economical

criminal activities and not lastly, I considered of being important the presentation of the money laundering phenomenon, this one being “the transition point of the money flux from the hidden economy to the official economy”

In my opinion, among the plenty meanings given to the term fiscal evasion, the most representative is the definition according to which “the fiscal evasion represents the decreasing of the base on which the taxes act, by breaking the legal rules, having as a result the avoidance, intentionally, of the taxes payment (direct or indirect) partly or totally”.

On the other hand, I consider that the existence of a permissive fiscal law, linked with the ability of some fiscal consultants that know the law and who allow the taxpayers a decrease of the taxes, isn't a legal fiscal evasion, as some authors say, in my opinion this one being a non-fraudulent type of evasion.

In this way, considering the concepts I classified the fiscal evasion as fraudulent and non-fraudulent.

Bearing in mind the term **corruption**, I drew the conclusion that the main forms of manifestation of this phenomenon refer to: the establishment of the “tick” type of companies, the fraudulent privatizations, the recapitalisation of the banks, the diverting of the European structural and cohesion funds, public buying made by breaking the legal laws.

The presentation of the causes of corruption was made without an exhaustive list. Among the causes we do specify the economical, political, social, judicial, moral, psychological and lastly the poverty.

Another important part of the hidden economy I considered to be the illegal employment or working without legal conditions. The disorder of the mechanism, which sustains the demand, and the offer of employment is the main cause in the creation of a parallel employment market with an informal character. A series of reasons of the illegal working were identified, the most important being: the increased taxation, the economical-financial instability of some companies from the IMM category and the low level of the professional conversion. Illegal working implies a series of risks both for the employer and for the employee.

In my opinion, **illegal working can be significantly reduced through two measures: one of them being the introduction of severe punishments, and the other one is reducing the employment taxes.**

The criminal economical activities represent the most dangerous part of the hidden economy and they comprise: production activities, drugs distribution and

consuming, arms dealing, nuclear material traffic, prostitution, human organs traffic, the corruption.

These activities assume a judicial strictness, but analyzing them as a phenomenon, we see that the social acknowledged by the society danger is doubled by an economical danger, equally critical, even if it is less seen and studied.

An important source of illegal income of the criminal groups is represented by **the drugs dealing**, the narcotic substances, which initially had just a “passive” character for the West European countries, nowadays becoming a social problem.

The free circulation of goods and persons encouraged this phenomenon firstly. At the same time, the existence of social problems (unemployment, precarious education, alcohol, teenager hoodlumism) and the development of the distribution and drugs consuming among the high-income average population (wealthy and well known families, especially through the children who have connections in the public key institutions) helped the increasing of this phenomenon.

The community funds frauds represented especially by the taking of the funds and their usage in other activities then the actual ones are illegal.

The measuring of the phenomenon of **the laundering of money** is pretty hard; the ones preoccupied by this use as a reference point an estimation of the net criminal product. We consider that **money laundering can be defined as being a set of techniques and economical and financial methods through which the money and the goods made as a profit from delinquencies are taken away because they are illegal, apparently legal, to be used in illegal operations.**

The hidden economy represents an accommodation to an excessive taxation, and its development takes place bearing in mind the conservation instinct of the economical background, having a self-recovery character, in the sense that the companies' avoidance of fiscal tax payments leads to a rough taxation which determines the moving of commercial companies from the real economy (official) towards the hidden economy.

The introduction of illegal funds from the hidden economy to the real economy, by the money-laundering phenomenon, underlines the financial-banking crime and it creates financial flux, among which the tracking and chasing of the money that come from the drugs business, arms, prostitution and smuggling, of sums obtained as a result of corrupted acts, fiscal evasion, financial –banking cheating, to be hard to develop and to be identified.

In **the third chapter** of the research paper “*The fiscal evasion concept. Forms of manifestation*” I made a presentation of the many meanings given to the notion of *fiscal evasion*.

The definition of the fiscal fraud is extremely difficult; bearing in mind the multiple meanings implied, especially by one of its base meanings, the fiscal evasion. There is a definition generally accepted by everyone, this one being a natural consequence of the economical evolution and of the activity domains where one can find it. Generally, each author has a personal vision in defining this term, but the main idea is still the same “*the avoidance of tax payments*”.

The most representative definition that we consider for the concept of fiscal evasion is **the decreasing of the base upon which taxation acts, by not following the legal norms for this cause. The effect of the fiscal evasion consists in the intentionally avoidance of the tax payments (direct and indirect) partially or totally.**

On the other hand, we consider that the existence of a permissive fiscal law, linked with the ability of fiscal consultants who know the law and who permit the taxpayers a decrease in the taxes, isn't a legal fiscal evasion as some authors name it, but is a non-fraudulent evasion.

In this way, by naming the concepts, the fiscal evasion can be classified as fraudulent and non-fraudulent evasion. Bearing in mind the forms of the fiscal evasion, its main mechanisms were identified, namely:

- the non-fraudulent fiscal evasion mechanisms: one do not show and register the accountant evidence of the VAT collected according to the sums charged; one diminishes the tax by registering some costs which are financially deductible but that didn't happen in reality; the compensation of the money given in advance (in the financial count 542) during a financial activity (having the title of provision payments) with the dividends distributed after the financial activity ended; the register in the exploitation costs of some tariffs for investments in the detriment of their capitalization; the incorrect allocation of the differences of costs of the merchandise sold out of the inventory.

- The fraudulent fiscal evasion mechanisms: doing some commercial operations from which the income isn't registered, declared, and consequently not imposed by the fiscal organs, or the partial declaration; the execution by the tax payer of double accountant evidence; developing phantom companies which are **the great actors of the fiscal evasion**; making some temporary imports to gain the production of the export, followed by the changing of the imported goods, by delivering them internally; the diminution of the

VAT collected or the increase of the deductible VAT; the sub-evaluation at the customs of the imported goods; the smuggling practiced at the customs, or by introducing the goods abroad, through other points than the customs ones, this implying the tax avoidance (customs tax, excises and VAT).

The attempt to fraud the state budget through illegal VAT reimbursement shows the methods used by the economical agents who benefit from the states money. By using these methods (unreal commercial operations through which they want VAT reimbursement), the commercial agents who practice this, in some cases have the fiscal aid, or at least they benefit from a lack of professionalism that the ones that have as duty the control of these transactions, show.

One of the mechanisms of the fiscal evasion that manifests itself intensively on the territory of our country, once Romania became part of the European community, is the “roundabout” type of fraud, concerning the VAT that belongs to the transactions between the countries inside the community. The actual mechanism is based on the transitive pattern of the actual taxes regime in the money goods exchange between the countries of the community, made between persons that should pay taxes, in the member state of the goods destination.

The manner through which the mechanism of the roundabout type of fraud concerning the VAT happens is like this: the economical operator from the origin country invoices without VAT (because he makes a delivery in the European community, which is part of the category of the operations made without VAT), and the economical agent from the destination country will apply the inverse tax regime for this operation (because he buys in the European community, according to the taxes of his country, collected VAT and deductible VAT, without actually paying it). At the end of the acquisition in the European community, the economic agent disappears without registering, declaring and paying the collected VAT of the deliveries made on the inside market (the so-called “tank” companies, that collect the fiscal obligations regarding VAT but which will never be paid). This economical agent (the so-called “tank” company) is also called due to its volatile character, “the phantom”-type regarding the investigations of the roundabout fraud and the “missing link” from the European community commerce.

The case study identified and presented in this research paper concerning the VAT “roundabout” type of fraud, evidences one of the methods used by the economical agents who benefited from the reimbursement right of the VAT, and who try not to pay to the state budget the VAT from some commercial operations, covered with a fake delivery in

the European community where an economic operator intervenes with justifiable documents. The presented case study shows in a manner the method through which an economical agent from Romania, registered with VAT, according to art.153 from the Fiscal Code, fakes deliveries to an agent from another member state, registered as well with VAT. To benefit from the VAT reimbursement, the actors of this fraudulent maneuver faked deliveries to another member state, in such a way that the merchandise didn't leave from the national territory, being sold through another company, at lower prices than the already existing ones on the market.

In the **fourth chapter** of my research paper, I made an analysis on the causes and effects of the fiscal evasion that came from the wish to stop and prevent this. In my opinion, the classification of the causes of evasion must be made according to their nature and the interference that the taxpayers have with the fiscal system. A group of objective causes was identified which includes the excessiveness of the fiscal tasks and the gaps in the laws system and a group of subjective causes from which the insufficiency of the citizens' education and the fiscal education of the tax-payer , the capacity of risks assuming and lastly the existence of the corruption in the control system are part.

The most visible effects of the evasion are the ones of financial nature, because they mean the diminution of the public revenues, followed by the economical, social and political ones.

It is well known the fact that the fiscal evasion manifests in all the market domains, and this phenomenon knows a new outbreak in the excised products, in the merchandise commerce, in the usage of the special documents and in the public services.

The prevention of fiscal fraud phenomena, especially the ones in the European community, the ones with the VAT, didn't make any progress in the last years in the European Union, the total financial loses being considered between 200 and 250 billions of euro, the equivalent of 2% of the E.U P.I.B.

Our conclusion to the approach to the measures of the fiscal evasion prevention suffers from a certain "generalization", it bases itself on the fact that most of the political forces, during the election campaigns, announce drastic measures against this "calamity", and after the elections victory they focus their attention only on certain situations of the moment. In our opinion, we think that in order to obtain some notable results in the fight against the fiscal evasion, the actions should take place along a general fiscal strategy, accepted by the majority of the political agents, to ensure its continuity.

Moreover, we are conscious that only by promoting a tough penalty regime, without being doubled by the prevention of the causes that generate fiscal evasion, it cannot determine miracle results in this direction, and the obtained effect will be the growth of the ingenuity of the methods of fraud. By the progressive relaxation of taxation (the increased taxation being identified as one of the main causes that motivates the tax-payers option for fiscal evasion), by the correcting of the lacks of the fiscal education and the sensitization of the fiscal conscience of the tax payers, linked to the harsh penalty regime, one can reduce and control the evolution of the non-accounted economy in the gross domestic product. (P.I.B).

Starting from the most visible effect of the fiscal evasion, **the delocalisation of some financial resources from their natural (and legal) means to aliment with funds the general consolidated budget**, we consider that this phenomenon, in some considerable limits, should represent a priority of the fiscal policy. For this, the reducing and the limitation of the fiscal pressure represents an efficient method in the prevention and the stopping of the fiscal evasion, because it observes the cause and not the effect of this phenomenon, respectively the premises which motivates the tax payer's behavior.

The fiscal laws have to take into consideration not only the punishment measures but also the ones that can generate a correct fiscal behavior for the taxpayers, able to lead to the limitation of this phenomenon.

In **chapter five**, there were presented the two great categories of determination methods of the hidden economy dimensions, respectively the direct methods and the indirect ones. The indirect methods of estimation are less used, because they have certain disadvantages, these referring to the direct supervision and detailed analysis of a group of taxpayers.

The indirect estimation methods, also called generically global methods or approaches of the indicators, differ according to the decisive behavior of the influence factors and comprise four distinctive approach categories: the difference between the income and the costs, the evaluation of the hidden economy based on the fiscal verifications, the method of the indexes which appear on the labor market and macro-economic techniques, comprising methods based on the monetary units and the global index.

According to the World Bank, the dimensions of the hidden economy manifest a growth tendency in the countries where the economic liberty is more reduced. The added value which is not reported because of the hidden work in the institutions registered in the

formal sector, according to the information provided by I.N.S, represents the most important section from the hidden economy in Romania, being associated, mainly, with the evasion from the payment of tax from the salary.

Referring to the level and the evolution of the hidden economy, remarkable conclusions were formulated in the study called "Underground economy in Romania" made in C.R.P.E, in which the authors of the study consider that the intern economy of Romania can be grouped in two sectors: the formal and informal sector. The formal sector, according to the Romanian national statistics comprises judicial persons organized in societies and public institutions, and the informal sector comprises family associations, free-professionals and the households of the people.

Moreover, these consider that the hidden economy is more solid, and through the extrapolation of the results of the Financial Guard they obtain a 31% percentage of the hidden economy in the total PIB, respectively 45% from the fiscal PIB, representing the equivalent of 16 billions of dollars that isn't fiscal, this sum sustaining the inflation and it creates a loss of equilibrium.

The hidden economy from Romania is estimated at 39,6 billions of euro in 2013, decreasing with 3,5% comparing to 2008 and almost 15% comparing with 2003, according to a report published in Visa Europe.

All of these seen, Romania is situated still on the second place in Europe according to the presence of the hidden economy in the PIB, estimated at 28% in 2013, equal to Croatia, Estonia and Lithuania, states that were outclassed just by Bulgaria, with 31%, according to the same study published by Visa Europe.

The hidden economy in Romania registered a mix evolution starting with 2008, despite the clear tendency of limitation of this phenomenon registered in the last ten years, according to the report „The hidden economy in Europe- The usage of the electronic payment system to prevent the hidden economy”.

CONCLUSIONS

Regarding the fiscal evasion, this one is an important problem of the Romanian fiscal system and it became more pregnant once the economic crisis happened, fact owed on one hand to the increase of the budget deficit, and also to the increase of the evasion due to the decrease of the profits and incomes.

In Romania the phenomenon of the fiscal evasion took, during the last twenty years, a great extension, affecting in a dangerous way the economical development of the country. Bearing this in mind, the phenomenon of the fiscal evasion continues to be hard to control and quantify. This is because of many reasons, some of which may be the imperfections and particularities of the fiscal law, the low level of living of the people, the reduced level of education, of culture and civic conscience, the aggressive fiscal policies that the state promotes, and lastly the corruption, which can be seen in the organizations that should fight against the fiscal evasion.

Romania registers a fiscal pressure extremely important for certain categories of taxpayers. A solution to make the situation better can be to sustain the economical agents and the people through fiscal facilities that can permit a growth of the consuming and the production made.

The existence of the phenomenon of fiscal evasion leads directly to the diminution of the volume of the states' income, which generates a consolidated budget of the smaller state that cannot solution the demand of the financial funds needed for the state to fulfill its base functions, resulting in distortions in the concurrent mechanism of the market and can lead to the appearance of social inequities, owed to the "excess" and different "appeal" of the taxpayers towards the fiscal evasion. The increased predominance of the fiscal evasion phenomenon leads to the decrease of the states' income and the growth of the tax level. In Romania we have a high fiscal pressure but the level of collecting the budget taxes is one of the lowest from the European Union, and this is why we propose as an indicator for the measurement of the fiscal pressure at a global level the balance of the public costs in PIB.

The prevention of the fiscal evasion phenomenon, both at a national and international level, needs the creation of a unitary and coherent system, which should comprise not only penal measures, because this socio-judicial phenomenon is determined by a group of factors, but also an excessive taxation of the incomes, an incoherent and unclear set of laws applied wrongly and not lastly the behavior of the taxpayers.

The phenomenon of fiscal evasion must be stopped or at least substantially diminished, in order to give away the consequences that this one can produce.

The existence of the hidden economy is a true challenge for the public authorities that by trying to limit or to take it as an official economy, they will have to take into consideration both the negative and the positive aspects.

Referring to the evolution of the hidden economy at a national level one can see that it has a pretty high level in the official PIB and that it influences differently the

individual PIB, the unemployment rate and the fiscal pressure. If between the hidden economy and the individual citizen PIB we have an indirect link, we cannot say the same of the liaison between the hidden economy and the unemployment rate and the one between the hidden economy and the fiscal pressure.

In Romania the growth of the hidden economy determines a growth in the rate of the unemployment through the level raise of the illegal work force to avoid the fiscal obligations. In the case of the other two correlations, the explanation is that the actual economic crisis influences the growth of the hidden economy. This thing generates a decrease in the official PIB and determines the taxpayers to avoid the payment of the fiscal obligations because the pressure on them is growing.

Nonetheless, the hidden economy is not totally a negative phenomenon on the real economy because during the economical crisis a growth in the hidden economy avoids an even more dangerous recession and the money earned by the people and the companies from hidden activities can be spent in the real economy helping in this way the economical and monetary growth.

The excessive taxation constitutes the support of the intensifying fiscal evasion. The avoidance of some companies to pay their fiscal obligations leads to the harshening of taxation that determines the change of companies from the transparent business towards the hidden economy.