

REDUCING TAX EVASION BY INCREASING THE QUALITY OF FISCAL INFORMATION

PhD Lecturer Adrian Ducu MATEI⁴

Abstract:

This paper emphasizes the fact that the harmful role of tax evasion primarily influences state revenues and implicitly the ability of the state to ensure equality of taxpayers. From another perspective, should the taxpayers compete against each other in the product, goods and services market, they must pay the taxes and observe the same fiscal regulations, instead of favouring some of them. The involvement of the state in the taxpayers' observance of the fiscal regulations all over the tax jurisdiction demonstrates the principle of equality before the law. Should it be affected and tax evasion increases, the environment does not favour fair competition and affects the economic development capacity of the country. Therefore this paper suggests an increased quality of fiscal information in order to counteract tax evasion.

Keywords: tax evasion, fiscal information, state and local taxation

JEL classification: H30, H62, H71

Introduction

Budget: A mathematical confirmation of your suspicions.
AA Latimer

An increased quality of fiscal information is a way by which the state ensures the effective control of activities carried out in the economy. In terms of the ways of exercising control in reality, the state chooses to encourage efficient activities, whereas a weak involvement creates chaos and uncertainty; it allows some taxpayers to have an incorrect economic behaviour, violate the law, and it generates unequal treatment in comparison to other economic operators.

Unwavering state control should discourage those behaviours which increase tax evasion and underground economy. This can be achieved if the body called to perform the state financial control would have independence and credibility. The elements which ensure independence may be assuming and adopting internationally recognized standards, having predictable laws which lack subjectivism and which do not favour interest groups, having and using assumed unitary guide lines and practices. These elements may diminish subjectivism; they may contribute to equal treatment for all taxpayers and an improved environment for the economic operators. For this purpose, institutional conversion is possible as well as adjustment of the international fiscal rules correlated with the European ones in the local legislation.

Economic and fiscal protection seem to be very important considering the varied changing and repositioning context and climate. Thus, fiscal space is vital in emerging economies, which by definition do not issue reserve currency; these economies need proper "buffers", especially in times of great uncertainty and slightly changing financial markets. The Romanian Leu is not reserve currency, and the National Bank of Romania does not have room for manoeuvre as some large central banks do. For these reasons, imbalances must be a serious concern for us in order to avoid failure in terms of financial stability, sovereign risk assessment, financing and economic dynamics.

One must consider that public debt is at reasonable level (about 35% of the Gross Domestic Product in 2018, according to the European Union methodology); yet the increase of the "twin

⁴ PhD in Economics, NIER, "C.C. Kiritescu", Romanian Academy, email: ducumatei@yahoo.com

deficits" over recent years, especially the external one (the current account deficit will probably exceed 5% of the Gross Domestic Product in 2020), with a structure in financing decrease, highlights Romania in comparison with other member states in the region; a correction seems to be significant in preparing the fiscal and budget strategy.

Mass departure from national economy borders as well as the increased lack of labour force create additional pressure, which leads to wage increases in order to diminish the phenomenon. If this reality is not considered, excessive external imbalances add up, irrespective of the national economic situation; thus important adjustments will be required when the international environment becomes unfavourable. Therefore, one must acknowledge that income increase should be decided only based on elements such as productivity and economic competitiveness.

Increasing the Quality of Fiscal Information

An increased quality of fiscal information may be achieved by a higher clarity of the tax base, reducing as much as possible the situations and possibilities of subjective interpretation of tax legislation by reassessing the tax and fee system in terms of maintaining some taxes, fees and contributions and their amount. The amount of the flat rate tax should be considered, especially as Romania has one of the lowest ones compared to other member states in the European Union.

There are researchers according to which there is a high level of inequality in Romania resulting from unfavourable employment structure and wage policy. It is necessary that the inequality index be lowered to values similar to the European average, by correcting these situations; the researchers' opinions are presented in a Romanian Academy report entitled "The Development Strategy of Romania in The Next 20 Years"⁵. It is also considered that Romania has been facing poverty during the transition period, which seems to be affecting in one form or another half of the population. The boom of poverty was generated by the decrease of wage opportunities, insecure employment, and low incomes. The report includes some internal opportunities, such as "*improving the quality of public finance management by intensifying the fight against corruption and tax evasion*".

Therefore, decision makers will have to promote mixed macroeconomic policies necessary to protect the balance. They will have to consider the medium and long term interests of the Romanian economy to avoid circumstantial measures without motivation based on reality, or counterproductive measures. Long term policies need to be designed so as to avoid sudden changes and be sustainable.

These elements are important not only to manage the current economic situation, but they must also lead to the achievement of more important objectives concerning deficit reduction in order to enable access to the Exchange Rate Mechanism - ERM2 and the adoption of the Euro currency.

Rigorous state control definitely contributes to the increase of tax revenues especially if we consider the underfunding of basic public goods in some areas of the economy such as education, health, basic infrastructure.

Efficient state control contributes to increase the quality of fiscal information; it helps increase incomes (by properly substantiating decisions to increase rates, the efficiency of collection, introduction of methods to reduce subjectivism in the fiscal apparatus by means of information technology, active combat of tax evasion and fiscal "optimization"); it may also concern an adjustment of public spending by firmly promoting the principle of efficiency.

Thus an efficient state control may contribute to reducing tax evasion and "optimization", increasing the quality of fiscal information for decision-makers, but it can also make an important contribution to substantiating the need for ample corrections of the consolidated budget.

Political decision-makers have often played an important role in the adoption of public policies in economic, social and control areas of the state, with increasingly varied effects.

⁵ The Report may be accessed at <https://acad.ro/bdar/strategiaAR/doc11/Strategia.pdf>

On the contrary, largely unsatisfactory control may lead to an important issue, as the adjustments will have to be made without knowing enough about the effects on the participants in the economic and social life (economic operators, consumers).

Previous efforts were a difficult process, largely focused on institutional construction, but in the following period it appears necessary to promote the social, economic and political interests of Romania, and continue the efforts with greater force.

An important contribution of the state financial control may be promoting professional honesty, assessing design and implementation of fiscal and budgetary policies, the relationship with other components of economic policy.

Increasing the quality of fiscal information may be achieved by acknowledging the rules of economic policy. Rules are needed because discretionary decisions are not optimal; they are inconsistent, as proved by the literature concerning "deficit bias" (Barro, Gordon, 1983).

The importance of rules in economic policy needs to be acknowledged

- from a temporal point of view (Persson, Svensson,1989), regarding the time horizon – the focus is on short term objectives rather than on long term ones
- from the point of view of decision makers' objectives, which are different from the general objectives of the society (Rogoff, Kenneth, 1990) due to reasons concerning:
 - different assumed interests (choices) or
 - promoting the interests of some groups which do not comprehend the impact of their implementation - "common pool problem"

Both have as result the improper use of the deficit and/or public debt in order to

- achieve short time benefits and/or
- limit the opponents' room for manoeuvre, especially the political enemies (Alesina, Tabellini, 1990).

The adoption of fiscal rules represent a solution to solve the issues listed above, mainly along with the discipline imposed by markets (Leiner-Killinger, Nerlich 2019).

A fiscal rule imposes a permanent constraint of the fiscal and budgetary policy by numerical limits applicable to the fiscal and budgetary aggregates which, once reached, lead to alterations of the fiscal and budgetary policies.

The purpose of the fiscal rules is to control the pressure so as to increase the deficit and / or public debt, to ensure fiscal responsibility and the sustainability of the public debt (Guerguil, 2013).

Fiscal rules may be classified into four categories:

- rules on public debts,
 - oA rule at the constitutional level and at the level of public finances law (from 1999, 2014) which specifies a limit of public debt of maximum 60% of Gross Domestic Product. It sets up corrective actions at levels of 50, 55 and 60% of Gross Domestic Product (Poland)
 - oas of 2019 a new rule regarding the maximum level of the consolidated public debt (ESA 2010) was set up at 35% of Gross Domestic Product, possibly to compensate for the relaxation of the rule regarding deficit (Sweden),
- rules on the budget balance (possibly adjusted periodically or adjusted periodically and with temporary measures - structural balance),
 - oRule regarding a budget surplus, on average, throughout the business cycle, of 1/3% of Gross Domestic Product; the existing surplus was 2% of Gross Domestic Product between 2000-2007 and 1% of Gross Domestic Product between 2007-2019 (Sweden).
- rules on public expenditure,
 - oThe Budgetary Control Act (2011) set up the limits on discretionary spending for the fiscal years 2012-2021 (some categories of expenses are exempted: emergency/disaster, war, integrity programs, and fires). However legislative changes between 2014-2019 raised the limits previously imposed (United States of America),
 - o rule / maximum limit on the nominal public expenditure (set up since 1997) of the central government and the pension system with a time horizon/the following 3 years, the target value for the last year out of these 3 (following) years being added / set annually (Sweden).

-rule on public income

- o Rule regarding the automatic allocation of the unexpected / unanticipated / non-programmed income of the central budget and of the pension system for certain destinations (France).

Fiscal rules in the Eurozone (but also in the European Union) are objectively needed both for the reasons which the economic theory in the fiscal field proves valid and for the fact that monetary union implies coordination of national fiscal policies, as well as a fiscal instrument at the central level (with main functions related to economic stabilization and ensuring debt sustainability (Leiner-Killinger, Nerlich 2019).

The specificities of the Eurozone and the Economic and Monetary Union (from a fiscal perspective) also relate to Robert Mundell's theory set forth in 1960 and regarding optimal monetary areas (Andrews, Henning, Pauly 2002).

The European fiscal rules are complex - the result of a challenging history (Andrews, Henning, Pauly 2002), the economic logic (economic analysis) within it being frequently replaced by considerations which rather take into account the political logic.

The European fiscal rules consist mainly of the following documents:

- a. Treaty on European Union (TFEU) and Protocol No. 12,
- b. The Stability and Growth Pact (SGP):
 - (i) Council Regulation (EC) no. 1466/975 ("the preventive arm") and
 - (ii) Council Regulation (EC) no. 1467/976 ("the corrective arm")
- c. "Six-Pack" regulations (fiscal supervision and coordination / Excessive Deficit Procedures (EDP) / rules application / fiscal framework / Macroeconomic Imbalance Procedure (MIP)) and
- d. "Two-Pack" regulations (DBP + Excessive Deficit Procedures (EDP)/fiscal-financial stability).

The fiscal regulations codified in this legislation (Andrews, Henning, Pauly 2002) mainly concern:

- a. under the preventive arm:
 - (i) rule on structural deficit - convergence to medium-term objective (MTO) + SDP,
 - (ii) rule on the rate of growth of expenditure (net discretionary expenditure)
- b. under the corrective arm:
 - (i) rule on maximum deficit level (3%)
 - (ii) rule on the maximum level of public debt (60%).

The complexity of European fiscal rules and their relatively limited success have led to reform initiatives (Leiner-Killinger, Nerlich 2019),⁶ which include:

- a. Increasing the consistency of the rules (deficit - debt - MTO; e.g. 3/5/60 vs. 134/3/60 or MTO -1/20 debt dev. tgt.);
- b. Reducing their complexity - which would also limit "flexibility" in implementation
- c. Avoiding the pro-cyclicality of rules (e.g. caused by the uncertainty of determining excess demand) - emphasis on expenditure rule (partial solution);
- d. Increasing the importance given to sustainability of public debt, in particular, and to the quality of public finances - in contrast to the current emphasis placed on the stabilization function throughout the economic / business cycle;
- e. The use of rewards as well, not only of penalties for failure to meet fiscal objectives and possibly safeguard clauses;

⁶ European Fiscal Board, (2019), Assessment of EU fiscal rules with a focus on the six and two-pack legislation, European Fiscal Board Report, August 2019.

- f. Clarification of the role of national fiscal policies and of the Eurozone aggregate one in exceptional situations (mainly the role of automatic stabilizers and the distribution of fiscal / monetary policies in boom / recession);
- g. Establishing a central fiscal capacity of the Eurozone (for "public risk sharing" / stabilization fund in the medium term);
- h. Encouraging / promoting investments - also achievable by a variant of the "golden rule".

At national level, Law no. 69/2010 on fiscal and budgetary responsibility is mutatis mutandis the implementation of the relevant European rules in Romania, with some simplifications but also with some (related) national rules. Thus:

- a. under the preventive arm:
 - i. there is the rule on structural deficit - Article 7, 14
 - ii. as well as rules on (the increase rate of) expenditure - Article 12c) and 12d)
- b. under the corrective arm:
 - i. there is the rule on the maxim level of deficit (3%) - Article 6
 - ii. and the rule on the maximum level of public debt (60%) - Article 6, 9, 10, 13.

The importance of state financial control in terms of rule and legislation compliance seems to be very important; it leads to an increased quality of fiscal information and not only; it contributes to the reduction of tax evasion as well. Thus the premises are created in order to achieve higher public revenues necessary to increase the financing of basic public goods in some areas of the economy such as education, health, basic infrastructure. If the state financial control also concerns expenditure and administration of the public and private patrimony, then more ambitious decisions can be achieved, such as reducing corruption which, as noticed, is at a high level.

Conclusions and proposals

The events of the last years have shown objectively some deficiencies in the functioning of political leadership: the boom of public awareness concerning corruption, which has existed from the beginning at informal level. Analyses argue that the transition state has a distinct profile, characterized by the fact that it also represents a mechanism for its exploitation by interest groups, with a high tolerance for all forms of corruption. Characterization such as feudal state, captive state, etc. are used in literature. Alongside corruption, there is a concern that we are affected by the fast process of bureaucracy, which blocks the efficient functioning of society.

Fiscal rules are used increasingly (at international and European level) to align decisions with the objectives of debt sustainability / stabilizing the economy. At European level, fiscal rules are complex and they are undergoing reform / simplification, in order to alleviate recently found dysfunctions which concern a more thorough integration in the Economic and Monetary Union, the current rules being also adopted in Romania, where some related national rules have been added. The rules applied in Romania seem to lead to mixed results; thus, the function of stabilizing the economy seems not to be addressed by the fiscal policy, and that of maintaining the fiscal and budgetary balance - the deficit - under the Maastricht threshold seems to have the constant decrease of public sector (expenditure) as a sine qua non a condition. This points to the need for structural changes in fiscal policy, in the sense of efficiency gains and of a trend to consolidate exclusively by expenditure reduction; it also compensates for the lack of performance in scheduling and collecting revenue. Moreover, multiannual budget programming and increasing the efficiency of both revenue collection and public expenditure seem to be solutions with great potential. Rules and the way of exercising state financial control are very important in order to supervise compliance especially by ensuring the increase of the quality of fiscal information and the reduction of the economy and tax evasion are very important. Thus the fiscal space necessary both for the stabilization function of the economy and for ensuring the sustainability of public debt can be rebuilt.

The exclusive focus on the procedures for the awarding of public programs together with the low attention given to the assessment of their efficiency has important distorting effects.

I propose research and assessment of a previous period of about 30 years concerning the role of the political decision on the economic evolution of Romania in order to understand what is best to do in the following period.

Bibliography

- Alesina, A., G. Tabellini, (1990), A Positive Theory of Fiscal Deficits and Government Debt, *The Review of Economic Studies*, 57(3), 403-414. Retrieved from www.jstor.org/stable/2298021
- David. M. Andrews, C. Randall Henning, Louis W. Pauly (2002), *Governing the World's Money*, Centre for International Studies, University of Toronto, First published Corlell University Press (2002).
- Guerguil, Martine, (2013), *Fiscal Rules and Small States: A Brief Overview*, IMF, Presentation Fiscal Affairs Department.
- Kamps, Christophe, Nadine Leiner-Killinger, (2019), Taking stock of the functioning of the EU fiscal rules and options for reform, ECB, Occasional Paper Series No 231, August 2019.
- Leiner-Killinger, Nadine, Carolin Nerlich (2019), Fiscal rules in the euro area and lessons from other monetary unions, ECB, ECB Economic Bulletin, Issue 3/2019, April 2019
- Robert J. Barro, David B. Gordon, (1983) Rules, Discretion and Reputation in a Model of Monetary Policy, <https://www.nber.org/papers/w1079.pdf>
- Rogoff, Kenneth, (1990), Equilibrium Political Budget Cycles, *American Economic Review*, 80, issue 1, p.21-36, <https://EconPapers.repec.org/RePEc:aea:aecrev:v:80:y:1990:i:1:p:21-36>.
- Torsten Persson, Lars E. O. Svensson, (1989), Why a Stubborn Conservative would Run a Deficit: Policy with Time-Inconsistent Preferences. *The Quarterly Journal of Economics*, Volume 104, Issue 2, May 1989, Pages 325–345, <https://doi.org/10.2307/2937850>
- Academia Română, (2015) *Strategia de dezvoltare a României în următorii 20 de ani Volumul I*, Editura Academiei Române
- Institutul Național de Cercetări Economice „Costin C. Kirițescu” (2018), *Convergența economică și monetară a României CU Uniunea Europeană – un demers necesar, etapa I*, 2018
- European Commission, (2019, 2018, 2017, 2016, 2013), *Vade Mecum on the Stability and Growth Pact*, European Commission, Institutional Paper 101, 75, 52, 21 și Occasional Papers 151.