

THE TAXONOMY OF THE SUBTERRANEAN ECONOMY

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In this article we plan to present the main conceptual approaches regarding the subterranean economy and tax evasion as form of manifestation of the subterranean economy.

Key words: subterranean economy, tax evasion, fiscal fraud, taxonomy

The subterranean economy represents the ensemble of the economic activities carried out with the breach of the social norms, having as direct purpose the obtaining of some incomes that can not be controlled by the state. The appearance of the subterranean economy is linked with the appearance of the state and the establishment of some rules, norms and regulations¹.

In the range of the subterranean economy² were included some very diverse practices, respectively: fiscal fraud and evasion, clandestine work, drug deal, weapons deal, corruption but also a series of household activities which bring unregistered incomes.

In the specialty literature, when one deals with problems related to the activities which are the subject of the subterranean economy, several terms are used, namely: hidden economy, unofficial economy, parallel economy, informal economy, black economy, shadow economy, unregistered economy, un-reported economy, criminal economy, illegal economy etc.

The unofficial economy, the unregistered economy and the un-reported economy suggest that the results of these types of economies are not officially described and one may not verify the liability of the exactness and of their truthfulness. The informal economy has the tendency to refer to craftsmanship economic activities, of small size, and which are usually related to the economies of the lesser developed countries. The hidden economy refers especially to the activities known under the denomination of tax evasion. The black economy and the parallel economy refer especially to the business which requires liquid cash. The shadow economy refers especially to the economic activities which do not belong to the official economies from the countries undergoing transition.

The criminal economy and the illegal economy refer especially to the economic activities which are carried out by intentional breach of the legal stipulations. I chose the term subterranean economy because the term "subterranean" may mean both the carrying out of some legal activities in its proper meaning as well as the carrying out of some illegal activities (for example the drug deal), of erosion or undermining of the official activities in its figurative sense.

The difficulty of defining the subterranean economy, generated by the diversity of activities which it encompasses, by the fact that these vary based on the space and time particularities, specific to this type of economy, lead to the appearance in the specialty literature of a multitude of definitions which express mainly the opposition of the subterranean economy to the official economy of legality or respect towards the valid regulations. In the concept of subterranean economy are encompassed, in broader sense, those activities the existence of which is not known (accounted for) officially and the incomes of which are not subjected to fiscal statements.

In this sense, one agreed that the definition given to the subterranean economy should include two aspects:

1. the subterranean economy is the one which "escapes" the statistic registrations and precise quantifications;
2. the activities in the subterranean economy must be expressed in the terms of gross domestic product, these allowing the comparison as size of the subterranean economy to the gross domestic product officially measured.

Vass Andrea "The Subterranean Economy has Positive Consequences as well?", "Tribuna Economica" magazine no. 51-52, December 2000.

²Pierre Pestieau "L'Economie Souterraine", Hachette, Paris, 1989

The definition given by Pestieau³ according to whom the subterranean economy represents the “ensemble of economic activities which are carried out outside the penal, social or fiscal laws or which escape (massively) the inventorying of the national accounts” is considered by specialists as being the most encompassing definition of the subterranean economy.

The System of National accounts (SNA) 1993 and the European System of Accounts (ESA) 1995 use the following concepts regarding the “invisible” economy⁴:

- illegal production;
- subterranean economy;
- informal sector.

“The illegal production” is defined by SNA and ESA as including:

- the production of goods and services whose sale, distribution and possession is prohibited by law;
- the legal production that becomes illegal when it is carried out by unauthorized agents.

In the category “illegal production” one includes the following activities: production, commercialization of drugs, prostitution, pornography, gambling games without license, the production and commercialization of copies made of movies, recordings, books and computer software without copyright, activities without license, contraband, thieving, bribery and blackmail.

According to SNA and ESA the “subterranean economy” comes from activities deliberately hidden from the public authorities due to reasons such as:

- evasion of the payments due to the income taxes, VAT and other taxes;
- evasion of the payments regarding the social insurance contributions;
- disregard of some standards/regulations established by law;
- avoidance of adaptation to some administrative methods.

The “subterranean economy” is considered to consist of:

- deliberately hidden activities with the purpose of reducing the costs (the economic part of the “subterranean”)
- statistically uncovered activities, because there are deficiencies in the statistics system (the statistic part of the “subterranean”)

Synthesizing and taking into account, as classification criteria, the relation with the national accounting and the legality of the respective activities one may perform the division of the subterranean economy into two sectors⁵:

1. a sector of the unaccounted for activities due to the fact that these are hidden by those that practice them (illegal, illicit) and which in turn divide into:

- activities allowed by the law (legal by their nature) but hidden with a view to avoiding the payment of the income taxes and taxes becoming, by hiding them, illegal (illicit): the private classes granted by a teacher, the hiring black work and other activities of fiscal fraud;
- activities hidden due to their illegality, activities which are not allowed by law, respectively those activities specifically criminal, of mafia type, such as the case of the drugs, weapons commerce, children traffic, organized prostitution etc.

2. a sector of the legal, known activities but which are not accounted for at national level: the household activities including one’s own consumption¹⁹, activities of voluntary work etc.

³ Identical, p. 35

⁴ Gutmann P.M “The Subterranean Economy” Financial Analysis Journal 1977, p. 26-28

⁵ Kaufmann D., Kaliberda A. “Integrating the Unofficial Economy into the Dynamic of Post Socialist Economies: A framework of Analyses and Evidence”, Washington D.C. Policy research working paper 1996

SUBTERRANENA ECONOMY

UNACCOUNTED FOR ACTIVITIES DUE TO CONVENTIONALLY UNACCOUNTED
HIDING (ECONOMICALLY ILLEGAL) FOR ACTIVITIES

ACTIVITIES OF FISCAL FRAUD CRIMINAL ACTIVITIES HOUSEHOLD, VOLUNTARY WORK ACTIVITIES ETC.

Fig. 1 The activities assimilated to the concept of subterranean economy grouped based on their relation to the national accounting

Source: conceived by the author based on the classifications presented by Kaufmann D., Kaliberda A. "Integrating the unofficial economy into the dynamic of post socialist economies: A framework of analyses and evidence", Washington D.C. Policy research working paper 1996

Lippert and Walk achieve, in the year 1997 another grouping of the activities assimilated to the concept of subterranean economy based on the monetary criterion and the legality of the respective activities

Type of activity	Monetary transactions		Non-monetary transactions	
Legal activities	Commerce with stolen goods, drug deal, prostitution, gambling, contraband and fraud etc.		The exchange of drugs, contraband, production and cultivation of drugs for one's own consumption theft for one's own consumption	
Legal activities	Fraudulent tax evasion (the non-reporting of the incomes to those who self-employ, the payment in cash or in kind from an undeclared work place related to the supply of legal goods and services etc.)	The legal tax evasion (deductions granted to the employees, the advantages received beside the salary which are not taxed etc.)	The fraudulent tax evasion (exchange of legal goods and services etc.)	The legal tax evasion (household activities, help granted to neighbors etc.)

Fig. 2 The taxonomy of the activities assimilated to the subterranean economy (Lippert-Walker model)

Source: Lippert O, Walker M. "The underground economy" Global evidence of its size and impact", the Frazer Institute, Vancouver 1997.

The predominance of a sector or another, the way of manifestation and the way in which it influences the official economy vary from one country to another based on the economic and organization system and the social and historical particularities.

Regarding the tax evasion as main form of subterranean economy, the specialty literature gives multiple interpretations of the concept of tax evasion. One of these defines the "tax evasion" as being the "totality of the licit or illicit methods with the aid of which those interested withdraw, totally or partially, their imposable matter from the obligations established by the fiscal laws"⁶.

Another meaning of the concept was given by M. Duverger who estimated that this phenomenon "designates the ensemble of the manifestations of running from tax income"⁷, in this sense there is tax evasion in the proper meaning of the term, when "the one who should pay the tax does not pay it without his obligation being passed on to a third party"⁸.

Carmen Corduneanu in the work "The Fiscal System in The Science of Finances" mentions that "the tax evasion consists in the avoidance of the tax payers of the payment of their due fiscal obligations, partially or totally, using the legislative flaws or resorting to ingenious maneuvers, with the purpose of hiding the imposable matter"⁹.

Regardless of the way in which this phenomenon is defined, the tax evasion represents, ultimately the non-fulfillment, by the tax payer of his fiscal obligations.

The dissimulation means used for withdrawing from the fulfillment of the fiscal obligations may be divided in our opinion in two categories:

- extrapolation of the legislative insufficiency or even the possibilities given by the law give with specific intentions;
- illicit methods

The specialty literature from Romania dedicated, based on the criteria of legality of observance or non-observance of the fiscal legislation, two terms for designating the forms of tax evasion: licit tax evasion(legal) and illicit tax evasion(fraudulent, fiscal fraud).

In the Anglo-Saxon literature¹⁰ for designating the two forms of withdrawal from the payment of taxes one uses the expressions “tax avoidance” which is legal and is based on the reduction of fiscal burden by means of tax exemptions, deductions or stimulants approved by the fiscal laws and “tax evasion” which is the illegal means of avoiding the payment of the income taxes for the taxable incomes, either by not reporting them or by the willful reduction of the taxable income.

The delimitation of the licit tax evasion from the illicit tax evasion is necessary and useful because it gives the possibility, at least theoretically, to estimate the size of the phenomenon in its two forms of manifestation. Moreover, this delimitation contributes to the sensitization of the factors of political and administrative decision to search for and establish the adequate means of limiting and fighting against the respective phenomenon.

Practically however, it is very hard to delimit the licit tax evasion from the fraudulent one so between illegal and legal there is no rupture but, more precisely a continuity, the successive attempts to profit from the law flaws leading the tax payer from legal to illegal.

Most often, the tax fraud designates an offence to the law, a willful breach of the valid fiscal law and distinguishes itself from the licit tax evasion, which represents an able use of the possibilities and alternatives offered by law.

⁶ Dan Drosu Saguna, Mihaela Tutungiu, “The Tax Evasion”, Oscar print publishing house, Bucharest 1995, p. 20

⁷ Maurice Duverger, “Finances publiques”, Press Universitaires de Frances, Paris, 1965- quoted by N. Honata “The Tax Evasion”, p. 218

⁸ Identical, p. 374

⁹ Carmen Corduneanu, quoted work, p. 347

¹⁰ Pissarides C.A., Weber G. (1989) “An Expenditure-Based Estimate of Britains’ Black Economy”, Journal of Public Economics no. 39/1989, p. 17-32.

The tax evasion may also occur as a result of some errors determined by lack of knowledge or wrong interpreting of the laws. Practically however, it is difficult to distinguish the involuntary error from a consciously taken decision with a view to diminishing the income tax, in this situation the establishment of the limits of the two forms of evasion are made separately in each case.

The underground activities ensure the official economy the flexibility and adaptability which it lacks, compensating for the fields which it doesn’t cover, offering work places to the unemployed and acting as a remedy in times of recession.

One must not omit however the fact that in case of acceptance of a dual society, composed of an official sector and an unofficial sector, the fiscality and regulation shall press more on the official sector as the underground sector shall get bigger. Any income tax not paid by one or more tax payers implies, in the hypothesis of maintaining or increasing the public expenses an increase in the taxes paid by others. In our opinion the size of the subterranean economy should be situated at a level which would not encourage the tax evasion but to have positive effects on the official economy.

The existence of the subterranean economy is a real challenge for the public authorities who, in the attempt of limiting or adopting it in the official economy will have to take into account both its negative and positive effects.

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