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FRAUD MECHANISMS - ACCOUNTING AND FISCAL EVALUATION - SEEN AS POSSIBILITIES FOR ESTIMATING THE UNDERGROUND ECONOMY

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Abstract: *The interrelationship between activities specific to the shadow economy and those specific to corruption is obvious and long-noted between academia, numerous authors, and international institutions. A deeper understanding of this economy can help to provide a basis for the behavioral analysis of those who are prone to fraud, so that opportunities for manifestation are limited by the creation of effective control mechanisms. The research issue, therefore, proves to be useful and front-runner to new directions for further development, taking into account its importance, timeliness, significance, and necessity, for financial management, both public and private, for accounting and tax professionals, and for any person interested in the harmonious good-boarder development of the society we live in. Statistical estimates are drawing strong alarm signals in global economies, where we are dealing with huge proportions of the “underground” economy, with estimates of up to half of the economic activity carried out. It is noted that the global trend toward macroeconomic modeling in the area of measuring the “shadow” economy is present. One example, which comes to support this idea, is our own country. According to the information provided by the National Statistics Institute, 20% share of the “underground” economy in GDP, while some specialists, including the Romanian Intelligence Service, estimate a 45% share of the “underground” economy. The differences are colossal and come to broaden the line of arguments that are not suitable for measuring the economy of this kind and its relevance.*

Keywords: “underground” economy, economics, economic development, globalization

JEL Classification: A14, B22, H26, F62

Introduction

The size of the “underground” economy currently does not allow us to move into ignorance. Quantitative estimates of the size of this economic component make us more responsible for the solutions that need to be developed to prevent and combat it. In our view, the difficulty in defining the phenomenon of the shadow economy may be mainly due to the multitude of activities that are included in its scope, as well as to the specific features of this type of economy in time and space.

From the literature study, I have noticed that the shadow economy has evolved on various steps, both in terms of appearance and extent and in terms of analysis and research. So today, we are talking about highly refined activities of the shadow economy that have taken on the world economy, and the writing in this area is beginning to be no longer content with police analysis, which they have become accustomed to in the long run, which is why we are seeing a fine analysis, bold over its status and the judging of the right to conceptual design. A striking example of this is the proposal already in the literature to stop obstinately trying to annihilate the shadow economy from the economic component of a country, but to try to establish a natural rate of this component, as is a natural rate of unemployment.

So, the shadow economy exists everywhere and will exist, which is certified by its very nature, which is closely correlated with human nature. Therefore, a real challenge in terms of scientific analysis is to highlight the impact on the level of economic development and not to obstinate the percentage of dissemination.

The current framework of the underground economy

Human nature is built in such a way that it tries to create as many ways as possible to satisfy its needs. The collective need requires input from the individual agent, who feels assaulted when he is deprived of some of the means he has acquired himself with his own efforts. The more the individual feels that his or her contribution is not effectively used, the more he or she will regard this effort as unjustified and will try to evade.

We therefore consider the scale of the “underground” economy to be fragile in the relationship between the state and the public, so that there is a strong need to improve it. From the above-mentioned considerations we maintain that the shadow economy can be studied mainly in relation to private agencies because they are most interested in protecting their own sources used in the economic area, rather than state agents, which operate not with their own sources.

We define the concept of a black economy as all those economic activities carried out at the limit or in breach of criminal, social, or fiscal laws, which are not recorded or invented in national accounts or official statistics, and whose measurement can never be measured accurately. Synthetically expressed, therefore, would be those activities that are clustered, illegal or fraudulent activities.

Economic and non-economic factors of influence of the underground economy

In our opinion, the existence and expansion of the shadow economy is to a large extent due to the legislative and institutional support of the official economy. The main factors that can contribute to the emergence of this sector in the economy are:

- a) excessive taxation;
- b) very strict government regulations for certain types of economic activity;
- c) prohibition of certain types of activity;
- d) fear of loss of social benefits granted by the state;
- e) too much flexibility in the use of labor.

The underlying factors of the shadow economy are an intensive research topic. They can mainly be classified as economic factors - through tax, legal, administrative and psycho-social pressure. Inequality of taxation and redistribution will always exist, regardless of the type of reforms implemented by the state authorities. Reality shows that the “underground” economy is the first and most important sign of government failure. As time has shown, on several occasions, the state is the most important organization in a society, and should be concerned about defending the social interest.

After the 1989 revolution, Law 31/1990 was the first measure to achieve the transition from the planned to the market economy, but did not have the expected effect due to the lack of implementation framework and the impossibility of adapting the company to the new realities. Unlike Western countries, Romanian legislation allows the setting up of single-member private limited liability companies. Although it is a company with legal personality, the managers often confuse the assets of the company with the assets of the individual, and there are many cases of ill-faith use of its credit.

At the administrative level, the inadequacy of internal and external controls is a decisive factor in the possibility of committing offenses in the area of the shadow economy. After the 1989 revolution, the need to control economic activity was underestimated. The period 1990-1991 followed when all forms of internal control and management were abolished. Law 58/1991,

on the setting up of shareholders' general meetings and the appointment of boards of directors, minimized the role of the supervisory bodies in ministries, which lost legal powers to intervene with controlling actions in companies. In many people's view, democracy and the separation of powers in the state were synonymous with the law of good liking, with defiance of the basic rules and standards of living together

In Romania, the internal controls of the companies are carried out by the censor, elected by the general assembly. They shall carry out a formal check in agreement with the management of those companies. Thus, when criminal acts are found, action is taken by the General Assembly and the persons responsible continue their work without being held accountable.

External controls are carried out by state institutions with powers of control in this area, but they are often insufficient and ineffective in finding offenses. This is due to the fact that the control topic does not specifically address the finding of criminal offenses, but to the specific aspects of individual institutions, administrative and non-criminal aspects. Where the constitutive facts of a criminal offense are established, criminal sanctions are usually applied and judicial bodies are not referred to take criminal measures where appropriate. In this respect, we believe that the persons in charge of control must be better trained, because they are of a different profession or economists and find it difficult to establish the criminal nature of an established act. However, police findings are few compared to the actual number. This is why we also believe that it is necessary to prepare them from an economic point of view, too, in order to be able to ascertain and properly deal with such crimes. It is also necessary that the logistical facilities of the institutions responsible for preventing and combating such offenses are much higher than those held by criminals.

It is added that some of the countries affiliated to Interpol do not allow extradition in the event of such crimes, even in the presence of an international Treaty, taking advantage of the existence of various restrictive conditions.

In conclusion, given the main determinants of the development of the shadow economy, they must be analyzed in order to limit the harmful effects of this phenomenon. In our opinion, starting from the inefficiency of the governing act and its influence on the legislative framework and the level of the fiscal pressure, there is a deterioration in the economic environment and a deterioration in social ethics.

Effects that are beneficial and complementary to the phenomenon of the underground economy

Following the study of the literature, we made a systematic assessment of the effects that underground activities have on economic and social life and classified them as follows:

- the effect on markets, where the shadow economy influences markets through the following channels of transmission: imbalance in supply and demand on official markets, through purchases of goods and services not reappearing in the supply, or through supplies of goods and services which do not correspond to demand; re-balancing the labor market through informal labor use; creating parallel markets for some goods and services, leading to parallel prices for the same good or service, leading to unjustified reallocation of resources.
- the effect on economic behavior by changing the nature of the public and private sector saving and investment function;
- the effect on the monetary balance that is influenced by the shadow economy over the following transmission channels: parallel prices, both for goods and services and for labor, for the national currency; the diversion of a significant monetary mass and thus the disruption in the cash/scriptural ratio; create waiting effects in relation to the main macroeconomic variables: interest rate, inflation rate and exchange rate; amplify speculative transactions; effect on the external balance of payments;
- effect on the general consolidated budget. The stability and efficiency of governance depend to a large extent on the quality of information that underpins the development of the programs of political, social and economic objectives.

One of the most serious effects of the shadow economy is that of increasing distances between different social groups. Economic differences are becoming significant in that some social groups participating in informal economic activities can reap huge benefits, while society is experiencing a worsening of the standard of living. The commission of crimes in the shadow economy is closely linked to other segments of social life and generates particularly serious overall consequences:

- ✓ increasing the process of social inequality through the rapid and unjustified enrichment of such persons, which consequently leads to a reduction in the standard of living of the vast majority of the population;
- ✓ the emergence of mafia-type networks, seen as the links of international financial fraud networks;
- ✓ the widespread practice of unfair competition vis-a-vis honest economic operators, who will be stifled and excluded from the market by those who earn illicit revenues;
- ✓ the illegitimate accumulation of capital by crooked people;
- ✓ the degradation of the socio-economic environment, which is collapsing since it is not based on real value;

- ✓ to slow down the process of economic and social reform, to the detriment of the large majority of the population
- ✓ the increase in the lack of confidence of some important sections of the population in the effectiveness of market economy, political authority, moral probity of state institutions, justice, with serious affectation of the principle of democracy.

In addition to these general consequences, crimes in the shadow economy also generate special consequences, such as:

- ✓ damage to shareholders presenting false financial statements;
- ✓ bankruptcy of a company by buying shares at a higher price or their sale at a price below the actual price;
- ✓ distribution of dividends from fictitious profits to the detriment of a company;
- ✓ reduction of the share capital in order to damage a company, without the associations being executed in order to make the payments due
- ✓ the issuance of shares and bonds for damage to a company;
- ✓ creating a state of danger for activities carried out in the framework of their functions in breach of the legal provisions on incompatibility;
- ✓ voting at the general meeting in exchange for material benefits;
- ✓ damage to the economic system and to persons who come into contact with a commercial company established in foreign countries and who carry out commercial papers without fulfilling legal conditions for the operation in Romania.

Methods for identifying and quantifying the underground economy

Most of the estimates of the underground economy in Romania are made on the basis of information provided by the National Institute of Statistics and the Ministry of Finance. The evaluations carried out assume that the underground economy encompasses legal activities, deliberately evaded reporting to public authorities in both the formal and informal sectors. According to the NSI (methodology developed with international assistance from EUROSTAT and PHARE) methodology, the formal sector comprises legal entities organized as companies, non-financial quasi-corporations or public institutions. In identifying and quantifying the shadow economy, according to the literature studied, the main use of direct and indirect estimation methods is made.

Direct estimation methods are seemingly empirical tests of quantifying the level and structure of the shadow economy. Based on simple but very complex models, these methods require the use and analysis of data obtained,

mainly from statistical surveys and their extrapolation based on specific methodologies. These methods are generally the only ones officially accepted and the results obtained are used to substantiate or justify the measures taken by political and administrative decision-making bodies.

The most commonly used direct methods of estimating the level of the shadow economy are:

- The method of statistical survey;
- The method of tax investigation.

In direct methods of estimating the shadow economy, the most important disadvantages are related to the determination of the sample to be investigated, the subjectivity of the data analyzed or the lack of representativeness of the values obtained, and the interpretation of these results. We also stress that, in general, the statistical survey method analyzes the level of the shadow economy in the light of the level of undeclared work as a component of the phenomenon being analyzed, and the objectivity of the method of tax investigation is largely due to the way in which the control program captures all areas with high potential for shifting activities from the real economy to the shadow economy. Between these methods, we believe that the method of tax investigation is more effective due to the very low bias of the data analyzed, and the development of an effective control program can eliminate the problem of its lack of representativeness. In contrast to direct estimation methods, which are based on micro-economic analysis, indirect estimation methods are generally based on macroeconomic indicators and target the inconsistencies (discrepancies) between them.

Conclusion

The “underground economy” is the first and most important sign of government failure, especially if we consider all the key factors in its development that need to be looked at from the perspective of limiting its harmful effects. Thus, starting from the inefficiency of the governing act and its influence on the legislative framework and the level of fiscal pressure, there is a deterioration in the economic environment and a deterioration of social ethics. Of course, we cannot ignore here the psychology of every person and the inadequacy of their tax and civic education. The growing difference between the living standards of different social categories, especially as some people have accumulated important wealth by dishonest means, has created honest people a state of social discomfort and has caused this type of crime to be committed. The assessment of the impact of this phenomenon has found it extremely complex and definitely cannot be based on an exact quantification, but at best only in probabilistic terms.

According to the National Accounts System developed by the National Statistics Institute, the underground economy refers to tax evasion on VAT and undeclared work. We believe that this method is wrong as an approach, but also as a calculation method. First of all, undeclared work is also a form of tax evasion by hiding the tax base (salary). Then, what NSI means by tax evasion is limited only to tax evasion related to VAT, ignoring other taxes and duties as the object of fraud, in particular corporate tax, excise duties and customs duties. The method used to assess undeclared work is based on comparing labor demand and supply to identify those who are engaged in a legal but undeclared activity with the law authorities. This method is considered irrelevant because it does not in any way reflect the amount of income earned by individuals in relation to their accumulated wealth and expenditure over a certain period of time.

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