

## Informality and the Moral Perception of Paying Fair Payroll Taxes – a Perspective on Institutional Quality Influence

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**Abstract:** In this article, we aim to realize an assessment of the economic literature on fiscal morality (the attitude of individuals towards taxes and especially towards tax payment) and its relationship to tax compliance (the final behavior of the individual in the context of the social contract with the state) in the wider set of informality and free-rider problem. Our research aims to identify the elements that lead to the shaping of informality, starting from the fiscal morality approach in a world in which poverty and inequality put additional pressure on individuals' decisions about taxes.

**Keywords:** informality; tax morale; free-rider problem; tax compliance; payroll taxes

### Introduction

The process of taxation would take into account three partners: on the one hand, the state (the one that coerces citizens by law to comply with the payment of taxes), on the other hand, the taxpayer (who decides to release parts of his income to the state in the spirit of tax obedience or normality), and the third partner is the society/the community because only in connection with society there can be a tax system and taxpayers, starting from the idea that the purpose of the state is to ensure social welfare for its citizens (Nuta, 2011c; Nuta 2014). In this context, informality seems to erode the relationship between the individual and state institutions, so that for various reasons, individuals who work without declaring work results or work in contexts where no one has the responsibility to formalize labor relations become individuals who evade the tax system and questioning the tax morale.

Tax morale is an element that is not very often included in studies that develop the subject of tax evasion. However, moral attitudes affect tax compliance (Robbins & Kiser, 2020) and are influenced by several factors, including religion and religiosity, level of education, social and cultural values, risk aversion, and so on.

The detaching of workers to the tax authorities occurs in an impressive variety of activities and is based on an even wider variety of reasons in the context of taking the risk generated by the option of not declaring work, either partially or in whole.

From this point of view, the perspective in which the workers are referred to the system of taxes and fees can also have a special importance. Can it be considered the correct attitude from the moral

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perspective the partial payment of taxes or their non-payment in the conditions in which the workers perceive the taxes as unethical instruments of a burdensome and rapacious/greedy state, irresponsible or corrupt or inattentive, generally speaking, to the taxpayer development needs? The quality of institutions has become a very important factor being linked to the compliance and acceptance of regulations in many other domains, as the environment, public initiatives, investment decisions, etc. (Ayad et al., 2023; Balsalobre et al., 2023; Dilanchiev et al., 2023; Abban et al., 2022; Abban et al., 2023; Nuta and Nuta, 2017; Tiwari et al., 2023, Khan et al., 2023b; Khan et al., 2023c; Nuta & Nuta, 2012; Zhang et al., 2023; Nuta & Nuta, 2020, Shahbaz et al., 2023) Thus, the reasons for avoiding regulations and taxation can be found even in the perception of the state (through its institutions) as a long-term partner or as an opportunistic one that pushes the worker to benefit from various opportunities or methods of circumvention of legal regulations.

The option of non-payment of taxes and social contributions or those payments related to health insurance could be based on the distrust of workers in the ability of the state to provide an optimal level of social or health services or the lack of state interest in managing institutions that are capable of ensuring a minimum of openness or assistance in the conditions of assuming the welfare state status regarding different features, like socio-economic development and education, infrastructure, institutional restructuring, and decisional transparency, etc. (Jiang et al., 2023; Khan et al., 2023a; Nuta et al., 2023, Nuta et al., 2021; Ullah et al., 2023; Nazam et al., 2022; Nureen et al., 2023; Alshaib et al., 2023; Nuta, 2008; Nuta, 2011a; Nuta, 2011b; Nuta et al., 2015a; Nuta et al., 2015b; Nuta and Nuta, 2014, Nureen et al., 2023)

## **2. Tax Compliance or Tax Evasion**

There are many questions about the reasons that could induce tax compliance behavior and whether there is a tax mechanism to encourage tax compliance. Auditing or verifying taxpayers and punishing those who use informal activities, as sustained in the traditional economic approach, still allows the existence of informality, and there are wide discussions generated by rewarding those who demonstrate correct social behavior from a fiscal perspective, given that the payment of taxes will lead to social return (Fatas et al., 2021) but the conclusions are not so optimistic regarding the decrease of the informality level.

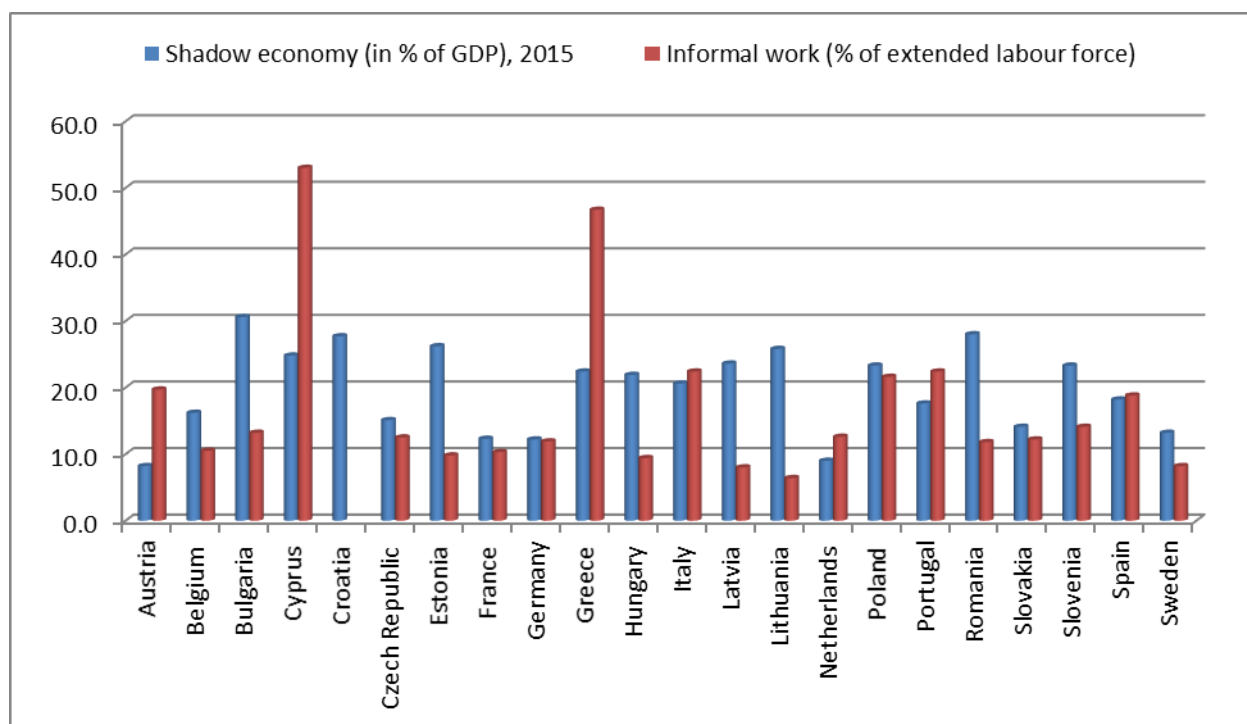
The specialized literature that analyzed this direction of awarding the correct behavior hardly found real examples, apart from the fiscal lottery created in certain states, that considers compliance with VAT by keeping a fiscal receipt (Romania, Italy, Malta, Taiwan, Lithuania, Portugal, Czech Republic, Slovakia, Latvia), but even in these cases, there is limited evidence regarding the achievement of the proposed purpose (Bazart & Pickhardt, 2011; Fabbri & Hemels, 2013, Berenson, 2018, Brockmann et al. 2016).

The behavioral economics approach presents a multitude of determinants of tax compliance in some studies (Van Rooij & Sokol, 2021), starting by separating coercive and legitimate power, and considers that an adaptation of tax institutions strategies in relation to the taxpayer is necessary to formalize a part of the informal economy. In addition, in the view of other authors (Brockman et al., 2016), individuals may have a greater inclination to pay taxes and social contributions to the extent that, in their opinion, the state acts efficiently and does not waste money collected through the tax system.

The argumentation of the fairness of taxes can be combated, and this can also be done because individuals relate differently, personally, to the tax system, each taking into account their own situation.

### 3. The Shadow Economy and the Free-Rider Moral Perspective

The shadow economy (González-Fernández & González-Velasco, 2015), seen as those legal, economic activities that are deliberately hidden from the payment of taxes and fees and social contributions, may have different implications on regional or state economies, their level being generally determined by reference to direct taxes, rather than indirect taxes in communities with the highest level of informal activity.



**Figure 1. The size of the Shadow Economy and Informal Work in Some EU Countries**

Source: EC, European semester thematic factsheet: Undeclared work, 2017

[https://ec.europa.eu/info/sites/default/files/file\\_import/european-semester\\_thematic-factsheet\\_undeclared-work\\_en.pdf](https://ec.europa.eu/info/sites/default/files/file_import/european-semester_thematic-factsheet_undeclared-work_en.pdf)

Figure 1 shows the estimation of the shadow economy level (as a percentage of GDP) in 2015 in correspondence with the estimation of the informal work level (% of the extended labor force). We can see that the level of the indicators is different, but the higher concentration of the shadow economy is usually visible in the former communist countries, which later joined the European Union. The lowest level of the shadow economy and informal work is observed in countries such as Germany, France, Netherlands, Belgium, Sweden, and Austria, which have larger labor forces and relatively lower levels of undeclared work, and the level of GDP per capita is higher (figure 2). The figure also shows countries such as Cyprus and Greece, where the level of informal work calculated as a percentage of the extended labor force is very high (respectively 53% in Cyprus and 46.7% in Greece) generated by a higher percentage of self-employment activities (Greece) and a higher level of the employment relationship (Cyprus) (Williams et al., 2017).

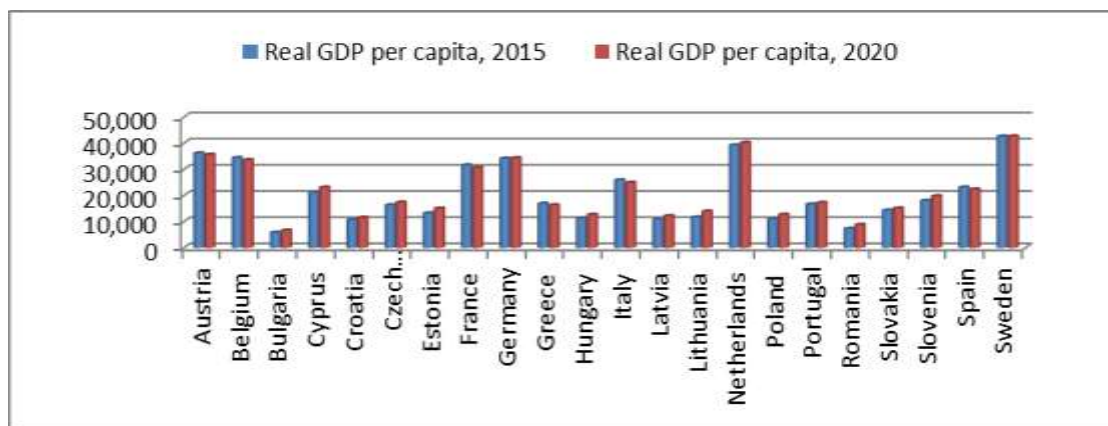
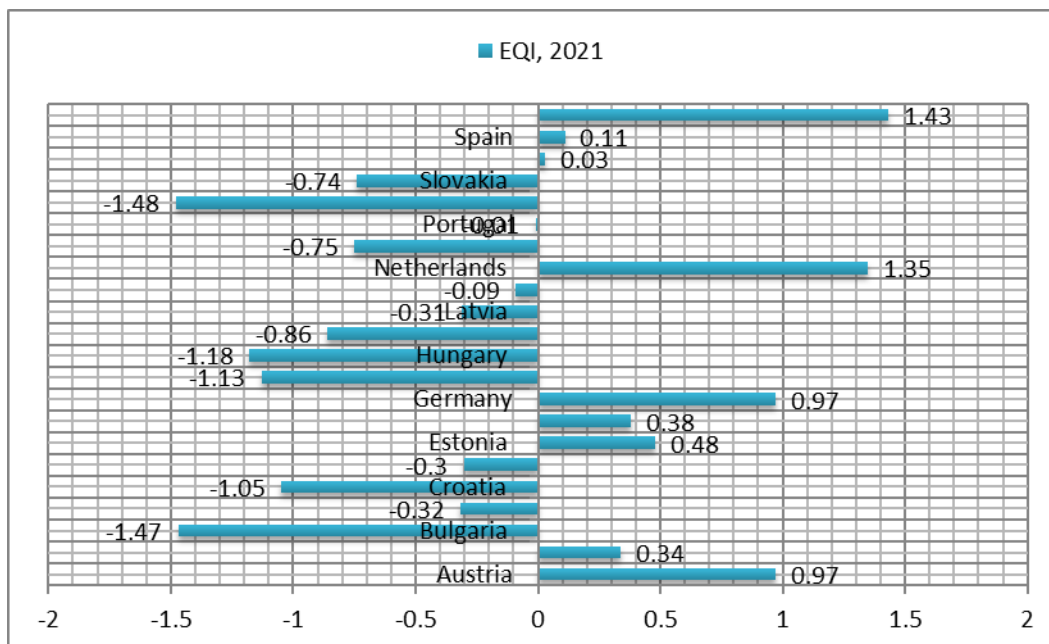


Figure 2. Real GDP Per Capita, Chain-Linked Volumes (2010), and Euro Per Capita in 2015 and 2020

Source: Eurostat [https://ec.europa.eu/eurostat/databrowser/view/sdg\\_08\\_10/default/table?lang=en](https://ec.europa.eu/eurostat/databrowser/view/sdg_08_10/default/table?lang=en)

Let’s look closely at Figure 1 and Figure 2. We may observe that the countries with the highest level of GDP per capita, expressed in euro/capita for 2015 and 2020, have the lowest level of undeclared work or shadow economy (Sweden, Netherlands, Austria, Germany, France, Belgium), meaning that the greater the level of GDP per capita, the lower is the prevalence of undeclared work and the lower is the level of the GDP per capita in Romania, Bulgaria, Latvia, the higher are levels of the shadow economy (Moldovan & Lobont, 2014).

In Figure 2, we highlight the European Quality of Government Index (Charron et al, 2021), focusing on perceptions regarding public corruption, calculated at the regional level in the original version, but which were highlighted as the average level of each EU state. In this case, we also notice that the countries with a low level of shadow economy in Figure 1 are included in the positive sphere of the diagram, having the highest values regarding the European Quality of Government index (Sweden, Netherlands).



Source: own calculations based on data from Charron et al. (2021) <https://www.gu.se/en/quality-government/qog-data/data-downloads/european-quality-of-government-index>,

The morality of the employers and employees are key factors in assessing the level of the shadow economy. Morality in general and tax morale in particular take into account the behavior of the taxpayer or potential taxpayer, possibly in relation to the ethical behavior of the state, so that only through policies of transparency and accountability of state governing or regional government can reduce the informality-friendly behavior.

However, tax morale has also been linked to individuals' opportunity to evade, and some results (Blaufus et al., 2015) point out that as workers find more opportunities for tax evasion, they consider this process less unethical.

We could consider the taxpayer who does not pay taxes to the state as a free-rider, an individual who prefers (or is forced) to reduce or cancel tax payments to ensure a higher level of his income but who does not participate in the development of the society in which he lives, although he is the beneficiary of some public services/goods offered by the state through his institutions, being oriented only to his needs.

However, the free-rider behavior will not lead to rehabilitating the existing conditions and the development of the state from the institutional, infrastructure, or educational perspective. To a certain extent, the worker's decision will have a snowball effect that will accumulate and entail a limitation of development and, simultaneously, the loss of the initial advantages. It is clear then that the more individuals adopt this behavior, the more difficult it will be for the community in which they live to reach an optimal level of development to ensure social welfare. In addition, some studies have questioned the link between moral duty (the attitude) and tax compliance (the behavior) Guerra & Harrington (2018).

#### **4. The Moral Code of Religions and Tax Morale**

Religion, in general, is an important factor in accepting tax evasion as a typical behavior of individuals. In this sense, the literature (Kirchmaier et al., 2018) has shown that religious people/believers have a greater aversion to non-payment of taxes and unethical economic behaviors due to the moral code on which religion is built so that morality is different from the religious perspective, (Shariff et al., 2014), in the sense that religious affiliation influences the moral attitude towards the state or society.

In addition, analyzing a series of articles by McGee (McGee, 2006; McGee & López Paláu, 2007; Coman, 2006), who stood out as a researcher inclined to emphasize the contribution of ethics and non-ethics induced by the religious laws of different categories of believers, he reaches interesting conclusions about tax evasion seen as an ethical process always, sometimes or never.

In this regard, referring to Halahá, the code of Jewish religious laws, it can be deduced that non-payment of taxes is theft and is prohibited. At the same time, other authors (Tamari, 1998) argue that theft from public authorities is awful than stealing from private individuals (because, in order to correct the mistake of returning the stolen property, it is more difficult to find the owner in the case of the public good). According to the same author, the Christian religion has sufficient evidence to strengthen the ethical side of paying taxes; in this sense, it is remembering the words of Christ who urged the people to give Caesar what is of Caesar's. There is, of course, a certain ethical justification for avoiding the payment of taxes, but its quantification remains a matter of the conscience of the

individual while the Muslim perspective claims that *zakat* payments are one of the Five Pillars of Islam, so it becomes a voluntary form of payment.

In essence, however, it is known that the extent of fraud is related to the practical possibilities of committing fraud, imagination, or the level of development of society. However, we must also consider the principles of ethics and religious references as impacting tax evasion. We believe that ethics succeeds in influencing individuals to a greater extent than religion in deciding to pay or evade paying due taxes, but this is not a rule.

## 5. The Inequality that Builds Informality

On the other hand, some studies analyzing 138 countries over the 1991–2015 period (Gutiérrez-Romero, 2021) have addressed inequality as a factor of informality and found that past levels of inequality are the most salient factors explaining the size of the informal economy in the long run, in contrast with reducing fiscal burden, which, following the analysis, have a relatively low impact.

For example, in terms of informal care provision, some research (Schmitza & Westphal, 2017) has highlighted a negative effect of this kind of activity on the ability of women involved in it to work full-time, with a negative impact on total annual income and on the potential pension they will be able to earn.

Some studies (La Porta and Shleifer, 2014) have shown that in developing countries, the level of informality is higher, but as *gig economy* jobs (Bracha and Burke, 2016) have increased, the level of informality in developed countries in high-productivity firms has become increasingly important.

Since informality involves giving up certain rights by the worker in favor of keeping a larger amount of money as a result of providing a certain service, this vulnerability in normal economic times becomes more important in the context of an economic shock generated by different factors. The lack of a certain level of safety at work is exacerbated in difficult economic times by the fact that the state does not have the intervention levers to reduce the risks of job insecurity performed in an informal or unregulated context. Thus, the implications of the *coronavirus* pandemic, both in the short and long term, are much more important for informal work than for formal work (Williams & Kayaoglu, 2020), given the desire of workers for more employment security (Web & McQuaid, 2020) in the conditions in which a fairly high percentage of employees and employers act in the informal economy in emerging market and developing economies (Ohnsorge & Yu, 2021, ILO).

## 6. Concluding Remarks

In our study, we developed a complex approach to informality and tax morale, aiming to reach the multiple dimensions of the phenomenon. Thus, the study of theoretical and empirical literature has allowed us to develop several research directions, starting from the factors that influence the informal economy or that this phenomenon affects through its dimensions.

Both the morality level and structure of a society can put pressure on the behavior of individuals in relation to the state institutions, especially with tax authorities or those that govern working conditions, emphasizing the importance of a high level of fiscal morality in order to achieve tax compliance at optimal levels.



The level of development of a society is again closely related to the share of the informal economy, but to the same extent, the new activities, known as *gig jobs*, have led to the creation of new forms of manifestation of tax evasion practices.

The negative role of these practices of illegal deducting some income from the incidence of taxation is essential to be delimited and diminished by the fiscal institutions and represents a real pressure, especially regarding the level of fiscal revenues collected at the local or state level and on the state's capacity to ensure the social welfare of its citizens.

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