

DOI: [https://doi.org/10.18371/fp.1\(37\).2020.201607](https://doi.org/10.18371/fp.1(37).2020.201607)

JEL Classification E 64, E 20, D 31.

FISCAL ILLUSION: THEORETICAL ASPECTS AND EMPIRICAL RESEARCH

KOLODIY S.Y.

Professor, management and information technologies chare

Banking University, Cherkasy Institute

ORCID ID: <https://orcid.org/0000-0003-0163-4569>

e-mail: kolodii_sergei@ukr.net

Abstract. *The article is devoted to the study of theoretical aspects and an empirical study of the fiscal illusion concept. Author investigated the dynamics of the six basic taxes (including pay-roll taxes) rates during 1999-2019 and found a trend to general liberalization of economic activity, which is emerging in lowering base rates. The unique economic-mathematical model of personal income taxation is developed. This made it possible to assess the general level of income taxation and substantiate using of two indicators: the fiscal illusion coefficient (K_{fi}) and the fiscal illusion scale (S_{fi}).*

Keywords: *fiscal illusion, direct taxes, indirect taxes, income taxation, economic model.*

Using of indirect taxes as a major source of tax revenue for the central and local budgets can solve the problem of ensuring the stability of revenues. In macroeconomic theory, direct taxes are seen as a built-in stabilizer that automatically regulates aggregate demand within the economic cycle. The perception of the «price» of governmental public good production depends on behavioural factors. Individual entrepreneurs are more sensitive to changing a taxation schema they make it themselves.

The purpose of the work is in studying and developing the theoretical aspects of fiscal illusion, and using the author's model, which allows evaluating empirically the dynamics of fiscal illusion indicators.

VAT in the post-Soviet countries has traditionally been seen as a source of corruption and financial fraud, linked to the

creation of fictitious firms, the overestimation of tax credit and the formation of counterfeit export transactions. Lowering the base rate of VAT will reduce the profitability of such transactions and reduce the fiscal illusion.

Investigating the dynamics of the six basic taxes (including pay-roll taxes) rates during 1999-2019 we found a trend to general liberalization of economic activity, which is emerging in lowering base rates. The unique economic-mathematical model of personal income taxation is developed. This made it possible to assess the general level of income taxation and substantiate using of two indicators: the fiscal illusion coefficient (K_{fi}) and the fiscal illusion scale (S_{fi}). Analysis of its dynamics in Ukraine and RF in 1999-2019 is allowed to draw a conclusion these countries are a similar taxation

system and characterised by reducing the total level of income taxation. Coefficients assessing allows concluding the fiscal illusion in both countries remains quite high. Step-by-step reduction of the VAT basic rate to 16% (by 1% per year) in Ukraine, with the simultaneous increasing an individual pay-roll rate to 3% should improve the taxation system,

increase the level of direct taxation and make a correspondence between the taxation and value of public goods. The application of such «tax manoeuvre» will lead to the fact that the share of potential income, which is redistributed by the government, will remain almost unchanged, and the scale of fiscal illusion will decrease from «2,292» to «1,992».

References

1. Stiglitz, Joseph E. & Atkinson, Anthony B. (1980). Lectures on public economics. London; New York: McGraw-Hill Book Co.
2. McNutt, P.A.(2002). The economics of public choice. Cheltenham; Amsterdam: Edward Elgar.
3. Musgrave, R.A. (1959). The Theory of Public Finance. New York: McGraw-Hill.
4. Olson, M. (1995). Logika kolektivnyh dejstvij. Obshchestvennye blaga i teoriya grupp [The Logic of Collective Action: Public Goods and the Theory of Groups]. Harvard: University Press [in Russian].
5. Johnson, D. (1991). Public choice. An introduction to the new political economy. Toronto: Bristlecone Books.
6. Lekar, S.I. (2016). Doktrinalnij analiz fiskalnoyi ilyuziyi [Doctrinal analyses of fiscal illusion]. *Naukovi zaspiski Institutu zakonodavstva Verhovnoyi Radi Ukrayini*, 4, 101-115 [in Ukrainian].
7. Katrushenko, E. V. (2005). Problema «obshchestvennogo vybora»: Fiskalnaya illyuziya ili racionalnaya neosvedomlennost? [«Public choice» problem: fiscal illusion or rational ignorance]. *Kultura narodov Prichernomor'ya*, 63, 57–61. [in Russian].
8. Puviani, A. (1903). Teoria della illusione Finanziaria. Milan: Remo Sandon.
9. Sanz, I. (2003). Fiscal illusion, fiscal consolidation and government expenditure composition in the OECD: a dynamic panel data approach. *European Economy Group Working Paper. Universidad Complutense de Madrid*, 21.
10. Sanandaji, T. (2010). Fiscal Illusion and Fiscal Obfuscation: An Empirical Study of Tax Perception in Sweden. *Research Institute of Industrial Economics*, 11.

11. Von Hagen, J. (1995). Budget Processes and Commitment to Fiscal Discipline. *European Economic Review*, 39, 771–779.
12. Buchanan, J. M. (1960) Fiscal Theory and Political Economy. Chapel Hill: University of North Carolina Press.
13. Buchanan, J. M. (1967) Public Finance in democratic process: fiscal institutions and individual choice. Chapel Hill: The University of North Carolina Press.
14. Bush, P. (2001). Neoinstitutionalism. *Encyclopedia of political economy*. New York Vol.1, 124.
15. North, D. (1990). Institutions, Institutional Change and Economic Performance, Cambridge University Press.
16. Baekgaard, M., Sorritzlew, S., Blom-Hansen, J. (2016). Cause of fiscal illusion: lack of information or lack of attention?: Cause of fiscal illusion. *Public budgeting & finance*, 36 (2), 26-44.
17. Dziemianowicz, R., Kargol-Wasiluk, A., Wildowicz, A., Wyszowski, A. (2017). Tax expenditures as an example of fiscal illusion. *Optimum. Studia economiczne*, 5 (89), 85-98.
18. Kolodij, S.Y. (2011). Institucionalnoe regulirovanie formirovaniya i ispolzovaniya finansovyh resursov gosudarstva v posttransformacionnoj ekonomike [Institutional regulation of government finance in post transformation economy]. Simferopol: OOO «DiAjPi» [in Russian].