

# THE RELATIONSHIP BETWEEN PRICE COMPETITION AND TAX EVASION OR AVOIDANCE

Mentor Gashi<sup>1</sup>, Halil Kukaj<sup>II</sup>

<sup>1</sup> European University of Tirana, Tirana, Albania

<sup>2</sup> University of Prizren "Ukshin Hoti", Prizren, Kosovo

## ABSTRACT

In order to find, if the companies that cause the evasion and avoidance, make it, only to survive the competition with other companies in the market, to make competition with other companies or to increase their profits without impact of competition, we found that from 239 answers, there are 95 or 39.76% answer where the respondents answered avoidance and fiscal evasion, because they have the motivation to cheat the state to increase their profits; 58 or 24.26% of the respondents answered avoidance and fiscal evasion, to dominate their own competition with lower prices and 86 or 35.98% of the respondents answered avoidance and fiscal evasion for protection from competition, because their competitors have hit the market with cheaper prices.

## JEL CLASSIFICATION & KEYWORDS

■ H26 ■ H32 ■ F12 ■ COMPETITION ■ FISCAL EVASION  
■ TAX AVOIDANCE

## INTRODUCTION

In this paper, our main aim is to determine the relationship between price competition and tax evasion or avoidance, based on same theoretical framework, we set the fiscal evasion on one side and competition between the companies on the other side. First is the review of literature, to study the work of the other authors about this subject and negative or positive relation between these variables. The question studied is: What do you think of companies that make avoidance and fiscal evasion in relation with competition? As optional answers, we submitted three factors that can be affected on the fiscal evasion in relation to competition price. The factors that are submitted are:

1. they have the motivation to cheat the state to increase their profits;
2. to dominate their own competition with lower prices;
3. for protection against competition, because their competitors have hit the market with cheaper prices.

In this case we have taken only the relationship between competition and fiscal evasion.

The results based on answers by the respondents are showed below: the first factor that has most effect is that they have the motivation to cheat the state to increase their profits, the second factor is to protect against competition, because their competitors have hit the market with cheaper prices, and the last factor is to dominate their own competition with lower prices.

## Review of literature

In this paper we started with the theoretical framework and literature review, because we are interested in the effect of competitive pressure on cheating. The literature on the

specific impact of competition on tax evasion issue is quite limited, but we have tried to find work on the same issue as Cai & Liu (2009). This article investigates whether market competition enhances the incentives of Chinese industrial firms to avoid corporate income tax. Here we estimate the effects of competition on the relationship between firms' reported accounting profits and their imputed profits based on the national income account.

To cope with measurement errors and potential endogeneity, we use instrumental variables, exogenous policy shocks and other robustness analysis. We found robust and consistent evidence that firms in more competitive environments engage in more tax avoidance activities. Moreover, all else equal, firms in relatively disadvantageous positions demonstrate stronger incentives to avoid corporate income tax. Cai, Liu and Xiao (2007) employ data of more than 20,000 large-and-medium-sized industrial firms in China during 1995 to 2002, and find that firms in more competitive environment and relatively disadvantageous positions hide larger shares of profits. Their paper suggests policies providing equal opportunities for enterprises to avoid firms seeking unlawful means to compensate such disadvantages. Even if, it is far from the most relevant empirical work directly supporting the adverse effect that competition could bring to firms: Tax evasion or avoidance, as underlying incentives to seek compensation for competition pressures (Goerka & Runkel, 2007). Using a Cournot oligopoly model with an endogenous number of firms and evasion of indirect taxes, this paper shows that more intense competition may have the negative side-effect of eroding tax revenues by increasing tax evasion.

The desirable result of more competition, less evasion and higher tax revenues. (Yiqun, 2009) Competition is a significant factor determining tax evasion behaviors. Competition pressure is a key stimulus to induce questionable manipulations of tax reporting behaviors. In this paper is an interesting lab experiment, of authors Schwierien and Weichselbanmer (2008). We experimentally test whether competing for a desired reward does not only affect individuals' performance, but also their tendency to cheat, scandals in sports as well as forgery and plagiarism scandals in academia have been partially explained by "competitive pressures", which suggests a link between competition and cheating. In this experiment, subjects conduct a task where they have the possibility to make use of illegitimate tools to better their results. Poor performers significantly increase their cheating behavior under competition which may be a face-saving strategy or an attempt to retain a chance of winning. In this focus, Shleifer (2004) suggests that competition may favor unethical behavior such as corruption or cheating. Counting this author said; when unethical behavior cuts costs, competition drives down prices and entrepreneurs' incomes, and thereby reduces their willingness to pay for ethical conduct. Nonetheless, it was said that competition might be good for ethical behavior in the long run, because it promotes growth

<sup>I</sup> mentorgashi15@gmail.com

<sup>II</sup> halilkukaj@yahoo.com

and raises incomes. Higher incomes raise the willingness to pay for ethical behavior, but may also change what people believe to be ethical for the better. Therefore, there are the theoretical models which are developed and tested, and their hypotheses present that a firm's incentive to hide profits are positively correlated with product market competitiveness, negatively correlated with its accessibility to capital market, and firms with disadvantageous market positions tend to have stronger incentives to hide profits. In paper by Schwierien and Weichselbanmer (2008), we saw that behavioural or psychological motives may lead to increased cheating under competitive pressure. Competition emphasises the importance of personal success. As a result, people who do not bring about the desired achievements may feel pressured to engage in pretence of such. Furthermore, competition draws the attention from the well being of the group towards the individual and thereby lessens the social cohesion within a group. Consequentially, individuals may find themselves less bound to adhere to standards of fairness but may find it legitimate to gain their personal share by cheating.

Cheating can be considered to be a criminal action - according to the economics of crime, as originated by crime can be viewed as a rational act that is chosen by an individual depending on the benefits and costs involved (Becker, 1968).

**Methodology**

Survey was conducted through questionnaires. We distributed 248 questionnaires, but collected 239 answers. Questionnaires were distributed mainly to the importing companies' officers that practice control over businesses, customs agents, accountants and international transport companies and others. The questionnaires were collected within few weeks, in the end of 2015. This research question was in the questionnaire that also has other questions, for other studies, but, these result are not publish in the other papers.

**Results for survey**

Inspite of many other factors that can be used to stimulate fiscal evasion and avoidance, we wanted to know that perhaps these companies are driven by force to make evasion or avoidance, without their desire, to survive in the market, or to protect against competition. We wanted to find if the company practice evasion and avoidance only to survive the competition with other companies in the market, to compete with other companies or to increase their profits without impact by competition.

In figure 1 and table 1 we have shown the results which are taken from the respondents.

They have the motivation to cheat the state to increase their profits	95	39.76%
To dominate with lower prices to their own competition	58	24.26%
For protected from competition, because their competitors have hit the market with cheaper prices,	86	35.98%
Total	239	100%

Source: Authors based on answers from respondents

**CONCLUSION**

In table 1, we have concluded, that from 239 answers of the questions in this study, there are 95 or 39.76% answers where the respondents think that avoidance and fiscal evasion happen because they are motivated to cheat the state, only to increase their profits; 58 or 24.26% of the respondents think that avoidance and fiscal evasion happen to dominate their own competition with lower prices and 86 or 35.98% of the respondents think, that avoidance and fiscal evasion happen as protection against competition, because their competitors have hit the market with cheaper prices.

In conclusion we can say that there is a relationship between prices, competition and tax evasion or avoidance. We show that it is done in order to increase profits and protect against competition's prices. Therefore, tax evasion can happen due to the competition as well.

**REFERENCES**

Becker, G. (1968). Crime and Punishment: An Economic Approach, *Journal of Political Economy*, 76(2), 168-217.

Cai, H., Liu, Q., & Xiao, Q. (2007). Competition and corporate tax avoidance: evidence from Chinese industrial firms, Working Paper, Peking University and University of Hong Kong.

Cai, H. & Liu, Q. (2009). The Economic Journal 119 (April), 764-795 The Autor(s). Journal Compilation, Royal Economic Society. Published by Black Publishing.

Goerka, L. & Runkel, L. (2007). CESifo, Working Paper, N0 2104, www.CESifo-group.org/wp

Schwieren, C., & Weichselbaumer, D. (2008). Does Competition Enhance Performance or Cheating? A Laboratory Experiment. *Journal of Economic Psychology*, 2010, 31 (3), 241-253.

Shleifer, A. (2004). Does Competition Destroy Ethical Behavior?, Working Paper N0. 10269. National Bureau of Economic Research 1050 Massachusetts Avenue, Cambridge, MA 02138.

Yiqun, W. (2009). Competition and evasion; a cross country study. Master thesis, Lingnan University.

Figure 1: Results from Table 1

