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Explaining Italian Tax Compliance

A Historical Analysis

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Ex-Prime Minister Silvio Berlusconi once famously claimed that the “evasion of high taxes was a God-given right” (Bhatti et al. 2012). Reports from Istat, Corte dei Conti, and l’Agenzia delle Entrate estimate that tax evasion in Italy costs the state €120 billion per year in lost revenue (Santoro 2010). Using data from the Istituto nazionale di statistica (Istat), Alessandro Santoro demonstrates that evasion of value added tax (VAT) averages about 34 percent across regions (Santoro 2010). Figure 5.1 shows evasion rates for the regional tax on production.¹

One explanation for relatively sluggish and asymmetric development in Italy argues that Southern Italy is driving most of these ills. This line of inquiry depicts Southern Italians as less endowed with civic virtue and social capital, which is reflected in their lower levels of economic development and, as shown in Table 5.1, government performance (Banfield 1967; Bigoni et al. 2016; Cartocci 2006; Putnam, Leonardi, and Nanetti 1994; Sabatini 2005a; 2005b). Here civic virtue is defined as high civic awareness and a shared consensus regarding the legitimacy of political institutions and public policy, together with political competence and trust (Almond and Verba 1963). Social capital refers to features of social life, such as networks and trust, that facilitate civic participation (Putnam, Leonardi, and Nanetti 1994).

This line of research typically associates development to the cultural underpinnings of society. Edward Banfield followed by Robert Putnam and his colleagues suggest that Southern Italy is a region characterized by *amoral familism*. Societies tied by amoral familism (bonding social capital) “emphasize family relations to the exclusion of all others” (Fukuyama 1995).

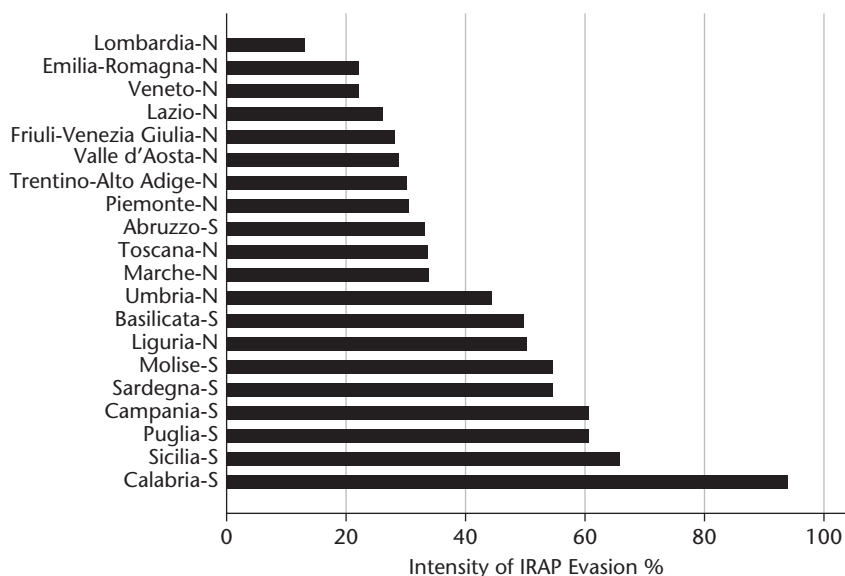


Figure 5.1. Rates of evasion of IRAP by region 1998–2002

Source: Istat in Santoro (2010).

Table 5.1. Quality of government: 14 Western European countries

Country	Quality	Impartiality	Corruption	Average
Finland	1.657	1.296	1.266	1.406
Netherlands	0.956	1.445	0.912	1.104
Denmark	0.723	1.004	1.560	1.096
Ireland	0.705	1.046	1.252	1.001
United Kingdom	0.507	0.797	0.871	0.725
Sweden	-0.030	1.128	0.897	0.665
Belgium	1.440	-0.229	0.054	0.422
Germany	0.265	0.322	0.651	0.413
Austria	0.320	0.133	0.359	0.270
Italy	0.187	0.187	-0.634	-0.087
Spain	0.083	-0.229	-0.115	-0.087
France	0.210	-0.758	0.074	-0.158
Portugal	-0.259	-0.848	-0.745	-0.617
Greece	-1.287	-0.655	-1.304	-1.082

Source: Nationally representative public opinion surveys were conducted by The Quality of Government Institute about perceptions of local education, health, and law enforcement institutions. Researchers asked participants to rate each of the three institutions on quality, impartiality, and corruption. For more information, see Teorell et al. 2011.

A centuries-old debate about the Italian character would have us believe the Italian “character is faulty, and that this faultiness even explains much of the social and political problems of their country today” (Patriarca 2010: 5). Indeed, Europeans perceive Italians as the least trustworthy of Western European nations (Mackie 2001).² In this framework, ethical behavior is thus

confined to the immediate family and closest friends. By *siphoning* money from the breadwinner, paying taxes, which benefits society at large, can be perceived as hurting the familial unit by imposing a cost coming out of their earnings that will indirectly benefit someone outside the familial unit, rather than directly benefiting themselves.

Nevertheless, the amoral familism argument has been met by a litany of critics, who argue that the social capital literature often confounds explanations with outcomes, which implies that public institutions and the elites that govern those institutions are somehow responsible for fostering a civic citizenry. For example, Levi suggests that a government's ability to protect property rights and a merit-based society (one opposed to the clientelism or nepotism found in Southern Italy) instill a generalized trust in society (Levi 1996). Even Putnam mentions in *Making Democracy Work* that the regimes prior to unification intensified distrust and vertical ties in the South, but he barely mentions how unification reduced the South to "semi-colonial status" and "its fragile commercial sector brutally merged with the North's more flourishing economy, a uniform tax system and customs union imposed on its vulnerable industries, and brigandage rooted out by a full-scale military campaign" (Tarrow 1996: 394). Filippo Sabetti contends that the growth of institutions and ecclesial infrastructure since the eighteenth century better explain the Italian political economy than the amoral familism stressed by Putnam.

Like these critics, I contend that the moralist argument fails to account for the institutional environment (such as a period of progressive politics, political competition, or strife between the Church and the state) from which behavior may manifest. While the vast majority of these scholars analyze economic and social development, I am concerned with why tax compliance is so low across Italy. Simply put, tax behavior reflects the quality of and perceptions about the government institutions to which a taxpayer is contributing. I argue that Italian tax compliance has evolved within a low-efficiency/low-trust equilibrium environment or what Bergman (2009) calls a low-compliance environment. There is ample evidence in the literature suggesting that individuals are more likely to pay taxes if they believe that their government is honest and efficient (Cummings et al. 2009; Edlund 1999; Frey and Feld 2002; Frey and Torgler 2007; Levi 1989; Levi, Sacks, and Tyler 2009; Pommerehne, Hart, and Frey 1994; Scholz and Lubell 1998; Smith 1992; Smith and Stalans 1991; Torgler and Schneider 2007). Taxation mobilizes citizens to demand accountability from their government, but on the other hand, a lack of government accountability can actually have the opposite effect, motivating individuals to evade their responsibilities (Huntington 2012; Paler 2013). According to Ross (2004: 234), "[b]oth the size of the tax burden, and the

quality and quantity of government spending matter; citizens ultimately care about the ‘price’ they pay for the government services they receive.”

It is no wonder that tax evasion is so rampant in Italy; Italy consistently ranks near the bottom on the Quality of Government index compared to other European nations (see Table 5.2). However, Italy’s 44 percent tax burden (the ratio of tax revenue to gross domestic product (GDP)) is one of the highest in the European Union; only Denmark, Belgium, France, and Sweden have a higher tax burden (European Commission and Eurostat 2012). It is possible then that Italians live in an institutional environment that legitimizes tax evasion. If Europeans have come to think of Italians as dishonest and Italians themselves have come to agree, this may be a byproduct of this low-efficiency/low-trust equilibrium. Because confidence in public institutions is a direct reflection of the quality of those institutions, clearly Italians should have far less trust in their public institutions than Swedes (see Jenny Jansson, Chapter 3 in this volume). I suggest that, consequently, Italians are more likely to cheat on their taxes and avoid funding public institutions.

The particular tax compliance environment from which tax behavior is derived is one of government instability, bureaucratic complexity, and administrative inertia. Italian unification pitted the state against the Catholic

Table 5.2. Quality of government: Italian regions

Region	Quality	Region score	Rank
Trento	1.043	1.981	41
Valle d’Acosta	0.653	1.603	82
Friuli-Venezia	0.373	1.331	109
Veneto	-0.186	0.788	146
Emilia-Romagna	0.217	0.757	149
Umbria	-0.495	0.488	168
Toscana	-0.495	0.450	170
Marche	-0.535	0.448	172
Lombardia	-0.542	0.442	174
Piemonte	-0.652	0.335	182
Liguria	-0.848	0.144	190
Abruzzo	-1.097	-0.097	200
Sardegna	-1.307	-0.302	204
Basilicata	-1.423	-0.414	208
Lazio	-1.512	-0.500	211
Sicilia	-1.588	-0.575	213
Puglia	-1.604	-0.590	216
Molise	-1.6609	-0.645	220
Calabria	-1.687	-0.671	222
Campania	-2.242	-1.210	232

Source: Nationally representative public opinion surveys were conducted by The Quality of Government Institute about perceptions of local education, health, and law enforcement institutions. Researchers asked participants to rate each of the three institutions on quality, impartiality, and corruption. For more information, see Teorell et al. 2011. Southern regions are in bold.

Church and the North against the South. After a relatively short period of asymmetric state-building, Italians found themselves fighting in World War I for a country that was still greatly divided. Citizens' disaffection with the political system and a sharp economic downturn led to the rise of Benito Mussolini, Italian Fascism, and another world war. Since World War II, Italy has sustained a relatively high level of prosperity, despite major political turmoil such as right- and left-wing political terrorism in the 1970s; a large corruption scandal in which half of parliament was charged with corruption in the 1980s; and sixty-three governments since the "First Republic." The political and institutional instability in Italy has led to a profound distrust of government, and alongside that, an unwillingness to contribute to the state through taxation.

In the following sections, I examine these issues, focusing on the ways in which specific timing and institutions have shaped this low-efficiency/low-trust equilibrium. I trace the ways in which unification pitted the North against the South, providing a different experience with the state in the two regions and hence different preferences regarding taxation. Furthermore, I argue that post-unification (1900–22) political instability fostered a deep distrust amongst Italians toward their political institutions, shaping a general political ideology that saw excessive taxes as an infringement of individual rights. This overarching political ideology curtailed the ability of successive administrations to create efficient and effective tax regimes.

This was then followed by a series of short-lived prime ministers, which led to the rise of Fascism (1929), followed by World War II, furthering Italian political discontent. Following World War II, a deep distrust of government shaped the new constitution, making tax collection an arduous task for the administration. Although the 1960s and 1970s can be characterized by unprecedented economic growth in Italy, much of it was fueled by clientelism and corruption, which in many ways contributed to tax evasion. Moreover, many in a series of major tax reforms implemented in 1972 to support the modern state were undermined by an overburdened judicial system, followed by a reliance on tax amnesties. Finally, the 1990s tax reforms attempted to address Italy's extremely large small-business and self-employed sector—one of the largest drivers of evasion. But those reforms were also watered down by the immense power of that sector weakening the administration's ability to collect taxes. In sum, I argue that unstable political institutions, such as a weak parliament unable to garner confidence and a constitution that protects the taxpayer at the expense of efficient administrative capabilities, beginning with unification, fostered a profound distrust of the state, which hindered the state's ability to collect taxes.

The Risorgimento and Italian Politics

In this section, I argue that the Risorgimento resulted in deep divides between the North and the South, which greatly affected citizens' willingness to pay taxes. Elites extracted a disproportionate amount of tax from the South to fund the development of the North, engraining a deep-seated distrust of the newly formed nation state in the South. The dominant ideology shaping the fiscal apparatus of the state reflected a great distrust in state power and intrusion. Tax collection thus was perceived to be a form of encroachment on individual rights, dampening the ability of the administration to collect taxes. By the end of the nineteenth century, interplay between the major political parties further shaped the tax environment. The Catholic Church and right-wing liberals joined forces in the North, where there was a strong industrial labor base, to organize mass political engagement in direct competition to the socialists. Catholic, right-wing, and socialist organizations made conscious efforts to build effective and efficient public institutions in order to garner support for their political movements; these institutions promoted a high-compliance environment in the North. On the other hand, the South, populated by mainly peasants, lacked any kind of industrial base and became disengaged with civic and associational life, leading to a low-compliance environment.

The Risorgimento (Resurgence) refers to a period of political consolidation in Italy from 1815 to 1871, ultimately culminating in Italian unification. Although the Risorgimento led to formally ratified political unification, it left the country divided between North and South, economically and politically. As Clark notes, the state imposed an unprecedented tax burden in the South at the time of unification, which funded the development of the North. The South made up only 27 percent of GDP, but 32 percent of the tax base, while the North generated 48 percent of national wealth and paid only 40 percent of the nation's taxes (Mack Smith 1997: 81).³ Due to a much larger agricultural base in the South, higher taxes on grain disproportionately affected the South, while the North benefited the most from public spending. Since bread was a staple of the Southern Italian diet, increased taxes on grain also hit Southern peasants the hardest (Carter 2010: 211). The North's political dominance meant that it controlled decisions on taxation and public spending, which favored citizens in the North and extracted important resources through taxation from the South, exacerbating the North–South economic divide. For example, between 1862 and 1897, 455 million lire was spent on landfills in Northern and Central Italy, while only 3 million lire was spent on such resources in the South. The majority of school and railway

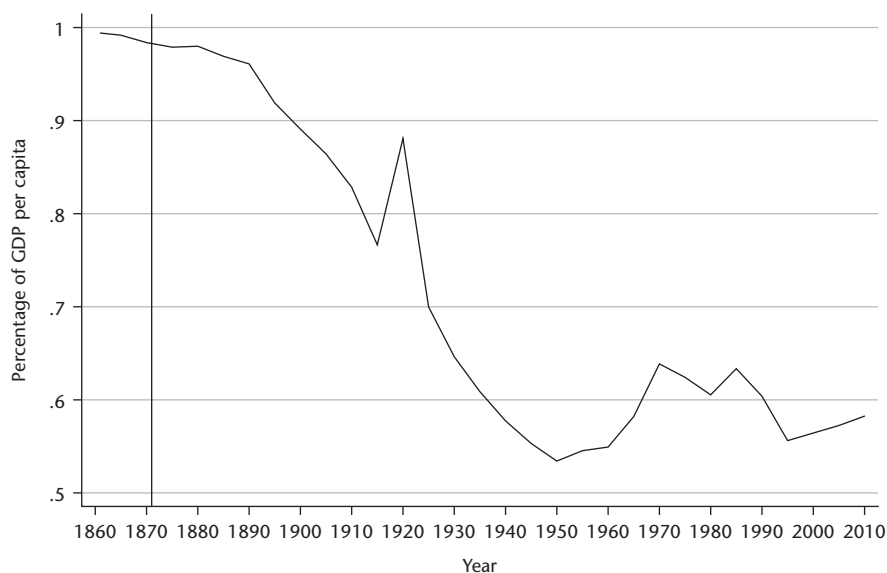


Figure 5.2. GDP per capita in the Mezzogiorno as a percentage of Northern GDP per capita

Source: Bianchi et al. (2011). Note: the vertical line represents unification.

spending was also concentrated in the North. Development in the South certainly suffered after unification, and, as a result, so did the Southerners' relationship to the newly formed state. Figure 5.2 illustrates the rapid decline in Southern (Mezzogiorno) per capita income as a percentage of Northern per capita income after the Risorgimento. These differences in economic development, investment, and taxation led to a sense of unfairness and distrust in the South, and hence to less willingness to pay taxes.

As the South was becoming further separated from the North economically, there was an important debate taking place regarding the fiscal state. Italy's history with foreign occupation instilled a sense of distrust of state power, which shaped the structure of fiscal institutions. It was thought that the government should never collect more than 5 percent to 10 percent of gross national product in taxes; the fiscal system would be based upon private rights, not public, and a system of laws, not authority; furthermore, the tax system would first and foremost respect the fundamental right of property. This last idea severely hampered the administration's ability to put together a land registry and has had long-lasting effects on the capacity of revenue officials to collect taxes, especially from the self-employed and entrepreneurs (Manestra 2010).

However, claims that the tax burden was too high were not solely the result of a liberal environment, but also an excessive tax burden. The early

foundations of the Italian state exerted a massive tax burden on a population that was cautious of the state and citizens of neighboring regions. According to Manestra (2010), the tax burden was approximately 10 percent higher than in Great Britain as a result of a series of wars that did not have wide consensus among Italy's diverse population.

Toward the end of the nineteenth century, the Giolitti government set out to reform the tax system, but in the end the administration was unsuccessful, leaving federal, regional, and local taxes relatively unchanged. This was a problem not only at the legislative level; problems existed at the administrative level as well, largely related to difficulties in implementing the new national cadaster (compare this to the situation described by Marina Nistotskaya and Michelle D'Arcy in Sweden, Chapter 2 in this volume). Furthermore, local administrations were reluctant to update their lists of taxpayers, given that their organizations were made up of taxpayers themselves (Manestra 2010). Tax authorities also found it difficult to sanction taxpayers, as tax commissions were often biased in favor of the taxpayer, largely as a result of the excessive tax burden, exceeding 50 percent. In addition, the tax administration had difficulty proving the incomes of the self-employed and other professionals (Manestra 2010). Taken together, this three-dimensional relationship between administration (tax burden), the state (structure), and ideas such as distrust and caution amongst the populace, fostered tax non-compliance very early on. Corrado Gini (1962) echoes this when he claims that poor economic conditions, an inherent lack of respect for the state, low administrative salaries, inconsistencies in tax law, and an interpretation of private law were all drivers of low tax compliance.

In addition to administrative difficulties, I suggest that the dynamics between political parties also had an important impact on taxpayer behavior. By the turn of the twentieth century, rising fears of socialism and a large labor movement in the North made Catholics and right-wing liberals strange bed-fellows. The Catholic Church and right-wing liberals, after the turn of the century, made a conscious effort to build civic associations as an alternative to a socialist workers' movement. This played an important role in driving civic consciousness and institutional development in Northern and Central Italy in the years immediately after World War I. By contrast, the lack of any significant industrial labor force in the South hampered political competition and inhibited the formation of efficient public institutions or a civic-oriented populace. Tarrow (1967: 168–9) argues that at the time of unification, "so ingrained was the clientele system that the mass of new voters, most of them rural and all of them dependent economically on the political elite, were easily integrated into the existing system." In other words, rather than having a political choice, poor Southern peasants became dependent on their clientelistic relationships with local elites. The provision of individualized goods from

patrons to clients inhibited the foundation of a civic-oriented populace. Here we begin to see the beginnings of two separate equilibria. I characterize the North as moving toward a high-trust/high-efficiency equilibrium shaped by political competition and a strong industrial base, while the South's low-trust/low-efficiency equilibrium was formed by the state's neglect of the South and consequential clientelistic relationships.

The rise of a Catholic political party (the Italian People's Party, Partito Popolare Italiano) after 1914 marked the beginning of Catholic mainstreaming in Italian politics and challenged the dominance of the ruling party in the North. Because the state had almost completely dismantled organized Catholicism in the South in the early twentieth century, support for the Italian People's Party came mainly from the Northern regions of Italy. Pope Benedict XV, Pope Pius' successor, immediately reversed his predecessor's anti-modernization policies, such as banning Catholic trade unionism, while improving the Church's relationship with the Italian government and the Italian people. While anti-Italian stigma had been attached to the Catholic Church since the Risorgimento, Italian-Catholic politicians and the patriotism of the Catholic clergy during the war changed the prevailing feelings about Catholicism in Italy, bitterly dividing the old ruling class and paving the way for outside parties such as the People's Party and the Socialist Party (Partito Socialista Italiano). These two parties took a combined total of more than half of the legislative seats in the election of 1919. Only in the South did the "old government" parties (Liberal Democrats, Partito Liberale Democratico) win more than half the votes. This was largely the result of the practice of *trasformismo*, in which ruling parties won over the opposition party in return for political and, often, financial favors. The old-guard liberals, especially in the South, made use of public resources for both individual and political gain.

Political strife in Italy only further divided the North and South along party lines. As a result of the 1919 election, 146 of the 156 Socialist deputies came from the North and central regions; 76 of the 100 People's Party deputies were also from the North; and 162 of the 239 deputies from the Liberal Party and the Radical Party (Partito Radicale), who had previously dominated parliament, were elected in the South. Although this election resulted in the first "Radical" government, led by Francesco Nitti, political turmoil between the Radicals, Socialists, and Fascists led to Nitti's resignation and the return of the Liberal Democrat Giolitti as prime minister in 1920. When elections were called again in 1921, the Giolitti government's hegemony was tenuous. To solidify his control, he made certain concessions to the Fascists, including adding them to the government's party list. The disparate governing coalition Giolitti put together was doomed from the outset, which resulted in his

immediate resignation, to be followed by a string of short-lived prime ministers and the eventual rise of Fascist leader Benito Mussolini.

In sum, the early twentieth century in Italy was marked by deep divisions between the North and South. These divisions were economic as well as political. The government extracted high taxes from the South to address its debts from the *Risorgimento* and develop the North. Political parties competed for the burgeoning industrial labor movement in the North by providing and building effective public services. The South, on the other hand, was ruled by the old ruling party (liberals), who enjoyed a large political monopoly. By providing public jobs and financial favors to the landed elite through *trasformismo*, the ruling party maintained its hegemony in the South, marginalizing Southern citizens from the political process.

The Fascist Period

Here, I argue that the rise of Fascism reversed the Northern progress toward a high-efficiency/high-trust equilibrium, and even furthered Southern resentment toward the state. The Fascist period can be characterized by two main approaches to building effective administrative capabilities and public services across Italy: an attempt to modernize the tax system with a series of uniform tax reforms and a series of public investments that had the unintended effect of increasing the North–South economic divide. To dampen some of the more negative consequences of the administration’s policies, the government funneled money through quasi-state organizations, strengthening clientelism in the South. Whereas in the North, the high-compliance environment began to unravel due to an authoritarian state and a second world war, clientelism hardened the low-compliance environment in the South.

Tax reform during the Fascist period involved three separate methods. The first, liberal tax reform in the early Fascist period (1922–5), provided preferential tax treatment to productive industries with the misguided expectation that these industries would then comply with existing tax law. After this reform failed, Mussolini shifted from liberal tax policies to an authoritarian model, where he would stigmatize and penalize evaders. He declared tax evaders “the worst parasites in the nation” and increased tax enforcement between 1926 and 1929 (Manestra 2010: 29). However, the corporatist economic model and increased foreign commitments, such as the Italian–Ethiopian War in the 1930s, which diverted administrative resources, led him to restrain the more authoritarian aspects of the administration’s tax policy, which demanded a large amount of administrative oversight. This

led the administration back to the more liberal, cooperative model of the 1922–5 period, especially with respect to businesses. Mussolini's industrial policy further accentuated economic divisions.

Although tax and administration reform are important aspects of any successful attempt to increase tax compliance, Mussolini's complete disregard for the South exacerbated the economic divisions between the North and South and therefore the differences in their tax compliance environments. Economic asymmetries and disproportional public investment generated a feeling of unfairness and distrust in the economic system, both of which reinforced the low compliance. Mussolini's industrial policy accentuated economic divisions between the North and the South by concentrating economic development in engineering, steelworks, chemicals, and hydro-electricity supply—all industries located in the industrial triangle of the Northwest. Almost half of industrial workers and two-thirds of engineers worked in Lombardy, Liguria, and Piedmont, while the majority of workers from the South were farmers and artisans (Clark 1996). The state also increased the extent of the welfare state in the Fascist period, making Northern industrial workers eligible for generous benefits not available to Southern workers—an imbalance that continues to this day. Because of the North's large industrial base, unionized workers were able to lobby for and win larger pensions than the average Southern Italian peasant. This contributed to patronage and clientelistic practices as a means of income supplementation in the South. Clients would directly exchange their votes for public employment and favorable tax treatment (Ferrera 1996).

Moreover, Mussolini's push to project Italy as an international power had adverse consequences for the Southern economy. Mussolini implemented a revaluation of the lira in 1926 to project Italy's position, which reduced wages and sharply increased unemployment, largely in the agricultural South (Neville 2014). In the late 1920s through the early 1930s, Mussolini increased tariffs on wheat, which amounted to a large concession to landowners, who gained the most from the government policies, whereas Southern peasants were hit the hardest. To lessen the damage in the South, the administration funneled jobs through *parastati*, quasi-governmental agencies that dealt with health, welfare, and pensions. Distribution through quasi-governmental agencies then became the most important criterion for resource distribution (Walston 1988).

Fascism only enlarged the economic and social disparity in Italy, and especially in Southern Italy. Moreover, Fascism's antidemocratic foundation and its overwhelming reliance on the state as the center of individual life reversed the virtuous circle in the North, while increasing discontent in the South due to the state's general neglect of that region. This had the effect of generating low trust and low compliance across the peninsula.

The First Republic

The period after World War II brought great, but asymmetric, prosperity to Italy. Just as during the previous period, political competition among the Christian Democrats, the Socialists, and the Communists (Partito Comunista Italiano) led to major public works and investment in Northern Italy, while the Christian Democrat political monopoly in the South intensified clientelistic networks. Although the central government invested heavily in the South beginning in 1950 with a Fund for the South (*Cassa per il mezzogiorno*), the implementation of the fund was greatly affected by clientelism. In 1970, regional governments were established, further exacerbating the underlying issues in the South. Regional governments were granted more autonomy and discretion in the distribution of resources, especially financial resources, which they could then funnel to private interests. While clientelism became stronger in the South as a result, one of the largest corruption scandals in Italian history unfolded in the North. Widespread distrust in the governing parties brought down the government and led to the Second Republic.

After World War II, Italian citizens were polarized both economically and ideologically. In the period 1944–6, Sicilian farmers formed a movement aimed at secession from the North, which led to a June 2, 1946 popular vote pitting the Italian dynasty (the monarchy ruled by Humbert II of Savoy) against the Republic. The North, led by the Communists, Socialists, and Christian Democrats, favored the Republic; the majority of the South voted to uphold the dynasty (Gilmour 2011; Pollard 1998). In 1946, tensions between the Communists and the Christian Democrats presented another challenge to national unity: while the Communist Party was closely tied to the Soviets, aid and investment from the US government and US firms influenced the Christian Democrats and the Alcide De Gasperi government.

The 1947 Italian Constitution, however, showed remarkable levels of compromise between the parties, reflecting also a deep distrust in the state. The Italian Constitution, first and foremost, protects the individual from the state, which has unintentionally hindered the ability of the tax administration to collect taxes. Article 53 states: “all shall contribute to public expenditure in accordance with their means.” Consequently, assessing an individual’s means accurately is an arduous process. The intended effect, however, was to associate taxes with an individual’s moral sensibilities. Referring to the tax reforms, Vanoni elegantly stated in the House of Deputies (*Resoconti parlamentari* 1948: 3744):

In our country there is often the feeling that tax evasion has become a way of life . . . the individual almost considers it a legitimate form of defense against an imposition he considers detrimental to their sphere of individual action . . . tax

evasion takes on the characteristics of real and substantial anarchy, a negation of the first requirements of social life and is precisely why it seems irrepressible to get to a system in which there is neither justification, nor moral, nor techniques for evasion, and that leads to more open condemnation, moral rather than legal, for the evader.

Vanoni thus sees tax evasion within this context-specific equilibrium. The legitimate fear that the state will infringe on individual rights reflects the historical circumstances specific to the Italian taxpayer.

Between the new Finance Minister Enzo Vanoni and his colleagues there was wide consensus that administrative reform was the most pressing issue regarding taxation. Cesare Cosciani (1950) argued that the history of the tax system was plagued by irrationality perpetuated by a legislature that created an overabundance of laws that only specialists could understand. With past failures in administration in mind, Vanoni implemented broad, but incremental, tax reform, emphasizing taxation as a democratic responsibility. On January 11, 1951 under Finance Minister Vanoni the Republic passed the largest tax reform since the Fascist period, known as the *Legge Vanoni* (Vanoni Law). The law had four main features: (1) taxpayers—both employees and the self-employed—had to fill out annual tax returns; (2) greater progressivity combined with lower income taxes overall; (3) a series of consumption taxes; and (4) business taxes on items such as stamps and licensing (Ambrosetti 2004).

Vanoni's measures, especially those addressing mutual trust between taxpayer and administration, did not outlive his term, however. Audits actually became more inefficient and tax investigators were increasingly underpaid compared to private tax accountants (Manestra 2010). In 1959, the administration began raising rates on everything from capital gains to self-employed income. As a result, taxpayers increasingly came to disrespect the administrators or tax collectors. Therefore, highly paid tax accountants, who are paid to keep taxes low for their clients, were in direct conflict with an underpaid and under-appreciated tax administration. Administrators were at a clear disadvantage.

Though the 1950s marked the beginning of approximately two decades of great prosperity, data provided by Clark (1996: 357) depicts Southern Italy as similar to many underdeveloped countries, but much larger in population and territory than most. The disparities between the North and the South were so considerable and evident that the state instituted the Fund for the South, a rural spending agency providing roads, housing, and water to rural areas. Although the "Italian Economic Miracle" led to a convergence of incomes, with Southern income reaching approximately 70 percent of the national average, the Fund also established large fiscal transfers from North to South and significant migration flows from South to North. This fueled cultural stereotypes and out-group resentments.

The “economic miracle” and a massive injection of state spending on welfare (education and healthcare) significantly increased the living standards of the average Italian individual in the early 1960s. However, by 1967 the Italian economy was showing signs of crisis. A large migration of unskilled Southern workers successfully supplanted highly skilled factory workers in the North, which led to major factory floor protests throughout Northern Italy. Subsequently, Southern factory workers took to the shop floor to demand better pensions, social security, housing, and health services. By 1976, the trade union movement had become a major force in Italian politics encompassing nearly 50 percent of workers (Clark 1996: 377). Large pay raises, however, exponentially increased overall labor costs in Italy, causing a considerable downturn amongst Italian firms. With labor costs exceeding by 39 percent those experienced by British and German firms, profits tapered off significantly by the end of the decade. Both the extreme right and left responded to the crisis with political terrorism, including assassinations and kidnappings.

Weak public institutions, such as an unstable parliament and a constitution that severely hampered administration, the resilience of strong informal institutions, such as clientelism, and economic downturn reinforced this low-trust/low-efficiency equilibrium. From unification to Fascism, followed by the First Republic through the end of the economic miracle, we can observe several recurring themes in which the administration attempts to address low tax compliance by reorganizing tax administration, but without addressing the underlying defects of the tax system. New laws were stacked upon old laws, and new taxes were introduced to pay for wars and social programs. The tax system became increasingly more complicated and incomprehensible to the vast majority of taxpayers, further decreasing trust in a severely underfunded administration. Not only was there a lack of trust between taxpayers and the administration, but strong regional resentment stemming from long-standing cultural stereotypes lingered, and even proliferated, as a result of migration patterns, economic insecurities, and fiscal transfers. And once again, Italians were concerned about political crises and, consequently, political terrorism. These institutional and political dynamics structured the way in which Italians viewed their state and fellow citizens, consolidating the low-compliance environment.

From the Tax Reform of 1972 to the Present

Two decades after regional governments had been enshrined into the constitution, the state introduced regional governments in the spring of 1970. By the mid-1970s, Italian regions could provide subsidies, fund and staff welfare

agencies, draw up regional development plans, and organize their own cooperatives. However, as Clark writes, these regional governments fed the Calabrian Mafia (*ndrangheta*) and the Neapolitan *camorra*, with local barons supporting particularism, rather than creating more efficient, democratic institutions. "There may," he notes, "have been little popular enthusiasm for the regions, but many of the organized interests-groups thought they were splendid" (1996: 392). Further unsuccessful attempts to curb tax evasion led to tougher sanctions on taxpayers and large tax reforms. However, a large aspect of these reforms concerned tax amnesty programs and a new Sector Studies program, both of which only furthered the low-compliance environment. Finally, in the early 1990s large-scale corruption was uncovered, bringing down the government and ushering in the era of Silvio Berlusconi—a renowned tax evader himself.

After the introduction of regional governments in 1970, important legislation was introduced to reform the tax system. Tax reform introduced in 1973 by the Minister of Finance, Luigi Preti, forced Italy to construct a more modern tax system to match the demands of a developed nation. It further had to complement a burgeoning public deficit and a far more uncertain situation than the preceding decade. The basic foundation of these reforms rested on the same principles as previous tax reforms: administrative changes, especially reducing a bloated bureaucracy and the numerous superfluous laws; and improving how the administration calculated taxable income. This included the establishment of a variety of new taxes such as the IRPEF (national progressive income tax), IRPEG (corporate income tax, replaced by IRES), ILOR (local income tax), INVIM (capital gains tax), and VAT.

The state even attempted to revert to a more authoritarian regime—tough sanctions and stigmatization—to enforce tax compliance. Provincial newspapers throughout Italy published the names of famous people who had evaded their taxes as well as 200,000 tax evaders between 1979 and 1981. Law 516/1982, the so-called *manette agli evasori* (handcuffs for evaders), designated a number of tax behaviors as revealing an attempt to evade taxes, making them serious criminal offenses with increased penalties. Prior to *manette agli evasori*, a judge could not indict an offender before there was undeniable proof of evasion (Santoro 2010), which, as I noted above, was an arduous process since the burden of proof was the responsibility of the investigators. *Manette agli evasori* resulted in an overburdened judicial system and a series of amnesty programs. As Manestra (2010: 42) states, "handcuffs for all, became handcuffs for no one." The courts found many of the provisions of *manette agli evasori* unconstitutional, and only a small fraction of accused transgressors were convicted under the law (Santoro 2010: Kindle location 951–2).

Additionally, tax amnesties and the inability to punish decreased compliance by influencing the compliance environment and social norms (Alm, McKee,

and Beck 1990). Nonetheless, the Italian tax administration has relied heavily on amnesties since unification. According to Manestra (2010), there were eighty-three separate amnesties between 1900 and 2002, and between the 1970 tax reform and 2002 a form of tax amnesty was used every year. One of the major defects of repeated amnesty is it decreases the amount of risk associated with evasion. If potential evaders foresee an amnesty in the future, they will likely underreport their income. The use of amnesty was so common that tax evasion became a safe way to increase one's income, as illustrated by the responses from the 2004 Bank of Italy Survey of Household Wealth. When asked about their opinion on tax amnesties, 50 percent of respondents said they were unfair, compared to 36 percent who said they were a good policy. In another question participants were asked what they believed the outcome of amnesty to be; 32 percent responded, "tax evasion increases because the amnesty rewards tax evaders and discourages honest taxpayers" and 30 percent said, "tax evasion doesn't change because once tax evaders have regularized their past position, they begin to evade tax again until the next amnesty."⁴

Following the 1973 reform, there were three main approaches that shaped the 1990s tax reform bill, according to Manestra (2010). The most important aspect of these procedural changes was reforming the way in which small businesses fulfilled their accounting obligations. Structural changes attempted to fix the major sources of tax revenue, mainly VAT and direct taxes. Finally, quantitative reform set out to address the number of taxes, especially on sources of income. The less punitive Law 154/1991 and Law 74/2000 replaced *manette agli evasori*. As was common throughout the neoliberal era, tax reform in this period reduced tax rates while broadening the taxable base. However, income tax evasion actually increased after implementation of the tax reform through 1978, decreasing slightly in 1978–80, but never falling below 33.7 percent in this period.⁵

The most important feature of the 1990s tax reform was the adoption of *Studi di Settore* (Sector Studies) in 1998. Due to the large size of the self-employed and small-business sectors, focusing on this particular aspect of the economy was an important step forward for the administration. While most countries collect various data on individuals and companies, then place them into homogeneous populations based on those characteristics with minimum expected incomes, Italy is rare in that it actually makes this data available to the taxpayer before they file their taxes. Moreover, published minimum expected incomes are first negotiated between the tax administration and taxpayer representatives, such as the Consiglio Nazionale dell'Economia e del Lavoro (CNEL). Sector Studies came out of the recognition that the main driver of tax evasion in Italy was its particular economic structure, but the small-business sector's clout with government officials was so great that Sector Studies actually resulted in a more favorable situation for most taxpayers.

It is easy to predict the outcome of a policy that informs taxpayers of their expected minimum income level. As Bergman (2009: 10) elegantly argued, "People maximize utilities inasmuch as they pay as little taxes as they can. But the environment in which people operate fundamentally shapes how they frame the maximization benefits." Hence, those who make above the expected minimum will reduce their income to match the mandatory minimum, while those who earn below the minimum will either risk being audited, which is very likely, and bear those costs, or they will increase their income to avoid the legal costs of an audit. The societal effect of this is also significant. If it is known that small businesses and the self-employed can easily avoid taxes, the ripple effects will weigh heavily on the Italian tax system.

The continual unsuccessful attempts to fix the tax system, coupled with a series of corruption scandals that would eventually bring down Italy's national government, only exasperated the low-trust equilibrium. The largest corruption case, *Tangentopoli* (Bribesville), exposed a number of high-ranking public officials (half of parliament) for acts of bribery and led to the so-called "Second Republic" and the prominence of Silvio Berlusconi—a billionaire businessman who came in as a political outsider profiting from the lack of trust and promising to reduce taxes. He also was later convicted of tax evasion. The vicious circle that Steinmo discusses in the Introduction to this volume is evident throughout Italian history. An inefficient, corrupt, or a perceived-to-be-illegitimate state shapes a climate of distrust, rendering tax collection troublesome. Thus, the efficient provision of public goods becomes increasingly more difficult, reinforcing this low-trust/low-efficiency environment, and, in that, low tax compliance.

Discussion and Conclusions

Walk into any bar in Italy and you will likely hear someone lamenting their high taxes, poor public services, and corrupt politicians. The compliance environment is a direct reflection of this. Indeed, taxes are often a major topic of national conversation. The fight against tax evasion in Italy goes back long before Italy was a unified nation. In fact, aspects of Italian life that we often take for granted are often the result of some clever way of circumventing tax laws. For example, a salt tax in twelfth-century Pisa persuaded Florentines to stop using salt when baking bread—an unfortunate trend that continues to this day. It has also been suggested that the beautiful Triulli buildings in Puglia were built with dry walls and without mortar to allow settlers to easily dismantle them when the "taxman" came. Furthermore, tax evasion has historically been so rampant that Mussolini famously claimed that tax evaders are the worst parasites on earth. Similarly, former Prime

Minister Mario Monti asked his fellow citizens to stop referring to tax evaders as *furbi*, meaning clever. Unfortunately, these references tend to lend weight to the amoral familial approach.

However, the flaw in the amoral familialist argument leads us back to the complexities this study has sought to address in terms of tax evasion, compliance, and morale. By constructing a historical landscape dating back to the Risorgimento through the fall of the First Republic, I have identified several periods and institutions that have influenced the relationship between state and citizen.

The Risorgimento clearly had significant repercussions for Northern and Southern institutions and, in that, defined two different patterns of taxpayer behavior. I have argued that Southern Italians perceived the North as a distinct entity apart from themselves, and even as colonizers, while the North embraced calls from liberals for a unified nation state. Because the North was politically dominant, the South was expected to contribute a disproportionate amount of revenue to fund public works projects largely going to the North.

The rise of socialism and a socialist workers' movement in the North forced Catholics and right-wing liberals to join forces in direct competition to the socialists for the growing working class. While the South was left neglected by the political class, clientelism became deeply ingrained into the Southern way of life. In the North, political competition helped shape functioning public institutions and a thriving labor movement. This put the North on track to form a high-trust/high-efficiency equilibrium, while a low-trust/low-efficiency environment was established in the South.

The advent of Fascism altered the North's course, however. Unification, two world wars and Fascism shaped the compliance environment in both the North and South. After the fall of Fascism and the end of World War II, a deep distrust in the state was further reflected in the new Republic's constitution. An underlying fear that the government would infringe personal freedom and rights made tax collection increasingly difficult. This led to several tax reforms, most of which had very little effect on the compliance environment. Moreover, many of the more intrusive policies that would have resulted in increased controls were deemed unconstitutional. The administration thus felt handcuffed by certain institutional arrangements, rendering their only option a number of amnesty programs.

These amnesty programs merely deepened the low-compliance environment, making it increasingly difficult to enforce existing tax laws. The administration, realizing that the main source of evasion was the self-employed and small-business sectors, implemented a series of reforms called *Studi dei Settore* in the late 1990s. However, due to the political power of this particularly large sector of the economy, the reform ended up benefiting the taxpayer instead of

the administration. Since then, the administration has attempted to fix some of the underlying problems with the tax system through pre-populated tax returns and a push to settle tax disputes out of court. Figures suggest that revenue as a result of these measures has increased.

Social norms and equilibria are sticky. Apart from major punctuations in the environment, change is usually incremental. Therefore, Italian policy-makers must address the underlying features of the low-trust/low-efficiency compliance environment. What is it that is driving this contagious behavior? How can policymakers address the metaphorical elephant in the room (the self-employed and small businesses) while at the same time fixing underlying economic issues? Vanoni had impeccable foresight when he said that administration reform must be implemented in a way that considers tax compliance as part of a holistic approach, accounting for not only the administration, but also the institutional (both formal and informal) environment. Benchmarking and learning from other European countries such as Sweden regarding these issues could be a step forward in creating a new taxpayer equilibrium.

Notes

1. In the Northern regions from Lombardy to Lazio, evasion of the regional tax on production (Imposta Regionale sulle Attività Produttive, IRAP) ranges from about 13 percent to 54 percent; in the South (the Mezzogiorno), covering Molise to Sicily, it ranges from about 55 percent to 94 percent (see Figure 5.1). It is worth noting that both Liguria and Abruzzo do not conform to the expected North–South pattern. Abruzzo performs just slightly worse on The Quality of Government index (see Table 5.1) than Liguria, but the percentage of self-employed in Liguria is approximately one percent higher according to Istat (see <http://noi-italia.istat.it/>). The combination of lower-than-average quality of government and a high rate of self-employed individuals in Liguria could explain this unexpected result. In addition, Tuscany, Umbria, and Marche all have higher rates of self-employed individuals than Abruzzo.
2. Italians' perception of one another varies across regions. See Putnam, Leonardi, and Nanetti (1994); Tabellini (2010).
3. The center made up the remaining 28 percent of GDP.
4. www.bancaditalia.it/statistiche/tematiche/indagini-famiglie-imprese/bilanci-famiglie/documentazione/index.html.
5. The figures are cumulative figures of evasion and avoidance rates for employees, agricultural workers, manufacturing, and the self-employed, calculated by Bernardi (1989); Visco (1984a; 1984b; 1992); and Vitaletti (1984) using data on taxable incomes provided by Istat. A more detailed table, aggregated by type of employment, can be found in Manestra (2010).

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credits for Huey, Dewey, and Louie, and found that his taxes came to \$13. After Donald races from Hollywood to Washington, the film shows how tax revenues (stacks of gold coins) are transmuted into guns, planes, and ships. Taxes were needed to beat the Axis. At the end when the American flag is formed by clouds around a setting sun, the narrator intones, "Taxes will keep democracy on the march."

In the controversial pamphlet *Battle Stations for All*, issued in February 1943, the Office of War Information pamphleteers sought to defuse accusations that the unprecedented level of taxation was in some way benefiting the New Deal social agenda. In a box set off from the rest of the page and headlined "Non-War Expenditures Reduced," the pamphlet asserted that "Under the new budget submitted by the President, ninety-six cents of every dollar spent by the Government will be for war costs and interest on the public debt and only four cents for so-called 'non-war' purposes."¹⁸ In later radio messages, the percentage of the federal budget going to the cost of war was set between 93 and 95 percent. And the federal budget was at unprecedented levels. The Office of War Information in 1944 described the enormity of the costs. "Direct war expenditures for fiscal 1943 were 12 billion dollars [...] a figure totally beyond human comprehension. But that incomprehensible sum figures down to \$2,894 every second of the day [...] an amount equivalent to about a year's wages for perhaps half of the persons who are expected to file income tax returns by March 15."¹⁹

By making the argument that taxes went to defeating the Axis and not to Dr. New Deal, the administration tried to legitimate a mass income tax as a very clear payment for war. If small-time taxpayers had not had to pay before, it was the war that was responsible. The "real authors of our tax burden" were "in Berlin and Tokyo" (Jones 1988–9: 721). As Eddie Cantor pointed out on his radio show in February 1944:

We want all you Axis countries to know that we in America are busy right now making out our income taxes. We know this must frighten you, because it's these taxes that paid for the ships that brought our men to your shores this year and we'll continue to pay our taxes so that we can beat you, Mr. Hitler and so that we can beat you, Mr. Tojo, and you, Mr. Mussolini [...] Musso—Whatever happened to you, Mr. Mussolini?²⁰

If it was the war (and just the war) that was being financed by new income tax payers, the legitimacy of the tax depended on assurances that everyone (particularly the wealthy) were paying their fair share. In late 1941, Irving Berlin submitted a song entitled "I Paid My Income Tax Today" to Treasury Secretary Henry Morgenthau Jr. A lower income tax payer is the voice in the song—glad to be newly subject to the income tax along with millions of other new taxpayers. Seeing an airborne bomber, the singer claims he helped to build them just as "Rockefeller" did.²¹

A December 30, 1941 letter from Morgenthau to Berlin suggests that the Treasury commissioned the song:

The more I think about your new song, the more I wonder how you ever managed to do the job so well. It wasn't an easy assignment to make people sing about taxes, but you have done it beautifully, and also hit the nail on the head as far as Treasury policy is concerned.²²

In early 1942, the Treasury Department sent the Barry Wood recording of "I Paid My Income Tax Today" to 872 radio stations with a letter asking for frequent air time. Four days later, the Danny Kaye recording of the same song was sent out as well. Sheet music was sent to sponsors of musical programs and the networks were asked to play the song as often as possible until the March 15 deadline (Jones 1988–9: 714).

The government also sought to insert appropriate wartime messages into movies that were largely for entertainment. The Office of War Information's Government Information Manual for the Motion Picture Industry suggested that movies show uncomplaining taxpayers. David O. Selznick's *Since You Went Away* followed up on this hint by showing a wealthy man claiming that it "suits me if they tax me 100 percent!" (Jones 1988–9: 718). Assurance that the wealthy were willing to pay their fair share apparently was intended to make income tax payments by the less well-to-do more palatable.

Those who did not meet their tax obligations were treated as "others" and, most assuredly, un-American. In a second Donald Duck tax film, *The Spirit of '43* (Disney 1943), Donald's paycheck is the subject of a debate within Donald's conscience between a spendthrift and a Scrooge McDuck-like character. This was before current payment or withholding, when Americans needed to save to ensure tax payments. Disney's McDuck reminds Donald that "every dollar you spend for something you don't need is a dollar – to help the Axis." The spendthrift is clad in a zoot suit and transmutes into Hitler. Mr. McDuck in his kilt, interestingly, is all-American. The zoot suit emerged as a symbol of un-American outsiders in another context. In June 1943, sailors in downtown Los Angeles dragged Mexican American youths from their seats in the Orpheum Theater, beat them, and destroyed their zoot suits. The Zoot Suit Riots demonstrated the marginalized societal status of Latinos in wartime (Sparrow 2011: 227–37). The Disney tax film made use of these racial stereotypes in encouraging adherence to the tax laws.

Making Tax Payments Less Voluntary

With the income tax's application to average Americans, it was clear to federal tax officials that the infrastructure of tax collection was "poorly adapted to the budgets and flow of income of 44 million taxpayers" (Paul 1954: 333–4).

At the time, income taxes were not collected. Instead, they were paid in quarterly installments in the following year. As incomes rose with rising employment and wages, failure to tax concurrently with income was an expensive defect in tax design.

Placing the income tax on a current basis found an outspoken champion in Beardsley Ruml, Treasurer of R. H. Macy & Company and Chairman of the Board of the Federal Reserve Bank of New York. Ruml professed concern for retirees and enlistees or draftees who experienced declining incomes, yet were expected to pay income taxes for a previous year out of more meager incomes. The solution was for the federal government to require income tax payments currently, but a problem lay in creating the transition to this method. Under the existing tax system, Year 1's tax liability was paid in Year 2. If, in Year 2, the tax payments were made current, a taxpayer would be required to pay Year 1's and Year 2's taxes in Year 2. This was seen as an unacceptable situation. In essence, Ruml's plan was to forgive Year 1 tax liability, but require the taxpayer to make his Year 2 tax payments. For Ruml, this was the "daylight savings" approach to government finance; a proposal under which the Treasury would lose only when "the books would finally be closed [on Judgment Day]." The Treasury objected to the greater benefits the wealthy would receive by reason of Year 1 forgiveness under the Ruml Plan. While some forgiveness was necessary to make the system current, the Treasury Department was disappointed by Congress' eventual solution in the Current Tax Payment Act of 1943—essentially a 75 percent forgiveness of the lower of 1942 or 1943 tax liabilities. Unforgiven tax liabilities could be paid over the following two years.²³

Most importantly, the Act established the now familiar withholding system for tax collection. The withholding system was a significant advance in administration of the income tax. Elimination of delay in payments made the income tax much more responsive to wartime revenue expansion. As wage earners had become used to periodic deductions from their paychecks for Social Security and unemployment taxes, income tax payment also became less detectable. The advent of withholding ensured the income tax's place as a major and massive revenue source.

The problem faced by income tax propagandists during World War II was legitimating the imposition of that tax on average citizens when it was formerly targeted exclusively at the wealthy. In seeking to justify mass income taxation, public officials struggled with the recent history of the tax as a class tax and with the reluctance to implement President Roosevelt's domestic and social agenda. While seeking to make reasons for taxpaying legible and persuasive to average citizens, Congress succeeded to a great extent in placing the tax beyond justification; to make it so routine that rationalization was not as necessary. The withholding system, by placing responsibilities for reporting

and payment on third parties, removed critical aspects of the taxpaying process from the majority of taxpayers who were employees and transferred them to their employers. This trend was furthered by the opportunity to file a return by answering a few questions on one's withholding receipt (Form W-2) and sending it to the Bureau of Internal Revenue where the tax due or refund owed would be computed (Jones 1988–9).

The Postwar Period

It is interesting to note that during much of World War II, there is little mention of tax evasion, avoidance, or penalties. This is in stark contrast to prosecutions and investigations of the wealthiest taxpayers (including, unsuccessfully, former Treasury Secretary Andrew Mellon) during the 1930s. The Treasury understood its very limited wartime capacity. As Secretary Morgenthau said in March 1943, "Suppose we have to go out and try to arrest five million people?" (Jones 1996: 139). The war itself, as the project funded by tax revenues, was a point of near consensus for the public. What would become of the tax system and compliance programs after VJ Day?

In an undated "Report on Postwar Taxation," the conclusion was evident. "The individual income tax . . . must be kept a mass tax, because after the war very large amounts of revenue will still need to be raised for many generations to come." This was the most flexible and important revenue source for the federal government. Dropping rates would be preferable to higher exemptions. "It would be bad for tax morale to drop millions of taxpayers from the tax rolls one year and in another year to bring them again under the income tax, only to drop them again as revenue requirements change."²⁴

The highest rates from the World War II years stayed with little modification, dropping from a top rate of 94 percent to 92 percent during the 1950s.²⁵ There was demand for a tax cut after the war and it took the form of a surrender on a tax compliance issue and a means of recognizing and encouraging marriage. As marginal rates crept up and more citizens became federal income tax payers, attention began to turn to the individually based nature of the federal income tax. Some states including Oklahoma, Oregon, Nebraska, Michigan, and Pennsylvania switched from Anglo-American common-law marital property systems to community property. This was because marital rights under the common-law system were seen as inchoate and insufficiently robust to support division of (usually) a husband's earnings or income from property owned by him. By contrast, in community property states, originally Southern and Western states, a husband and wife would each have an equal, undivided interest in income earned by a spouse and in income from community property acquired during marriage. A 1930 US Supreme Court case,

Poe v. Seaborn held that in community property states, each spouse should be taxed on one-half of the community income, whether that income arose from labor or from capital.²⁶

Because of steep progressive rates, a married couple would, as a couple, pay the least tax if they could divide income between them equally. This was relatively easily accomplished in community property states. It was more difficult to accomplish in common-law states. Husbands tended to be primary breadwinners and joint spousal ownership of property was not engrained in property titles as yet (Hines 1966). Average citizens in non-community property states resented their disfavored tax position. An Iowan wrote to his senator, Bourke B. Hickenlooper: "I wish you would do all you can to inact [sic] a law, so that husband and wife can split their income and thereby reducing their income tax. It isn't right that some states are able to do so and others are not... I have a brother-in-law [in California] that has much larger net income than I have and yet we have to pay more income taxes than they do."²⁷ In common law states, the Bureau of Internal Revenue and the courts were called upon to assess the tax validity of a new proliferation of family partnerships—attempts to split income among family members. The Bureau took a relatively hard line on these partnerships often finding that wives made no capital or labor contributions, or using gendered measures of the value of women's work to the business. In many of these cases, the partnership agreements were not viewed as a sufficient basis for income-splitting between spouses or among family members (Jones 1988).

With more states converting to the "foreign" community property system (which afforded women somewhat increased legal ownership of marital income and property) and with an explosion of family partnerships, pressures to reduce taxes after the war and to deal with asymmetrical family taxation resulted in the federal adoption of the joint return in 1948. This original joint return computed the tax on one-half of the couple's income, and then doubled the tax—reaching roughly the same split income result as community property achieved. The difference was that state legislatures could offer tax reductions only by altering married people's legal rights to income and property. Congress enacted tax reduction without any change in the legal rights between spouses (Jones 1988).

The joint return came at a propitious time and was aligned with changes in American culture. During the war, many women took jobs outside the home, sometimes in family businesses, sometimes as clerks and secretaries, sometimes as the iconic Rosie the Riveter in defense industries. Once the war had been won, over two million women left the labor force in 1946. Women represented 35.4 percent of the civilian labor force in 1944, but that figure fell to 28.6 percent in 1947, although it was still higher than it was before the war (Hartmann 1982: 168).

For some women, the war's end meant a return to domesticity and social and gender stability. As tax legislative counsel and (later) Harvard law professor Stanley S. Surrey said in 1948:

[One implication of the split-income plan is that] [w]ives need not continue to master the details of the retail drug business, electrical equipment business, or construction business, but may turn from their partnership "duties" to the pursuit of homemaking. (Surrey 1948: 111)

The return to postwar domesticity and the production of a generation of baby-boomers was also consonant with Cold War ideology. American domestic life with a wife working at home was seen by many Americans as superior to the factory and other work performed by Soviet women. The 1959 "kitchen debate" between Vice President Richard Nixon and Soviet Premier Nikita Khrushchev illustrated this contrast. Nixon claimed that "diversity, the right to choose, [...] is the most important thing. [...] We have many different manufacturers and many different kinds of washing machines so that the housewives have a choice. [...] What we want is to make easier the life of our housewives" (May 2008: 422). Khrushchev rejected that "capitalist attitude toward women" (May 2008: 432). In the United States, Nixon was viewed as prevailing even if his characterization of domestic life in postwar America was not entirely accurate. Adopting the joint return served as a legal expression for the postwar nuclear family—culturally expressive, not disruptive of the familial status quo, and easier to enforce than the earlier individually based regime. In addition, it solved an apparent unfairness in the income tax system from the point of view of many Americans.

Once the atmosphere and imperative of total war was removed, what was it that taxpayers were paying for in its absence? For the Truman administration, World War II quickly morphed into a cold war with the USSR and other communist movements. Just as World War II was configured as a war against evil, godless communism came to be seen as the antithesis of the American way.

After World War II and during the Cold War, the United States—containing Protestants, Catholics, Jews, and secularists—began to adhere to what Jewish theologian Will Herberg called a "civic religion of the American Way of Life" (Marty 1996: 294). A rather abstracted religion was seen as foundational. President Dwight Eisenhower stated that "a democracy cannot exist without a religious base. I believe in democracy" (Marty 1996: 302). Godliness was seen as the cause of America's growth. Americans were to battle communism, in the words of Democratic presidential candidate Adlai Stevenson, "for [the new enemy's] aim is total conquest—not merely of the earth, but of the human mind. He seeks to destroy the very idea of freedom, the concept of God Himself" (Marty 1996: 306). Yet in a country with many faiths and many denominations within those faiths, historian Daniel Boorstin stressed the

importance of “nondenominationalism” and an “ability to produce a kind of elixir, sometimes vapid and always unpingent, a blended distillate of all our different religions” (Marty 1996: 308). The signal achievement of this civic religion may be the addition to “one nation” of “under God” to the Pledge of Allegiance in 1954 and “In God We Trust” as the national motto in 1956. It expressed a providential faith in American exceptionalism, strength, and superiority. The high point of this civic religion was the late 1940s to the early 1960s. Tax revenues were tithes to that project.

In the postwar period, church membership and church construction experienced enormous growth (Ahlstrom 2004: 949–63). The alignment of civic religion and the federal government in the fight against communism seemed to support defense outlays and, for some, increased foreign aid.

For much of the first part of the twentieth century, the Protestant Federal Council of Churches and its successor, the National Council of Churches (NCC), presumed to take a leading role in articulating a Christian ethic for the United States. Formed during the height of the progressive social gospel movements, the Federal Council of Churches sought to institutionalize the social gospel—“the application of the teaching of Jesus and the total message of the Christian salvation to society, the economic life, and social institutions . . . as well as to individuals” (Hopkins 1967: 98). Individual charity was seen as inadequate to the challenges of modern society. “Stewardship was then applied in a sense to the state, which, as guardian of God’s gifts to the people, should oversee their just distribution” (Hopkins 1967: 98).

Ties to government were especially visible after World War II as President Eisenhower placed the cornerstone for the new National Council of Churches building in New York and as prominent figures with political ties such as Allen Foster Dulles and Charles P. Taft were active in its affairs.

Nevertheless the postwar period saw the NCC come under attack from more conservative business-allied groups. The NCC formed a Lay Committee and J. Howard Pew, a retired Sun Oil executive, became its leader. Pew viewed the NCC as comprised of “ministerial economic illiterates.” Dupont executive Jasper Crane wrote in 1948 that economist Friedrich Hayek had told him that “it was the Church of England that led Great Britain into socialism. Must we admit that the Federal Council of Churches is leading the United States on the road to serfdom?” (Jones 2002: 95).

A survey by libertarian religious group Spiritual Mobilization found that 88 percent of ministers found nothing morally wrong with a progressive income tax, and 59 percent felt it was just to tax the wealthy at rates as high as 80 percent. Only 23 percent of clergy felt that “taxing the rich to help the poor through government welfare is against Christian (ethical) principles, because it removes the voluntary aspect of true charity” (Jones 2002: 106).

Pew and his allies, the National Association of Manufacturers and Spiritual Mobilization, battled NCC liberals during the 1950s with both sides employing schools on economics for ministers, book reviews, and publications of various sorts. Rev. John Bennett saw two warring factions within Protestantism: a Social Gospel emphasis “rather uncritical of collectivist answers” against “a very extreme type of individualism which wants to go back to an absolutely unreconstructed capitalism” (Jones 2002: 162). Conservatives accused the NCC leadership of communist sympathies, distributing a pamphlet entitled “How Red Is the Federal/National Council of Churches?” Some NCC leaders did have socialist ties. As Senator Joseph McCarthy began to move against NCC leaders in 1956, President Eisenhower condemned such attacks as “irresponsible” and “against American principles of freedom and democracy.” The attacks were defused, but left a weakened NCC in its wake.

Polling in the 1950s showed Americans were supportive of progressive taxation. In their famous 1952 essay, “The Uneasy Case for Progressive Taxation,” Professors Walter Blum and Harry Kalven Jr. identified the reduction of economic inequality as the strongest case for progression. They, too, cited the survey of Christian ministers.

If the case for progressive taxation was uneasy as a matter of economics, celebrated theologian Reinhold Niebuhr saw taxation as coercion, but “also a method of supporting his own long-range sense of duty toward the community as against a short-range disinclination to do so.” Laws, Niebuhr wrote, provided an “approximation of a loving community [...] under conditions of sin” (Niebuhr 1953: 244).

In the postwar period, the NCC faced a vigorous and new level of opposition from evangelical Christians and conservative businessmen arguing for a Christian libertarianism.²⁸ Much of the critique from this branch of Protestantism was directed at the welfare state. As one minister wrote in his sermon contest entry, “The growing acceptance of the philosophy of the Welfare State is a graver peril to freedom in America today than the threat of military aggression” (Kruse 2015: 32). James W. Fifield Jr., head of the anti-NCC Spiritual Mobilization, called out minimum wages, price controls, social security pensions, unemployment insurance, veterans’ benefits and a wide range of federal taxation as “tyrannical” and violative of “natural law.” For the NCC and its ilk, there was contempt: “Unclothed, their gospel is pure socialism—they wish to employ the compulsion of the state to force others to act as the social gospellers think they should act.”

The conflicts over race, the Vietnam War, and President Lyndon B. Johnson’s War on Poverty and Great Society programs, expanded divisions among American citizens. Mainline ecumenical NCC and allied local leaders were instrumental in the passage of the Civil Rights Act of 1964 giving greater rights to African Americans (Risen 2014). It was an attack on the Jim Crow South

(and Northern practices as well). To fundamentalist and evangelical Protestants, this coerced integration was unacceptable. Many Southerners left the Democratic Party (which was in part responsible for the Civil Rights Act), enrolled their children in religiously based unintegrated private academies and became more rejectionist toward the federal government and its taxes. It was this rejection of big government taxation and power that fueled the election of Ronald Reagan in 1980.

Superficially, civil religion was no longer even united. Religion came increasingly to mean evangelical religion, while the mainline NCC churches lost members and political influence. For fundamentalist and evangelical Christians, the Republican Party became, in the words of Daniel K. Williams, God's Own Party.

Secular conservative movements also began to organize and resist federal taxation. From Ayn Rand to household employers in Texas to Vivien Kellems, protests about the level and techniques of federal taxation received a fair amount of publicity. Even some popular children's books were not supportive of the federal government. *The Little House on the Prairie* books by Laura Ingalls Wilder do not paint a positive picture of the government. In one of the books in the series, *The Long Winter*, Mr. Edwards, a former neighbor, shows up in South Dakota escaping eastern territories that are "too settled-up." Mr. Edwards is portrayed very positively in the series as the savior of the Ingalls' homestead and the bringer of presents from Santa Claus. Mr. Edwards' visit this time, however, is comprised almost entirely of a passionate complaint against taxation (Ingalls Wilder 1971: 112–13).

Without a compelling and unifying cause for taxation, tax compliance propaganda in the postwar era morphed from the wartime celebrity and nongovernmental voices urging patriotic support for the war effort. During the Truman administration, the shift in public relations emphasis was to anecdotes about government apprehension of ordinary people. In a *Collier's* article, "They Can't Fool the Revenue Man," Undersecretary of the Treasury A. L. M. Wiggins told of a friend's challenge to him. "Oh yes, I know you get most of the big boys. But how about the little fellows? There must be thousands of them who get away with murder every year." Wiggins went on:

Well, my friend was wrong. Take the case of the man who ran a filling station and lunch counter on the outskirts of a sizeable city [...] He figured that he could chisel a few hundred dollars in income taxes without running any risk. He operated on a cash basis; how could anyone know how much he took in? [...] I estimated that it cost this man about \$1,000 to try to evade \$300 in taxes.

(Wiggins 1947: 68)

Wiggins did not discuss what it cost the Treasury to pursue this small-time evasion. The Commissioner of the Internal Revenue Service warned tax-cheating

farmers in Minnesota, paperboys, and a delicatessen owner feeding his family from inventory: “You see, it’s almost impossible to deceive our investigators, because most of them are generally familiar with every type of tax dodge ever attempted, and if they run across what appears to be a new one, they can look into the files and find it’s been tried before” (Schoeneman 1949: 126). Tax evaders could be tripped up by “disgruntled or underpaid employees,” “unusual currency transactions,” “sudden displays of wealth,” “hat-check receipts, tips to waiters,” an “estranged and angry wife,” even success stories in newspapers and magazines (Wiggins 1947: 71). The Treasury’s boasts about compliance could be seen as assuring ordinary taxpayers that everyone would pay taxes under the federal income tax. Of course, it was withholding and third party reporting that did the heavy lifting for the mass income tax.

Conclusion

The earlier emphasis on the wealthy targets of a class tax allowed ordinary Americans to see a part of the federal revenue system as aimed at those most able to pay. The establishment of Social Security taxes enabled the government to tax average citizens, who, it was thought, would receive direct payments in exchange for their contributions. During Roosevelt’s New Deal, the income tax was a class tax directed at the wealthiest Americans. With the advent of World War II, the image presented was one of Americans’ consent and unanimity in support of the war effort. Propaganda stressed that taxation was for this purpose and not for less popular New Deal programs. This story of purpose was part of the Roosevelt administration’s compliance program—linking the purpose of taxation to the war and making it clear that all were paying their fair share.

In the meantime, citizens became more legible to the federal government. With the introduction of withholding by employers for social security and bond purchases, the government was able to use third parties to collect taxes before workers got their “take-home pay.” The expansion in 1943 to withholding of income taxes made a mass income tax possible. The amount of income known to the government and accounts were reconciled on annual income tax returns with taxpayers identified by social security numbers. For decades, this very ordinary compliance device has been a foundation of federal revenues.

As the mass income tax was launched during World War II, agreement on the aims of taxation supported the transition from class tax to mass tax. During the immediate postwar period, a period of consensus seemed to be operating within popular culture with respect to anti-communism and civil religion, and regarding tax policy. Some of this “convergence” could be

viewed as the result of the Democratic Party's de-emphasis on class politics and its support for a variety of tax cuts (Brownlee 2016).

Beneath this "consensus" were the beginnings of deep divisions about the size and purposes of federal government, and the role of government as opposed to other societal institutions. The 1960s exposed societal rifts on race, gender, sexuality, and America's role in the world that have continued to the present day. Evangelical churches have emerged as the most perceptible religious voices in debates about government, federalism, and morality. The denominations comprising the social gospel-based NCC are on the decline in members, in political power, and in budgets. Historian David A. Hollinger in his Presidential Address to the Organization of American Historians has argued that the NCC's support for racial equality and against American adventurism abroad created alliances with secular organizations and attitudes that continue to have societal influence. As Hollinger wrote:

This sympathetic engagement with diversity that has become so visible and celebrated a feature of the public life of the United States is the product of many agencies, but prominent among them are the egalitarian impulses and the capacities for self-interrogation that ecumenical Protestants brought to the great American encounter with diversity during the middle and late decades of the twentieth century... Our narrative of modern American religious history will be deficient so long as we suppose that ecumenical Protestantism declined because it had less to offer the United States than did its evangelical rival. Much of what ecumenical Protestantism offered now lies beyond the churches, and hence we have been slow to see it. (Hollinger 2011: 48)

The unifying themes of total war and One Nation Under God may be seen as diminishing as America fights non-state actors, terror, and itself. Today a variety of enforcement problems threaten to erode public trust in the competence and fairness of the Internal Revenue Service. The structure of income taxation is seen by many to be unfair. The World War II and postwar era did establish the federal government's power to collect income and social security taxes from the waged and salaried masses. But corporations and hedge fund managers seem to be able to use international entities and to exploit the lower rates on capital gain income to reduce their effective tax rates in ways not available to average Americans.

In addition to questioning the fairness of the income tax system, Americans are divided, in truth very divided, on the purposes to which tax revenues should be put. The level of social insurance from Social Security, Medicaid, Medicare, and the Affordable Care Act is under active Congressional debate, let alone contests over domestic spending, military expenditures, and outlays for "soft power" abroad. The perceptions of fairness in taxation and a lack of consensus on the role of government will persist in plaguing the American

tax system as it continues to collect a majority of its revenues by means that take many choices about compliance away from wage-earning and salaried citizens.

Notes

1. See also Mehrotra (2013). In one of the most memorable passages of his writings, Seligman (1895: 72) argued for a notion of fiscal citizenship.
2. 157 U.S. 429 (1895). <https://supreme.justia.com/cases/federal/us/157/429/case.html>.
3. 268 U.S. 378 (1925). <https://supreme.justia.com/cases/federal/us/268/378/>.
4. Seltzer (1968: 62) shows that under 10 percent of the population were covered by taxable returns, with the exception of 1920.
5. Most American state sales taxes were adopted during the 1930s and required retailers to collect the tax from customers (Pomp 2015: vol. 1, 6–5).
6. 79 CONG. REC. 9657 (1935). www.gpo.gov/fdsys/pkg/GPO-CRECB-1935-pt9-v79/content-detail.html.
7. 79 CONG. REC. 9657–8 (1935). www.gpo.gov/fdsys/pkg/GPO-CRECB-1935-pt9-v79/content-detail.html.
8. www.archives.gov/exhibits/treasures_of_congress/text/page19_text.html.
9. In 1976, Ronald Reagan told a memorable story:

In Chicago, they found a woman who holds the record. She used 80 names, 30 addresses, 15 telephone numbers to collect food stamps, Social Security, veterans' benefits for four nonexistent deceased veteran husbands, as well as welfare. Her tax-free income alone has been running \$150,000 a year.

While not all of Reagan's stories would survive fact-checking, this one was based on Linda Taylor, officially listed as "white as a child, but could pass as black." www.slate.com/articles/news_and_politics/history/2013/12/linda_taylor_welfare_queen_ronald_reagan_made_her_a_notorious_american_villain.html.
10. Paul to the Secretary (May 19, 1942), 529 (in Blum 1967: 262); Cann to the Secretary (July 28, 1942), 554 (in Blum 1967: 285); Memorandum to Assistant Secretary Sullivan from Acting Commissioner Cann (July 29, 1942), 555 (in Blum 1967: 64); Mr. Sullivan to the Secretary (July 30, 1942), 555 (in Blum 1967: 220).
11. Paul to the Secretary (May 19, 1942), 529 (in Blum 1967: 262); Cann to the Secretary (July 28, 1942), 554 (in Blum 1967: 285); Memorandum to Assistant Secretary Sullivan from Acting Commissioner Cann (July 29, 1942), 555 (in Blum 1967: 64).
12. Meeting on President's Speech (April 23, 1942 10:10 a.m.), 520 (in Blum 1967: 11).
13. Inflation Group Meeting (April 8, 1942, 4:00 p.m.), 514 (in Blum 1967: 197, 201–2).
14. Dollars in the War (April 23, 1942, 10:00–10:30 p.m. EWT, Blue Network), 520 (in Blum 1967: 40, 51).
15. Preliminary 6th War Plan Advertising Press and Radio Plan (prepared for August 8, 1944 meeting), Bruce Barton Papers, State Historical Society of Madison, WI, 70–3.

16. "To Everyone in the New York Office" (December 11, 1944), Bruce Barton Papers, State Historical Society of Madison, WI, 70–3.
17. Group Meeting—Taxes (November 27, 1943, 9:30 a.m.), 680 (in Blum 1967: 1160).
18. Pamphlets 1942–3, Records of the Office of War Information, Record Group 208, National Archives, College Park, MD.
19. Fortnightly Budget for Wartime Editors of Women's Pages (March 4, 1944) Taxes—Radio, Program Guides and Publicity Materials for the Economic Stabilization Campaign, Records of the Office of War Information, Record Group 208, National Archives, College Park, MD.
20. Eddie Cantor Program, (OWI Plug) (February 23, 1944) Taxes—Radio, Program Guides and Publicity Materials for the Economic Stabilization Campaign, Records of the Office of War Information, Record Group 208, National Archives, College Park, MD.
21. I. Berlin, "I Paid My Income Tax Today" (December 26, 1941), 480 (in Blum 1967: 83).
22. Letter from Henry Morgenthau Jr. to Irving Berlin (December 30, 1941), 480 (in Blum 1967: 82).
23. Current Tax Payment Act of 1943, Pub. L. No. 78–68, § 6, 57 Stat. 126, 145–9 (1943). <http://legisworks.org/congress/78/publaw-68.pdf>.
24. Department of Treasury, "Report on Postwar Taxation" (n.d.), 37–8, Blough Papers, Harry S. Truman Presidential Library & Museum, Independence, MO.
25. Historical Highest Marginal Income Tax Rates. www.taxpolicycenter.org/statistics/historical-highest-marginal-income-tax-rates.
26. *Poe v. Seaborn*, 282 U.S. 101 (1930). <https://supreme.justia.com/cases/federal/us/282/101/>.
27. Letter from George Werning to Bourke B. Hickenlooper (January 6, 1948), (Tax, Income, 1948) Bourke B. Hickenlooper Papers, Herbert Hoover Presidential Library, West Branch, IA.
28. This is well documented in Kruse (2015).

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Part VI

Romania

10

Tax Collection without Consent

State-Building in Romania

Clara Volintiru

In Romanian folklore tax collectors are often portrayed as predators. For example, Mihail Sadoveanu wrote in his historical novel, *Dimineți de Iulie*, of 1927: “There was a time when great was the surprise that this people had not totally disappeared. Like birds of prey, the tax collectors would hover over them at all times.”¹ This is not surprising, as in pre-modern times the level and use of collected duties tended to have nothing to do with the citizens’ wants or needs. In response, evading taxes is equally poignant in popular culture, as the expression for running away literally means escaping taxes (*a da bir cu fugiții*).

Romanians’ cognitive framing of paying taxes sheds light on why there is a low fiscal collection rate to this day. Inefficient and ineffective administration characterizing this country is traceable to a weak state capacity in early modern times. In short, Romanian citizens seem to be traditionally “unwilling” to pay their duties to the state. Nevertheless, the puzzle that this case study addresses is how this can be, given that our experimental research clearly shows the opposite. Romanians are in fact inclined to be highly compliant; but, they do so when the social context involves cooperation mechanisms such as sharing the money, or acquiescing to the use of the collected sums.

The historical analysis of the Romanian case allows us to look at Romanian institutions and the behavior of Romanian people, but we cannot trace a single Romanian state per se in early modern times, given that its territory was split. Romanians have historically inhabited three main regions: Wallachia, Moldavia, and Transylvania. 2018 marks the one hundredth anniversary of the unification of all these regions. Given foreign influences and the subsequent development of the state in each of these provinces, this case study presents us

with a natural experiment of sorts. Austro-Hungarian rule and influence in Transylvania developed an early bureaucratic system, while the institutional environment of the Principalities of Wallachia and Moldavia was modeled in the periphery of the Ottoman Empire. These differences informed the relationship citizens have with administrative authorities and, to a certain extent, even after the institutional homogenization of the past century, we can observe a higher compliance in Transylvania than in the Principalities.²

Both the legitimacy and the authority of fiscal collectors were poor. Two factors affected their legitimacy: they were representing foreign (i.e. Austro-Hungarian or Ottoman) powers, and there was a complete lack of correlation between collection and redistribution. Monetary and in-kind taxes were collected under obligations toward an external beneficiary, while internal suppliers such as ecclesiastical units or local noblemen supplied care or security functions. This uncoupling of fiscal functions is also reflected in the deficiencies of authority: regulations were inconsistent or superfluous, given that they were designed for a quasi-colony or a periphery state. Overall, the authorities' capacity to monitor was weak; enforcement was not undertaken in a systematic or institutional manner, but rather was discretionary, under the contextual burden of external fiscal pressures.

To resolve deficits of legitimacy and institutional capacity, tax collection in Romanian territories was largely conducted through local intermediaries. What stands out in this case study is that the Romanian rulers' main involvement in foreign affairs was paying taxes to foreign powers. The sequencing and the manner in which fiscal revenue was collected (i.e. after it was paid by the ruler) established a patrimonial system. As such, informal rules and practices emerged and consolidated over time, especially with regard to the provision of a basic redistributive system (e.g. hospitals, policing, and dispute settlement).

An institution whose authority is firmly rooted in informal practices is the Church. It has acted as an intermediary of administrative and political affairs since pre-modern times. The Romanian system of redistribution was developed around the ecclesiastical institutions. Both the Orthodox and the Catholic Churches were able to extract their own revenues from the general population and noblemen. Whereas the Catholic Church was much more heavily assimilated in the Austro-Hungarian administrative apparatus, the Orthodox Church has worked in parallel with any formal administration up until modern times. It has legitimized rulers and provided cultural, social, and religious services to the population.

Under a quasi-colonial developmental path, Romanian authorities have not developed a proper social contract with the people. The tax collection process has been one of enforcement (to the extent possible), with little rights or

privileges granted in return. This was especially true in pre-modern times, but also largely applicable to the administrative reforms of the monarchy, or those of the authoritarian communist regime, throughout the twentieth century. While redistribution significantly increased over the modern period, the internalization of cooperation logic between taxpayers and the state did not occur. As far as general social norms go, we find Romanians, much like Italians, presenting strong personal values of honesty and compliance, but poor trust in institutions.³

Why Use Historical Analysis in the Romanian Case Study?

A large amount of literature exists on the contemporary failures of the Romanian state. In addressing the quality and legitimacy of state authorities in Romania, several studies have explained contemporary state incapacity in terms of post-communist transitional legacies (Ban 2014; Light and Phinnemore 2001; Pop 2006; Stan 2009; Stan and Vancea 2015).

In this field of studies, some authors have looked at the political actors and the institutionalization of the party system (Light and Phinnemore 2001; Mungiu-Pippidi 2002; Stan 2009; Volintiru 2012). Others have focused on disruptive shifts in the Romanian political economy (Ban 2014; Gabor 2010; Pop 2006). Such studies reflect a process of post-transitional consolidation framed by a wider comparative literature on new democracies (Ban 2016; Dimitrov, Goetz, and Wollmann 2006; Kitschelt et al. 1999; Linz and Stepan 1996). They reveal the formation of poor contemporary expectations from the state, and implicitly, citizens' low tax morale (see Todor's analysis of the post-communist tax system in Chapter 11 in this volume).

Given this wealth of arguments on why Romanians are unlikely to trust their state, and consequently pay their taxes, the question is why we should look further back to pre-modern times to explain this behavior. The answer is because Romanians have faced an uncoupling of the functions of collection and redistribution since early modern times. As I show here, this historical separation between collection and redistribution has made people less willing to take "the leap of faith" even when circumstances improve. Furthermore, the historical variation in institutional capacity between regions informs people's behavior to this day. If anything, the most systematic statist redistribution of public goods and services occurred in the twentieth century. This has not managed, though, to change Romanians' perception of administrative institutions as extractive bodies (and just that).

The historical analysis pursued in this chapter provides us with several key insights into why Romanian institutions never managed to build contingent

consent—a close connection between taxpaying and public goods or services. As foreign powers have directly or indirectly ruled the Romanian territories, developing a systematic tax collection capacity was not a priority. Consequently, Romanian citizens did not get much back from the state, and the Church intervened to provide much-needed welfare goods. This situation contrasts with the Swedish case where the Church intervened to consolidate the collection capacity of the state (see Nistotskaya and D’Arcy, Chapter 2 in this volume). The balance of power between administrative and ecclesiastical authorities in Romania is more like the competition logic of the Italian Church (see Hien, Chapter 4 in this volume), even though it was not competing for collected resources (as in the Italian case), but just for legitimacy or moral authority.

Much like everywhere else, the tax collection process in Romania has been linked to the dynamics of international power relations. Throughout their history the Romanian Principalities have been ruled or dominated by larger regional powers. Since pre-modern times, the duties and obligations shared between national elites (i.e. local rulers and notables) and foreign powers (e.g. the Hungarian Kingdom, Ottoman Empire, Austro-Hungarian Empire, and Russian Empire) have had a decisive effect on the manner in which revenues were collected.

More importantly, the dynamic of these power relations had a determining role in how the extracted revenues were to be spent: they were not redistributed. This in turn affected the expectations of taxpayers. As the Romanians harbored low expectations of redistribution and negative perceptions of tax collectors, a vicious circle of low compliance (given the opportunity) has been formed and has persisted to the present day. Furthermore, low expectations of redistribution, although engineered by foreign administrators, have been maintained in later years by domestic elites.

We thus find the emergence of a patrimonial system that was being supported by the international balance of power. Foreign powers, which did not wish to engage in the direct administration of Romanian territories, encouraged a bilateral relationship with rulers, while formally recognizing the rights and privileges of the citizens (mostly as a leverage against the rulers). Consequently, there was only a marginal preoccupation with systematically collecting taxes from citizens, as rulers relied predominantly on their own personal fortunes and foreign creditors. Secondly, the historical setting of Romanian territories allowed for a consolidation of informal practices, especially in terms of redistribution. There were few regulatory provisions, most of which in turn derived from foreign systems (e.g. Ottoman law). Extended regulatory provisions on the systematic delivery of public goods and services were introduced later, tentatively in the eighteenth and more specifically in the nineteenth

century (see, for example, the Organic Statute, discussed below in “*Taxes, intermediaries, and bureaucratic genesis*”). The Church provided informally most of such services as medical care (*bolnițe*), education, and dispute settlement.

In the Romanian case study we find little evidence of a direct relationship between citizens and the state as we would define it under a social contract rationale. Instead, we find a high reliance on intermediaries to ensure administrative processes. Throughout the early modern period, most administrative institutions have been constructs of foreign powers, based on diplomatic relations or contextual interests. This “captive” status of the Romanians, in between semi-colonial and autonomous rule, consolidated the power of informal practices as constant benchmarks of conduct and practice. Acquiring the consent of taxpayers, or convincing them to cooperate with the state to solve collective problems was not the framing upon which tax collection was developed here (as opposed to Sweden, for example; see Nistotskaya and D’Arcy, Chapter 2 in this volume). Instead, a pyramidal system of enforced collection was the prevalent practice.

Both state capacity to extract resources and the availability of resources are relevant in the process of fiscal collection. Historical sources tend to showcase Transylvania as having a higher administrative capacity and more (taxable) resources, while the Romanian Principalities lacked both. This is not entirely so. The economic development of the regions varied extensively over pre-modern times, which means that institutional evolution played a major role in the tax collection capacity of each region.

When looking at urbanization levels as a measure of economic development there is no distinguishable developmental pattern for the Ottoman-controlled Romanian Principalities of Wallachia and Moldavia on the one hand, and Transylvania on the other.⁴ If anything, both in the sixteenth century and as late as the eighteenth century, Moldavia was more like Transylvania than Wallachia, which had a higher urbanization rate, similar to that of other European countries such as Denmark or Ireland (Murgescu 2010).

Transylvania did indeed grow, but slowly and steadily on a basis of gradual urbanization, and in such communities monitoring and administrative reach was easier. In the case of Wallachia, like other European economies of the time, the main economic driver was an increase in agricultural productivity (e.g. the introduction of corn crops) (Murgescu 2010: 94–9). In Moldavia, the sharp increase in urbanization in the eighteenth century can be attributed to a preferential fiscal regime from the Ottomans, given the Russian Empire’s expansion in the area. It is therefore a story of institutions and not one of economic endowment.

Legitimacy and Social Expectations on Redistribution

Romanians had a shifting image of the state throughout pre-modern times. Autonomy alternated with dependency; the conditions of dependence alternated as well. The Ottomans, for example, provided no clear, predictable expectations of the relationship between center and periphery, as they treated each province differently (Barkey 2008). Hungarian rule was more institutionalized, but it gave way to Ottoman domination in the sixteenth and seventeenth centuries in Transylvania. Whether it was through military action, fiscal compliance, or strategically developed trade relations, the Romanians have been in a perpetual process of redefining the limits of authority and the duties owed.

While enduring a prolonged state-building process, Romanians experienced a steady development of informal institutions and social norms (e.g. feudal relations, ecclesiastical community norms). These were consolidated by iterations and confirmations through practice. Because of the constancy and predictability of such community-based norms of sharing and creating public goods and services, along with the legitimacy of their promoters (e.g. local lords or priests), Romanian behavior was shaped by the (ever-changing) regulations of informal rather than formal institutions. Gretchen Helmke and Steven Levitsky assert that informal institutions can often have a profound and systematic effect on political outcomes, and scholars “who fail to consider these informal rules of the game risk missing many of the most important incentives and constraints that underlie political behavior” (2004: 725).

Romanian systems of collection and redistribution were mentioned in formal decrees, but the manner in which the duties were fulfilled was not. An extensive, carefully detailed literature covers the Ottoman fiscal system (Darling 1996; Fischer-Galati 1959; Karaman and Pamuk 2010; Panaite 2013), and through this we can find important details on collection (not so much redistribution) in Romanian Principalities (e.g. how much was owed and on what basis, frequency, to whom and by whom the payments were delivered).

It is, however, a mirrored perspective, as we find out from Ottoman sources how things (were supposed to have) happened. When we look at fragments of domestic historical records in Romanian territories, the regulatory image becomes blurred by domestic, ad hoc practices and means of implementation (e.g. monetary approximations, in-kind compensations, substantial annual variations, and off-the-books payments).

Similarly, while we can find detailed accounts of fiscal administration in Hungary (Bonney 1999), it is much less clear how resilient administrative practices were in Transylvania after it fell under Ottoman influence, or how rural areas compared to urban centers.

For example, Richard Bonney raises the question of informal consolidation of practices in tax collection, as he asserts: “fiscal systems have always been with us, but . . . the ‘fiscal state’ was not” (1999: 2). If we look at the historical formal and informal institutions shaping fiscal compliance (or lack thereof) in Romanian territories, we need look no further than the legitimacy and authority of tax collectors. A domestic fiscal state (see Levi 1988; Migdal 2001; Skocpol 1979; Tilly 1992) was not characteristic of the Romanian collection system, the extractive role being fulfilled by foreign states. As such, the effectiveness of fiscal collection relied on the degree to which domestic agents or intermediaries were recognized themselves as legitimate or authoritarian.

Romanians’ perceptions on the legitimacy of fiscal duties were significantly influenced by the fact that these were external impositions. The Romanian Principalities of Wallachia and Moldavia were politically dependent on the Ottoman Empire throughout the entire pre-modern period.⁵ Transylvania had been annexed to Hungary in the eleventh century and fell under Ottoman rule in the sixteenth century, under similar conditions to the other Romanian territories. It was not until the eighteenth century that the Austro-Hungarian administration model became systematically implemented in Transylvania.

Some of the main historical Romanian studies treat the territories under Austro-Hungarian influence separately from those under Ottoman influence (see e.g. Murgescu 1996; 2012). I am, however, resisting this approach, as the fiscal system bears similar limitations (with lasting effects): foreign authority (i.e. an external collector), lack of correlation between tax collection and redistributive benefits (i.e. national suppliers) and an overall poor institutional capacity—both for monitoring and enforcement, especially in the predominantly rural areas. The distinguishing element that is of main interest to the present analysis is that the administrative capacity of monitoring and systematic enforcement, as well as the delivery of public services (i.e. contingent consent) were implemented sooner in Transylvania via Austro-Hungarian influence than they were in the Principalities. This in turn shaped citizens’ perceptions and expectations.

Taxes, intermediaries, and bureaucratic genesis

When looking at the early modern period, “due to high shares of intermediaries, Ottoman revenues lagged behind those of other states in the seventeenth and eighteenth centuries” (Karaman and Pamuk 2010: 593). Obviously, using intermediaries was not restricted to Ottoman practices. England, for example, used appointed commissioners to collect and evaluate taxes in exchange for a fee or commission, while Sweden used the Lutheran Church as agents of tax collection and monitoring. The latter was more successful on grounds of

legitimacy and territorial penetration. According to historical records, the rulers of the Romanian Principalities were seen as tax intermediaries themselves.

Land tax was the predominant fiscal revenue up until modern times. In the eighteenth and nineteenth centuries the village was still a “collective fiscal unit,” meaning that the entire community was responsible for land taxes, called *cisluire* (Lupan 1937: 11). Beyond limited collection capacity, other drivers of this indiscriminate approach were the high capacity of community leaders to maintain order, and a sense of equity. The small, agrarian communities had a high level of informal monitoring or self-regulation driven by local authority figures (e.g. priests, local lords). Furthermore, because the land tax was one of the main sources of fiscal collection, the Ottomans would frequently use the status of “protected lands” for the Romanian principalities to ensure their territorial integrity. This in turn implied the safeguarding of the property rights of nobles and churches with large land holdings, paying their taxes in a predictable manner. An incipient social contract was formed between domestic elites and foreign powers.

As weak as monitoring was in comparison to Western European countries of the time, there were some administrative instruments of oversight worth acknowledging. Given the Western influence, Transylvania started to develop bureaucratic monitoring in pre-modern times (e.g. cadastral records, life events, judicial decisions on debts and duties). With the frequent administrative changes in Wallachia and Moldavia Principalities, and the high level of illiteracy, the Church’s census records here were much more reliable than the administrative ones. Most of the peasantry would be highly compliant with ecclesiastical procedures of life events such as birth, marriage, and death.

The lasting effect of this largely informal overseeing of tax payments is that neither the state’s monitoring capacity (e.g. cadaster records, census data) nor the overall approach to tax enforcement has improved significantly in modern times. We can see the interpretative nature of the evaluation of taxpayers’ income for fiscal purposes, even on the eve of the contemporary statist structure: “when the lifestyle of a taxpayer shows a discrepancy with known incomes, fiscal authorities can recur to evaluation according to *hints and assumptions*” [in Romanian, emphasis in the original text] (Madgearu 2014: 88).

Most of the administrative constructs of the Romanian state were “improvisations based on random practices in Europe” (Rădulescu-Motru 2012 [1937]: 6; see also Janos 1989). In the early twelfth century, court positions occupied by local noblemen or boyars (*boieri*) were Slavonic constructs (e.g. *logofăt*, *pharnic*, *spătar*, *ban*), having a ceremonial role rather than an official function (such as responsibility for stocks, or the armory). They further became territorially bound in *județe* (the Latin term for county) after the

Orthodox alignment with the Western branch of Christianity. Following the Unification of the two Romanian Principalities of Wallachia and Moldavia in 1859, French administrative structures were imported as well (e.g. Prefectures).⁶ In a noteworthy analysis in the early twentieth century, Constantin Dobrogeanu-Gherea (1910: 29) underlines the tensions between Western institutional imports and the socio-economic realities of Romania: “the peasants did not request the introduction of liberal capitalist institutions, but rather the suppression of serfdom; they would have been sooner satisfied with an absolutist monarchy or a ruler [*Vodă* in the original] liberating it from serfdom [*iobăgie* in the original].”

The dependency of administrative development upon contextual constraints continued during the seventeenth and eighteenth centuries. Legal Codes were introduced in Wallachia and Moldavia, integrating existing informal practices with former Byzantine concepts of law.⁷ These state-building efforts brought all the Romanian territories to a more consistent level of institutional development. Still, these reforms were essentially driven by the rulers’ desires to increase and extend tax collection as much as possible (Ghica 2014 [1880]).

Later, in the nineteenth century,⁸ the Organic Statute (*Regulamentul Organic*) introduced the first common legislative framework for both Principalities, under the Russian protectorate. It built heavily on existing administrative and judicial practices, but under the direction of the Russian administrator Kiseleff they were formalized and homogenized, while “striving to prevent abuses.”⁹ The Statute delineated for the first time the internal engagement of the state to provide public goods and services such as roads, street lighting, cleaning and signage, fire stations, policing and prisons, medical personnel, healthcare centers, schools, regulation of pharmaceutical suppliers, and various judicial and administrative functions. More significantly to the present study, the Organic Statute specifically included the “establishment for the first time in the Romanian countries of a regulated centralized accountancy system that would ensure the checks over the duties collected by state agents, and create a formal framework for the provision of pension, as opposed to the discretionary decision of the ruler as before.”¹⁰

While legal scholars argue that no constitutional foundations existed before the Organic Statute, historians point to the existence of approximately twelve versions of legal references framing the administration of rule of Wallachia and Moldavia, as well as the provision of “common good” (*binele obștesc*) that the rulers were supposed to safeguard (Barbu 2000).

Subsequently, increasingly fervent nationalist emancipation movements established international connections with neighboring organizations, such as the Greek Anti-Ottoman revolutionary society Etaireia. Nationalist Romanian movements imported many demands regarding citizens’ rights and

administration procedures from them, constructing the modern framings of state legitimacy.¹¹

The Church as a redistribution agent

The Romanian case study shows that, over many centuries, most state and Orthodox Church functions have been interlinked (Stan and Turcescu 2011). One of the fundamental organizational principles derived from the Orthodox Church's Byzantine past is the theocratic notion of *symphonia*—taken to mean harmony between Church and state. This relationship developed steadily as the Church became an essential vehicle for nationalist movements serving “as an important transmission belt from state to society, implementing an agenda of domestic integration and homogenization” (Van Meurs and Mungiu-Pippidi 2010: xiii).

The existence of the Orthodox Church under the Ottoman Empire was readily encouraged by the Sultans. It was regarded as a means to control the vassal populations and to help in the collection of taxes (*tribut*), given the informal authority of the clergy and the already well-organized network of monasteries. Additionally, as non-believers, the South-Eastern European populations were charged a higher tribute or tax (*harac-i maktu*) to preserve the autonomy of their territories (Panaite 2013: 403). Collection of the annual per capita tax (*cizye*) owed by non-Muslims in Wallachia and Moldavia was overseen by the same Ottoman treasurer (*baş defterdar*) (Darling 1996: 75).¹²

While the Byzantine Empire subsidized the activity of all Orthodox clergy (Zachariadou 2006), revenue sources changed under Ottoman rule. In order to maintain its day-to-day activities, the Orthodox Church developed a taxation system, complementary to that of the state:

The collection of these taxes was a privilege granted by the sultans, who apparently continued the Byzantine tax, known as the *kanonikon*, levied on the inhabitants, the priests and the monasteries of a region in order to cover the expenses of their metropolitan bishop. (Zachariadou 2006: 179)

Much like in Italy, competition was created at this stage between the Church and the administration in the collection of taxes (see Hien, Chapter 4 in this volume, on the Italians' contributions to the Catholic Church). Still, local nobility worked closely with the ecclesiastical elites as their legitimacy was codependent. Tax collection was thus not impeded but actually facilitated by this cooperation.

In exchange, the Church enjoyed a wide range of privileges. For example, records from the rule of Constantin Brâncoveanu in Wallachia show the numerous tax exemptions the Principality enjoyed (Zachariadou 2006).

As taxes in the seventeenth century were largely paid in kind, monasteries were not only exempted from giving a proportion of their production (e.g. wine, honey) to the state, but were also allowed to trade in these goods by establishing selling points, such as wine cellars.¹³ These fiscal privileges coupled with the autonomy it enjoyed, generated significant wealth for the Church.

Fiscal burdens owed to foreign powers increased markedly at the beginning of the seventeenth century, especially in Wallachia. Consequently, many free peasants started to lose their status, selling off any property they might have had, and becoming “dependents” on the estates of some local lords, but predominantly on those of monasteries (Murgescu 2010: 40).

While the external fiscal burden on the Romanian Principalities increased, the number of new monasteries that were being established continued to grow. By the fifteenth century, all of the main Romanian territories had a similar number of monasteries, but in the following centuries many more monasteries were being established in Wallachia and Moldavia (Table 10.1). Historical records show the provision of public services in both Catholic and Orthodox monasteries. The latter increased their provision of social services significantly: hospitals (*bolnițe*), educational centers (from primary schools to academies, e.g. Sâmbăta de Sus), printing presses (e.g. at Trei Ierarhi), orphanages, elderly care centers, and the supply of food and clothing for the poor. Local churches would assume many informal care-giving functions, but did not possess the personnel and physical infrastructure (e.g. buildings, land) that the monasteries did.

After the Unification of the two Romanian Principalities in the nineteenth century, the state took over the wealth of the monasteries (*secularizarea averilor mănăstirești*). Subsequently, much as in the aftermath of the Reformation in England and Sweden in the sixteenth century, the Church became an agent of the national state. Furthermore, it created a very important class for the years to come: the peasant landowner. This notion of property for the lower classes was quintessential in the subsequent exercise of tax collection.

Table 10.1. Number of newly established monasteries in Romanian territories

	15th century and earlier	16th century	17th century	18th century
Moldavia	12	23	21	13
Transylvania	14	0	15	12
Wallachia	20	28	35	18
Total	46	51	71	43

Source: Author’s calculations based on the Romanian Orthodox Church (BOR) archival records, Archives of Hungary, www.archivportal.hu/en/archives-of-hungary/archives-of-the-romanian-orthodox-church/. Small ecclesiastical centers are excluded; both Catholic and Orthodox monasteries have been accounted for in the table.

The Romanian Principalities of Wallachia and Moldavia: Fiscal Responsibilities and Payment Mechanisms

Periphery status and contractual legitimacy

The entire economic exchanges of Wallachia and Moldavia in the sixteenth century were driven by their fiscal duties to the central government of the Ottoman Empire: “Romanian products were being exported south of the Danube, or towards Western Europe . . . through fiscal duties these trade networks were filling the coffers of the rulers who in turn used them to pay to the Ottomans” (Murgescu 1996: 313). Furthermore, while fiscal duties changed yearly (depending on the internal constraints of the Ottoman Empire) the responsibility of fulfilling them lay with the appointed ruler.

A reciprocal legal relationship existed between the core and semi-periphery: Romanian territories have been (at times) “tributary states” (i.e. owing tribute—both levies and gifts, military and foreign policy support) as well as “protected states” (i.e. Ottomans owed military and foreign policy support, and could interfere in internal matters in the interest of Romanians) (Panaite 2013). In order to safeguard their fiscal base in these territories, the Ottomans adopted “specific measures designed to ensure the protection and stability of the [vassal] population in Wallachia, but also other sources of revenues, like customs, salt mines and the taxation on the grazing of animals belonging to people south of Wallachia” (D. Panaitescu 2014: 60). The Ottoman Empire’s central government used its protection responsibilities to confirm or redraw its support for the rulers’ actions and property rights. It did so in Moldavia and Wallachia to a considerably greater extent than in Transylvania.

The Ottoman central government would thus provide a sense of legitimacy to the tax collection process: as long as subjects paid their taxes owed to the Sultan, their rights and property would be safeguarded, even against the oppression of their own ruler. To this end the official demands would “often invoke the fundamental role of the ruler to protect the life, the property, and the wellbeing of the inhabitants of Wallachia, Moldavia or Transylvania, as subjects of the sultan” (Panaite 2013: 419).

The common framing of taxes as “recognition gifts” (*tribut*) created an ambiguous framing of underlying contractual provisions due to fluid power relations between the Romanian Principalities of Wallachia and Moldavia on the one hand, and the Ottoman Empire on the other hand. Duties paid on time ensured that the Ottomans would not invade the “autonomous” Romanian Principalities’ territories, but the latter were still heavily dependent in economic and diplomatic matters on the former. In turn, the Ottomans enjoyed minimal costs in administrating these territories, and no responsibility for developing institutions or enforcing compliance on a geographically dispersed population.

Tax collectors and duties owed

According to the system of appointment by the Sultan, the rulers were directly responsible for the payment of duties owed. They would thus, for their own sake, secure the annual payments, often taking out loans to top up the yearly collection. Some historical records refer to the rulers of Wallachia and Moldavia as “leaseholders of duties” (*arendași ai tributului*) (as in the chronicle of the Ottoman bureaucrat Tursun Beg in Panaite 2013: 403). The Principalities were consequently ruled in an openly patrimonial manner, whether by local lords (i.e. *voievozi* or *domni*) or Greek rulers imposed by the Ottomans.¹⁴

According to the seventeenth-century chronicler, Grigore Ureche, starting in the sixteenth century in Moldavia and the seventeenth century in Wallachia, governors were appointed to take on administrative duties, such as collecting taxes (Ureche 2011). This arrangement reflected the relative detachment rulers and *boieri* had towards this source of income. As Pippidi notes:

The political organization of Moldavia and Wallachia appeared centralized and despotic, yet real administrative power was weak. The state was conceived as an extended household... Members of the ruling class, including hired foreign experts in fiscal matters and administration, were seen as servants of the prince and were promoted for reasons of nepotism or simple favouritism, not as free men who had consented to a contractually limited obligation to serve the state.

(2010: 119)

Under the rule of Constantin Brâncoveanu, Wallachia enjoyed considerable freedom in international affairs, both in terms of trade and diplomatic relations with Transylvania and other Western countries, such as the Italian city states of the time. It was during this rule that the first systematic inventory of fiscal duties and debt was created—the “Registry of Wallachia’s Treasury during the Time of Constantin Brâncoveanu.”¹⁵ This registry covered all types of tax and repaid loans, so that we can disentangle the mechanisms employed by rulers to pay their duties to the Ottomans. On average, a quarter of the duties were supplied on site, from local creditors in Istanbul, as the ruler or his representatives would arrive to pay the annual duties to the Sublime Porte (Table 10.2).

Even though he possessed a large personal fortune, Brâncoveanu still relied (like his predecessors) on Istanbul-based loan sharks. Some of them were Muslim guild leaders (e.g. the leader of the butchers’ guild, Casap-bașa, or the leader of the furriers guild, Mehment Celebi Chirchiu-bașa¹⁶), while others were Orthodox noblemen and tradesmen. This dependency of Romanian rulers on third parties (i.e. lenders) to fulfill their fiscal duties to the Ottoman Empire illustrates clearly the lack of sustainability of the domestic fiscal collection system.

Given that the loans bore considerable annual interest, their proportion of 73.72 percent out of the total amount paid to the Sublime Porte in 1702

Table 10.2. Duties and loans in Wallachia (1694–1703)

Year	Repaid loans		Total duties paid to the Sublime Porte
	Sum in Thalers (silver coins)	Percentage of Total Payments	Sum in Thalers (silver coins)
1694	35,533	10.62%	334,554
1695	33,554	8.73%	384,478
1696	44,960	11.22%	400,574
1697	45,189	13.93%	324,484
1698	112,675	30.34%	371,422
1699	100,688	37.37%	269,447
1700	52,900	13.74%	385,134
1701	203,722	41.55%	490,342
1702	180,290	73.72%	244,570
1703	184,980	27.88%	663,591
Total	994,491	25.71%	3,868,596

Source: Based on data from the Registry of Wallachia Treasury, Berza 1958, quoted in Murgescu 2012: 118, adapted by the author.

reveals the fiscal burden as disproportionate. This high debt share is striking, especially since total duties were half of what they were the previous year. It confirms the wide variations of domestic collection capacity, as well as the level of spending by the ruler.

Brâncoveanu cut several taxes for tradesmen and Church duties. He invested at the same time in the development of many administrative and ecclesiastical centers. He pursued the development of a semi-autonomous state in Wallachia (with redistributive functions) by balancing increasingly stronger (economic) ties with the West with duties owed to the Ottomans. Ambitious as his reforms were, the contextual circumstances were not in his favor. Along with his four sons, he was decapitated in Istanbul in 1714 after all their fortunes had been confiscated. There was both domestic and foreign opposition to his endeavors to change the status quo of Wallachia at that time. Brâncoveanu's reforms are important because it was the first time that a social contract was tentatively developed between a Romanian ruler and his subjects.

From the early eighteenth century to the beginning of the nineteenth century, the Ottoman Empire appointed lords of Greek origin in the vassal Principalities of Moldavia and Wallachia called Phanar Lords. These were usually promoted from previous positions (*dragomani*) of interpreters (i.e. intermediaries) or officials, and as such were trusted by the Sultan to serve his pecuniary interests in these territories. They also had to pay for such appointments, with the highest bid usually successful. They would promote their own patronage networks of power, using lower ranking dignitaries

whom they trusted, to the detriment of the more established local noblemen (*boieri*) of the Principalities.¹⁷ Generally, such rulers used power to enrich themselves—given the predictably short timeframe, and serving at the pleasure of the Sultan. Some even absconded with most of the national budget (*visteria*) after finding out about their imminent dismissal. Ion Vodă Caradja emptied Wallachia's coffers when he ran away to Pisa in 1818, after tripling his personal fortune by selling noble titles and some of the national salt mines (Ghica 2014 [1880]).

Formal and informal systems of payment

Throughout the pre-modern period, formal records indicate that the Romanian Principalities (and Transylvania in the fifteenth and sixteenth centuries) owed three types of tax to the Ottomans. *Haraci* or *tribut* refer to the collective duties owed yearly by a given province via its ruler. *Peşcheş* or *plocon* refer to dedicated payments to the Sultan or various high dignitaries for personal use (e.g. securing the throne) or domestic interests (e.g. representing legal interests in international negotiations) of the ruler. Finally, there were payments in support of military campaigns that would go either to the Sublime Porte for subsequent distribution, or directly where they were needed (e.g. the Crimea). Under the rule of Brâncoveanu (1654–1714) the relative distribution was as follows: a third were the collective duties (*haraci*) and goodwill payments for the Sultan and his close circle (*plocon de bairam*); a third were formal bribes or payments to obtain favors from Ottoman officials (*plocon*); and a third were military support payments.¹⁸

Rulers were normally selected domestically, from amongst and by the dignitary boyars, but sometimes informal payments were made to ensure patronage from Ottoman officials (*ruşefet*) (Murgescu 1996: 215). While *peşcheş* or *plocon* were forms of bribe made transparently and recorded, *ruşefet* was made “under the table” in a personalized manner, bypassing domestic deliberations. Anecdotal accounts from the sixteenth century suggest a bid-like system, where one contender, Mihnea Turcitul, offered one million gold coins, while the other, Petru Cercel, offered 1.16 million coins (Murgescu 1996: 215). Considering that collective duties for that period ranged between 50,000 and 70,000 gold coins annually, we can see the disproportionate size of these informal payments for which we have no systematic coverage.

With a vast territory, predominantly agrarian land, and a small community social structure, the local noblemen or boyars (*boieri*) were important figures of authority in the Romanian Principalities, mediating the obligations of subjects with the responsibilities of the ruler. This can be traced to a patrimonial legal structure: the system of property rights over land and the people living

on and working that land, as well as the benefits they were required to give in return, such as housing.¹⁹ Noblemen thus realized the basic functions of a fiscal system: they collected the duties, and provided protection and benefits in return to the population.

More importantly still, the strong institutionalization of local authorities originates in local elites. The average rule lasted only about three years (Pippidi 2010: 19). In contrast, the boyars were more resistant to change, and managed to ensure their rights and privileges in an organized manner; it was from amongst them that Romanian rulers were usually selected.

Taxes paid to local dignitaries—whether administrative (i.e. delegated boyars) or ecclesiastical (i.e. the bishops and clergy in monasteries)—were mostly in kind. They in turn had to deliver both in-kind and monetary taxes to the representatives of the Ottoman Empire. An example of an annual duty to the Sultan would have been carried by the leading noblemen to Constantinople: “as a sign of our obedience, the ruler will make sure to send to the Sublime Porte, by way of two Moldavian *boieri*, 4,000 Turkish ducati, 11,000 piasters, 40 hawks, 40 gestate mares—all as a gift [original in Romanian]” (Ureche 2011).

Between the eleventh and eighteenth centuries frequent taxation systems on the population were joint labor (i.e. an extended family was collectively taxed) in exchange for working on the land (*clacă*) (e.g. for four days a week²⁰) or a tenth of produce (*dijma*). The latter was often specific to each of the major production sectors (e.g. *vinărit* for wine producers or *oierit* for livestock). In the pre-modern period, bearing similarities to a tax farming system, various categories of collector were established based on the type of duties or levies they were charged with collecting. Historical records also show specialized collectors for products such as fruits (*găblari*), agricultural products (*găletari*), or hay (*fânari*). Along with labor contributions, in-kind levies were collected by people from local rural communities. In contrast, monetary levies collected by such appointees as *birari* or *dăbilari* were the responsibility of early versions of clerks, often situated in more affluent urban communities.

As experienced tradesmen, Greek rulers would often impose heavy duties on certain desirable imports from the Austro-Hungarian Romanian territories (e.g. strong liquor). They thereby ensured their own monopoly and maximized their personal profits. Previous Romanian rulers had gone out of their way to liberalize such trade across the borders of the Romanian territories; an example is Constantin Brâncoveanu’s decision to lift taxes on wine traders from Braşov—a city on the border with Transylvania.²¹ Trade liberalization was key to both the maximization of the fiscal base and the consolidation of links across Romanian territories.

Transylvania and the Early Development of Administrative Capacity

Collection and redistribution

Under Austro-Hungarian rule a public administration system was developed in Transylvania.²² Becker and colleagues argue that the shared formal rules of local communities and the “well-respected administration increased citizens’ trust in local public services” (2015: 40). The Austro-Hungarian Empire provided various public goods in exchange for the taxes collected, such as bridges,²³ road infrastructure, and stable administrative practices.

In the early thirteenth century, we find in the Austro-Hungarian territories “truth courts” (*loca credibilia*) run by both the judiciary and the (Catholic) Church, signifying that formal bureaucratic institutions had an earlier history in this region. By contrast, Wallachia and Moldavia relied at this time much more heavily on feudal rule.

By comparison to the formalism and uncertainty of the fiscal contract with the Ottomans, under the Hungarian annexation, citizens’ expectations were more clearly constructed. Responsibilities were no longer placed solely on the ruler, the delegated figures of authority having a clearer mandate. However, as late as the nineteenth century, enforcement and monitoring mechanisms were not very effective: tax collection would involve troops who would occupy “entire villages, search the houses of delinquent taxpayers, and proceed to remove anything of value” (Janos 1989: 340).

Much like elsewhere in Central Europe at that time, Transylvanian citizens were called upon to contribute in order to support ongoing military campaigns. In the fifteenth century, various taxes were proposed with the specific purpose of financing offensives against the Ottomans or standing armies (Bonney 1999: 266). The legitimacy of such taxes would have been higher than those collected in the Romanian Principalities, as the taxpayers would also be direct beneficiaries (i.e. from a security provision). Their usage was nevertheless very limited.

Given the same population, with the same level of development, over certain periods there was a much better correlation between the extractive and redistributive functions of the fiscal system. Transylvanian taxpayers also had the advantage of their proximity to Western markets, thus creating more flourishing urban centers with a sharp increase of urbanization in the seventeenth century. The development of existing urban centers, alongside supporting administrative services, had been pursued actively in previous centuries by the policies promoted during the Hungarian annexation of the fourteenth and fifteenth centuries (under, for example, King Mathias Corvinus). After the decline of the Hungarian Kingdom, much of the administrative system was overshadowed by Ottoman law. The still predominantly agrarian

population subsequently suffered the same fate as that in the Romanian Principalities, becoming trapped by exploitative land-owning elites (Janos 1989: 335).

Duties owed and resources

The Romanian territories found themselves under single rule for a brief period in 1600, under Michael the Brave.²⁴ Under his rule, the issue of finances became very important and informed the actions that led to unification. At a time when debt had reached a record level, Michael the Brave's decision to rebel against the Ottoman Empire "while risky, . . . was nevertheless reasonable from an economic point of view" (Murgescu 1996: 251). Michael duly leveraged his military position of fighting against the Ottomans to ensure financial support from Western powers. Historical records contain evidence of this in his correspondence (in Latin) with such Hungarian intermediaries of Emperor Rudolf II as Nicholas Puffy and Bartholomeus Pezzen (Murgescu 2012: 46).

There was a marked increase in fiscal burdens in the sixteenth century (see Table 10.2): "relatively limited in Transylvania, considerable in Moldavia, and extreme in Wallachia . . . the comparison to other [European] states shows unequivocally the exceptional nature of this increase before 1594" (Murgescu 2010: 39). This benefited the people of Transylvania as much as it did its rulers, because the system here was much more effective in extracting its due share. Also, rulers in Transylvania never had a sense of autonomy—being previously annexed by the Kingdom of Hungary—as the rulers of the Principalities constantly strived for.

If we account only for per capita monetary duties, we would find Wallachia on a level with the Venetian state. Nevertheless, we can see that a heavier fiscal burden was felt in Wallachia if we look at in-kind taxation: 134 kilos of wheat per capita. Bearing a similarly large agricultural capacity, Transylvania was only taxed 40 kilos of wheat per capita (Table 10.3). Overall, Transylvanian duties, both monetary and in-kind, were in line with those within the Ottoman Empire.

In comparison to the other Romanian territories, Transylvania benefited in several unique ways. Firstly, the province possessed significant resources of precious metals, and *aspri* silver coins were produced in large quantities here throughout the sixteenth century. Secondly, it benefited from an increasingly advantageous exchange rate over the years. Transylvania predominantly used coins of Hungarian circulation (e.g. florins), as opposed to the Ottoman dinar that was experiencing faster depreciation. Thirdly, fiscal collections in Transylvania had less to do with diplomatic affairs. Rulers of the Romanian Principalities had the additional burden of the high value of bribe payments (*plocon* or *peşcheş*) to secure their rule and their borders. Transylvania was

Table 10.3. Comparative fiscal duties in the sixteenth century

State	Duties owed in gold coins per capita	Duties owed in kg of wheat per capita
Poland (1580)	0.14	10
Egypt (1596)	0.15	–
England (1600)	0.25	21.5
India (1600)	0.34	86
Transylvania (1590)	0.4	40
Ottoman Empire (1581–3)	0.5	60
Moldavia (1590)	1	67
Venice (1600)	2	50
Wallachia (1590)	2	134
Low Countries (1650)	4.5	148

Source: Murgescu 1996: 286–8.

much more clearly placed under the protection of Hungary, with which it shared its fate in good and bad times. As such, fiscal collection here was mainly about funding administrative and military expenses, similar to the Western bureaucratic system.

The introduction of a bureaucratic system of tax collection only occurred in Romania as a whole after the eighteenth century. Even though “the system of collection remained ineffective, the revenues would be collected anyway by individual bureaucrats, who used the power of their office to extort the bribes that would keep them in a style regarded as commensurate with their social status” (Janos 1989: 341).

Essentially, the success of early bureaucratization in Transylvania was that it provided the authorities with a way to monitor tax payments. Much more advanced records of property and life events were not only possible because of the manner in which the administration worked, but also its own institutional survival over time. Ottomans did not intervene in Romanian territories’ domestic administrative affairs; this meant that they neither created (in the Romanian Principalities), nor destroyed (in Transylvania) the existing records. This meant that over the centuries ownership of private and public property became traceable.

Concluding Remarks

This chapter has illustrated in the case of Romania the importance of the mechanisms through which fiscal collection is exerted. The extent of their legitimacy and authority is sourced in important elements such as the (un) coupling of collection and redistribution functions, whether the collection of

taxes is done for the benefit of domestic or foreign entities and who is responsible for collection.

As this volume sets out to show, political culture and political institutions matter greatly in the taxpaying process. In the case of a functioning, trustworthy state, the leap of faith means that personal resources would be invested for the common interest; taxpayers at least believe it to be so. Throughout most of Romania's history, the leap of faith merely meant surrendering willingly personal resources. Without the administrative capacity to systematically monitor and enforce, let alone redistribute, paying taxes in this case study generally meant taking personal responsibility within your social group.

According to existing theories, fiscal compliance occurs when citizens believe: (1) that they will get something in return, and (2) that they will be punished if they do not comply. The case study of Romania illustrates what happens if these two conditions fail to coincide. Rulers paid because they acted under a contractual logic: they maintained their privileges and rights (i.e. they got something in return) as long as they paid, and they expected to be punished if they did not comply. In contrast, citizens were subjected to a much more discretionary collection mechanism with limited monitoring capacity. They paid their tax when they could not escape it, being pressured by recognizable figures of authority. Importantly, both the enforcement and redistribution functions were done through informal intermediaries, such as local noblemen or Church representatives.

I use this case study to argue that there is more to paying taxes than a simple logic of returns. As Marcelo Bergman points out: "tax evasion has cultural roots in social norms and institutional arrangements" (2009: 2). In the Romanian case study, neither social norms nor institutional arrangements worked in favor of systematically acquiring the taxpayer's consent in the fiscal collection process. There was a process of collection, but without consent. Within the context of the semi-periphery, where little beyond declarative support came from the Ottomans, paying their taxes was not a priority for the impoverished population. In contrast, social norms as well as institutional arrangements did apply some pressure in the fifteenth and early sixteenth centuries to the urban areas of Transylvania, where a nascent bureaucratic system provided benefits of predictability and rule enforcement for tradesmen and guild workers.

One of the key insights of this chapter is the historical role of localism. This is in contrast to the mainstream understanding of the process of state-building as a process of consolidation of formal administrative structures. Looking at the historical experience of Romanians with fiscal authorities, we see a fluency of rules and institutional actors. But, beyond these shifting structures, there is a constancy in the normative power in local communities, or small elite groups. Compliance in Romanian territories is a product of common

agreement, much like in more developed states, the difference being that the mechanisms of deliberation and benefit distribution remain hidden as informal channels.

The second departure of this chapter from mainstream Romanian studies literature was to treat all Romanian territories within the same comparative framework. Because of contextual (i.e. foreign influence) and institutional differences (i.e. administrative practices) scholars tend to analyze them separately. Romanian territories present themselves as a sort of natural experiment, with different administrative and fiscal systems during pre-modern times. A variation we can observe is that the predictability of the bureaucratic administrative system in Transylvania does seem to have created a certain civility in citizens' interactions with the state. In contrast, Romanian Principalities have gone through a consolidation of patrimonial practices and opportunistic self-interest maximization. As various studies on fiscal compliance suggest, the extent to which Romanians perceive the collection process to be beneficial to them makes a difference. For a state to be able to create this perception, it must be able to respond to the wants and needs of the tax-paying population.

There are several avenues through which the present analysis can be strengthened or expanded. On the one hand, as this volume proves, there is much to be learned from comparative historical analysis. While the Romanian case study bears great similarities with Italy, it differs significantly from Sweden or England. Both single cases and comparative studies that investigate further the long-term effects of the coupling of regulations with practices would be informative. On the other hand, Romania shares many contemporary behavioral patterns with other periphery countries, thus a wider historical comparative analysis on informal mechanisms of distribution and enforcement in developing countries could be revealing.²⁵

Notes

1. [A fost un răstimp în care de mirare este cum n-a ajuns acest popor la stingere totală. Stăteau asupra lui stolurile prădalnice ale birarilor și dăbilarilor.]
2. Based on the author's interviews with public affairs specialist, Adelina Țanțariu, and on the analysis of fiscal collection data series at www.dpfbfbl.mdrap.ro/analize_bugete.html.
3. See "Willing to Pay?" dataset, <http://willingtopay.eu/>; and the World Values Survey datasets, www.worldvaluessurvey.org/WVSCContents.jsp.
4. I refer to Bogdan Murgescu's modified measure of urbanization, to include smaller towns (i.e. over 2,000 inhabitants) and not only larger agglomerations (i.e. those of over 5,000 or 10,000 inhabitants) (Van Zanden 2005).

5. While the regulation of their status varied over time, especially in terms of duties owed and the ruler appointment system, they can be characterized as a quasi-colony, as they were a conventional part of the Ottoman Empire.
6. In the aftermath of the Crimean War (involving foreign powers that were heavily influencing the Romanian state at that time—the Russians and the Ottomans), Romanians found an innovative way to unite the territories of Moldavia and Wallachia by electing the same leader, Alexandru Ioan Cuza, at the same time in both Principalities, thus creating from a political perspective the modern state of Romania.
7. *Pravalniceasca Condiță* by Alexandru Ipsilanti, 1780, Wallachia; *Legiurea Caragea*, 1818, Wallachia; *Callimachi Code*, 1817, Moldavia.
8. 1831 in Wallachia, and 1832 in Moldavia.
9. *Regulamentul Organic: Partea Politică și Administrativă* [Organic Statute: Political and Administrative Section], 99. www.digibuc.ro.
10. www.digibuc.ro.
11. *Proclamația de la Padeș* by Tudor Vladimirescu, 1821; *Proclamația de la Islaz* by the Revolutionary Government, 1848.
12. Tax exemptions were made for those engaged in military service or those who could not afford to pay (e.g. women, children, serfs).
13. Ruling decisions of Constantin Brâncoveanu from Sâmbăta de Sus Monastery.
14. Denominated Phanar Lords—derived from Phanar, which was the name of the area in Istanbul where the Constantinople Patriarchate resided, along with a concentration of the Greek population from the capital.
15. *Condica vistieriei Țării Românești din periaoda lui Constantin Brâncoveanu*.
16. Based on Bogdan Murgescu's historical analysis (Murgescu 2012: 119).
17. Numerous contemporary fictional accounts portray this shifting dynamic of power in favor of these foreign rulers.
18. Calculations made by Dragoș Ungureanu from the National Patrimony Institute.
19. *Certa puncta* (1769) reproduced by Augustin Bunea, Episcopii Petru Pavel Aron și Dionisiu Novacovici, sau istoria românilor transilvăneni de la 1751 până la 1764, Blaj, 1902, pp. 404–12, in Murgescu (2001: 118).
20. *Certa Puncta* (1769) (Rules on the reports between noblemen and peasantry in Transylvania).
21. Ruling decisions of Constantin Brâncoveanu from Sâmbăta de Sus Monastery.
22. Hungarian rule spans 1866 to 1918, but this section also looks at the period when the Austrian Empire exerted authority over Transylvania (including Banat and Bukovina provinces). Transylvania became Romanian territory in 1918, at the Great Unification (*Marea Unire*).
23. A seventeenth-century bridge in Oradea was under the guarantee of the Austrian constructor until recently.
24. He was a wealthy nobleman himself, holding high offices (e.g. Ban of Craiova, a position similar to that of a treasurer), and possessed a vast personal fortune, acquired especially through land purchases (Murgescu 2012: 45; see also P. P. Panaitescu 2002).
25. I am grateful for the key insights provided by Cornel Ban, Dan Brett, Bogdan Murgescu, Marina Nistotskaya, Viorel Panaite, Andreas Stamate, and Vladimir

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Willing to Pay? The Politics of Engendering Faith in the Post-Communist Romanian Tax System

Arpad Todor

Despite the fact that Romania has constantly had one of the worst performing tax systems, with the highest levels of tax evasion among EU countries, a recent experimental study on tax compliance found that Romanian subjects are significantly less likely to cheat than Italian and UK subjects in similar experiments.¹ This high tax morale² is furthermore backed by opinion poll data showing that Romanians tend to believe tax avoidance is not excusable. To explain the puzzling gap between the willingness to pay and the constant underperformance of the tax system, I investigate the process of the post-Communist creation of a new extensive and comprehensive tax system and its failure to motivate its subjects to pay their taxes. As the most recent democracy, with the newest tax system, least influenced by path dependencies, the Romanian case allows us to investigate easily the explanatory power of various competing theories of tax compliance looking at the weight of competing causal factors within the same condensed time frame. This case study furthermore allows us to gain an insight into how to improve tax compliance in developing countries in the contemporary world.

I argue that the structure of incentives created both for those paying mainly personal income taxes (PIT) and for firms paying corporate income taxes (CIT) makes it rational to avoid paying them. The high instability and low quality of the legal framework in combination with the absence of political debate on fiscal issues; the high level of taxation combined with widespread tax evasion, high tolerance for state budget debt and generous tax breaks for large firms; and low spending on infrastructure and other public services, have signaled constantly that the tax system is not governed by any significant mechanisms

generating reciprocity and laying down the base for a fair fiscal contract. Furthermore, dismal social expenditure (except in pensions, an area with a broken connection between contribution and benefits) creates the impression that average citizens do not receive much from the state in exchange for paying their taxes. Overall, given the constant failure to create an adequate legitimacy for the tax system, the capacity to directly tax citizens and companies has slowly decreased in recent years, in parallel with an increasing reliance on indirect taxes.

To substantiate my argument I analyze historical evolutions and examine the current trends. First, I elaborate the puzzle motivating this investigation and briefly present the main theoretical approaches on tax compliance that inform my inquiry. Second, I discuss several features of the Communist tax systems and the influence of those features on the initial choices and subsequent developments of the new tax system. Third, I analyze the most important characteristics of the post-Communist Romanian tax system that shaped its capacity to generate tax revenues. Fourth, I evaluate some characteristics of the structure of state expenditure, focusing on the absence of significant welfare policies and the consequences for inequality. To conclude, I discuss the implications of my analysis on the volume's aim to untangle the mechanism through which states have developed comprehensive tax systems and motivated their citizens to comply with their tax obligations.

The Puzzle

By all metrics, Romania has experienced significant changes in the last quarter of a century since the fall of the Communist regime, transitioning to a market economy and achieving measurable improvements in many areas of institutional quality, and quality of the political process. All these evolutions allowed it to join the European Union in 2007 and experience high rates of economic growth after the first decade of transition. Yet Romania is a constant laggard in the area of taxation compared to other post-Communist countries that joined the EU. Today, Romania still has the lowest tax revenue as a percentage of GDP in the EU,³ the highest levels of tax evasion, and one of the worst performing tax collection systems (PricewaterhouseCoopers 2014).

Nevertheless, a recent experimental study on the willingness of subjects to comply with their tax obligations under various incentive structures found that, on average, Romanian subjects were highly cooperative and less likely to cheat than participants in Italy and the UK. The results from the nine Romanian experimental rounds⁴ showed a compliance rate ranging from 70 percent to 82 percent, rates that are significantly above the Italian average, and especially above the results from the three locations in the UK (Oxford, London,

and Exeter). Although the lowest compliance rate (70 percent) was obtained in round six of the nine, where a 50 percent income tax was applied, this was still 20 percent above the Italian (51 percent) and the British (48 percent) rates. This gap is all the more intriguing since, unlike Italy and the UK, which have steep progressive tax systems, Romania has had a flat personal income tax since 2004 of 16 percent; thus, the 50 percent tax rate should have appeared extremely high for Romanian participants.

The relevance of the subjects' high compliance rate for the entire Romanian population is strongly backed by other experimental studies and opinion poll data. For example, in a study of full-time students from four countries (Romania, Austria, Russia, and Hungary),⁵ participants from Romania and Russia tended to identify low-trust scenarios as being more representative of the situation in their countries (Kogler et al. 2013: 172). When faced with a similar incentive structure, the students did not differ that much in their responses; however, differences were apparent when they were confronted with a scenario similar to that from their own country (Kogler et al. 2013: 176). Opinion polls tend to tell the same story. For example, in the 2005 Rural Eurobarometer (Fundatia pentru o Societate Deschisa 2005), 83.2 percent of respondents considered that paying taxes is very important. Also, the October 2007 Barometer of Public Opinion (Fundatia pentru o Societate Deschisa 2007), a country-level representative sample, revealed that 70 percent of the respondents believed that not paying their taxes, assuming that they could avoid them, is never justified, while only 10 percent considered that it is justified always or most of the time.⁶ Furthermore, a 2008 opinion poll (Fundatia pentru o Societate Deschisa 2008) showed that 80 percent of respondents believed that it is unacceptable for corporations not to declare revenue, while only 3 percent considered this partly or completely acceptable.⁷

These findings contrast with the observation that the Romanian tax system has the poorest performance among EU countries in terms of the tax gap and difficulty of paying taxes. In other words, although Romanians do not trust their country's institutions, living in a society with high levels of corruption and an inefficient tax system, they do believe that taxes should be paid and are willing to pay when presented with an ideal tax system.

The literature on the relationship between tax compliance, institutional quality, and trust can be divided into three main groups, based on their core mechanisms of generating compliance: state capacity, deterrence, and cultural-behavioral-based approaches. In her influential account, following Schumpeterian tradition, Levi (1989: 1) argues that "[the] history of state revenue production is the history of the evolution of the state." Her theory of the tax state is built around the notion of "quasi-voluntary compliance" (1989: 52-3), compliance dependent on the population's perception of the

number of non-cooperators. Centered on the state, but focusing on the relationship between taxation policies in the light of political structures that have shaped various political conflicts, Steinmo has developed an approach to understanding the differences between diverse tax systems. While multiple checks and balances in the US led to a fragmented tax system, the Swedish corporatist model led to a unitary, stable, and efficient tax system. British politics, on the other hand, dominated by strong parties, has led to an unstable tax system (Steinmo 1996). Steinmo argues that tax compliance can be seen as a “fiscal exchange” that manifests a positive correlation between the chance of winning from the common pot and citizens’ willingness to pay. In a similar analysis, focused on the post-Communist space, Easter (2002) has compared Russia and Poland in order to explain how various political constraints led to the structuring of the tax system. While in Russia the tax extraction system was the result of elite bargaining over taxing corporate profits, in Poland the extraction strategy is centered on taxing household incomes.

Parallel to the state-centered literature, starting with Allingham and Sadmo’s theory of tax compliance based on taxpayers as *utility maximizers*, various authors have analyzed deterrence mechanisms as a function of the chances of being detected, the size of fines, and the potential gains from tax avoidance. Most theoretical models based on deterrence imply that increasing fines and control intensity would lead to lower tax evasion and add elements such as the amount of information available to tax authorities, the formulation of penalties and responsibilities, audit probability, and non-compliance penalties (Luttmer and Singhal 2014). Building on this literature, a new generation of models focuses on the subjective nature of each individual’s assessment of the probability of being detected. While these theoretical models can be useful to understand some features of citizen–tax authority interaction, their explanatory power is rather low given that most tax systems in the world are not based on deterrence, and do not offer much guidance for tax authorities in their efforts to improve compliance (Luttmer and Singhal 2014).

The third strand of literature has developed around the concept of tax morale as an implicit psychological contract between the state and its citizens, where loyalty is very important while rewards and punishment can crowd out intrinsic motivations (Frey 1997; Frey and Feld 2002). For example, Kirchler (1999) discusses tax compliance as a social exchange between the state and citizens, while Porcano (1988) and Alm, McClelland, and Schulze (1992) emphasize that tax compliance could be improved if government accentuated tax compliance as a fiscal exchange. A different type of approach to tax compliance is developed by Bergman (2009), who argues that the level of tax compliance is a function of the “compliance equilibria” reached in different counties, equilibria that are highly dependent on deeply rooted social norms. Instead, other studies have employed games centered on the

public good to analyze what kind of variables influence tax evasion levels (Feld and Tyran 2002; Frey and Feld 2002; Scholz and Lubell 1988).

Focusing specifically on the Romanian case, Bădescu (2007), Rothstein (2004; 2005), and Uslaner and Bădescu (2004) advance different explanations for the link between generalized trust, people's incentive to pay taxes and the quality of governance. Rothstein (2004) writes that even in a low-trust society like Romania, the establishment of universal and impartial institutions that implement public policies aimed at reducing economic inequalities generates social capital of the type necessary to support economic development. Instead, Uslaner and Bădescu (2004: 35) argue that "When corruption is rampant, as in Romania, people become inured to it. They don't think worse of their fellow citizens, who must get by in any way they can in a system that seems rigged toward those at the top. People are disturbed by corruption in government, but they may feel powerless to do much about it." Thus, Uslaner and Bădescu stress that the causal link moves from economic equality to social trust. Also, while generalized trust does not lead to higher levels of personal tax compliance, it influences people's propensity to accept higher levels of PIT (Bădescu 2007: 319). Bădescu argues that trust, perception of state capacity, and tax compliance are linked through three causal mechanisms: (1) if there is a generalized perception that most people avoid paying taxes, it is rational to try the same strategy; (2) perceiving that the mechanism for spending taxes is inefficient and rigged by corruption stimulates noncompliance; (3) those who believe that poverty is caused by a lack of work and individual merit would be more prone to avoiding paying taxes (Bădescu 2007: 308).

All in all, the explanatory models advanced by different theoretical accounts of compliance focus on the same core variables, but give them different weights and put different emphases on the causal links among them. To understand what kind of theoretical model can offer more insight into the causes that lead to the puzzling data that motivates this inquiry, in the following sections I will investigate how the state, and the tax system in particular, relates to citizens. The historical narrative starts with the Communist period, when most developments that influenced the post-Communist period occurred.

Path Dependencies

Starting with August 23, 1944, when Romania switched sides in World War II and turned against Nazi Germany, the USSR's influence on Romania quickly increased and led to the installation of the Petru Groza cabinet in March 1945 and the fraudulent 1946 elections, culminating in the forced abdication of

the last monarch and the proclamation of the Popular Republic in December 1947. Under close supervision from Soviet advisers whose authority was enhanced by the presence of Soviet troops (Pop 2006), the economy was transformed into a socialist one, with the elimination of practically all private property and the collectivization of agriculture and tax extraction. The new approach to increasing tax compliance was detailed in Law no. 344 from December 1947, which introduced harsh penalties against tax evasion but also the option of paying previously avoided tax in order to escape prison sentences. For the first time, tax evasion was regarded as equivalent to state sabotage and was sanctioned by harsh punishments.

While various forms of small private economic activities survived, during the Communist period most economic actors were state-owned enterprises (SOEs) and the exact level of taxation of their profit was established through negotiations between the Ministry of Finance and the SOEs. Also, workers were mainly taxed through hidden payroll deductions, directly retained by the SOEs; thus employees were not even aware they were being taxed. As the Communist regime started to transform the economy and eliminate private economic actors, a new set of regulations was elaborated with Decree no. 202/1953 regarding the modification of the Penal Code. This law introduced a chapter on offences against the economic system, which defined tax evasion as sabotage. While this regulation was eliminated from the 1969 Penal Code, Law no. 18/1968 regarding the control of goods owned by natural persons who had obtained them illegally introduced the state's right to evaluate people's wealth and to compare it with their existing means of income (Virjan 2012: 7). According to this law, any unsubstantiated wealth was taxed at a rate of 80 percent.⁸ Given the substantial size of the shadow economy, especially in the agricultural sector, the discretionary ability of tax authorities to apply arbitrary formulas to evaluate income and expenditure, and the limited means available to appeal decisions in the courts, this law was occasionally used as a discretionary tool of repression. While no official data exists on how widespread the application of this regulation was, the law created such a climate of insecurity that the 1991 Constitution included a special formulation in Art. 44(8): "Legally acquired assets shall not be confiscated. Legality of acquisition shall be presumed."⁹ Basically, this constitutional provision limited the possibility of enacting laws that would require the obligation to prove the source of someone's wealth, a limitation that was confirmed by a 1996 decision of the Constitutional Court that declared unconstitutional the still unabolished 1968 law.

Another development, peculiar to Romania's final decade under Communist rule, is represented by the self-imposed austerity measures begun in 1982, following the 1973 oil crisis since which the balance of payments had deteriorated and foreign debt increased (Pop 2006: 16). According to Ban (2012),

Romania embarked upon a harsh austerity program that led to a collapse in living standards and the explosion of an informal economy. Following the 1982 debt crisis, the combination of Stalinist and nationalist views on development policies led the Ceaușescu regime to embark on a course of rapidly paying off all foreign debt and prioritizing industrialization. These policies led to a significant decrease in consumption, extensive food and other goods shortages, and led to an exhaustion of the regime's sources of legitimacy. Furthermore, to justify the decrease in the availability of goods (Ben-Ner and Montias 1991), the Communist regime imposed a *program of rational nutrition* that set a strict basic food quota for each person. Combined with a chronic undersupply of official groceries and severe limitations on imported food, all the conditions for the development of a parallel system of food production and distribution developed. Thus, a large part of the population was using that alternative system, a factor that implicitly meant that they participated in tax evasion activities and were liable to harsh punishments, a situation that significantly affected their institutional trust in the decades to come. Within this context, the percentage of goods acquired through the shadow economy has significantly increased and the process that indirectly affected Romanians' propensity to pay taxes during the Communist regime has developed as a coping mechanism for the inefficiency and scarcities of official production and poor distribution of goods, especially food.

The Communist legacy was responsible for equally deleterious outcomes in the area of business taxation. Despite their limited development, non-state-run enterprises have been subject to detailed tax regulation since 1968, when Decree no. 65 introduced a steep taxation system with rates from 10 percent to 45 percent (Rotaru 2009). Subsequently, Romania increased the progressivity of its taxation policy in this sector, introducing tax rates of up to 77 percent, a change that generated only insignificant revenues as the state's interest in controlling these businesses was limited. Also, given the high integration of production streams (Pasti 2006: 358) the socialist system had separated the organization of production from cash flow as trade among firms took place through planning allocations and not profit- or efficiency-based mechanisms (Pop 2006: 18). All in all, these legacies would prove to have long-lasting effects during the transition period from communism to a free market economy.

The Unfinished Post-Communist Fiscal Contract

Given the significant differences between the logic of a tax system designed for a centralized as opposed to a market-based economy, the post-Communist authorities faced significant dilemmas regarding the transition toward a new

tax system. Also, the initial choices were made under conditions of economic downturn and rapidly decreasing state revenues, as well as limited access to capital markets (Ban and Tamames 2015). Given that the price system had been bureaucratically determined, the process of price liberalization inflicted significant economic pain, with a hugely inefficient and energy-intensive industry (Pop 2006: 16) in need of significant restructuring. As hard budgetary constraints started to affect big SOEs, they started to proactively avoid paying taxes. By the end of 1991, the state abandoned its coordinating functions in the economy (Pasti 2006: 356) and the effects of price liberalization and firms' restructuring led to protests and a period of high mobilization by the unions (Pop 2006: 22). The initial reforms adopted under pressure from the IMF led to a deleterious recession, contraction of credit, increasing inter-company arrears, and the collapse of purchasing power (Ban and Tamames 2015: 77).

Furthermore, the absence of an indirect taxation system and a widespread lack of trust in most state institutions (with the exception of the army) made it difficult to rapidly create and implement new fiscal rules and institutions. Thus, in practice the new government had chosen to enact a CIT system that borrowed many of the features of the Communist system for taxing independent activities. The first tax reforms began in early 1991 with the introduction of a CIT based on a sixty-seven-step scale starting at 5 percent (for income between 25,001 RON and 50,000 RON) and rising to 77 percent (for income above 955 million RON), a tax rate among the highest in the world. Meanwhile, foreign investors were given special status and corporations with full foreign ownership paid no taxes for the first two years after they started to earn profit from their investments. Subsequently, the Ministry of Finance could further offer them a 50 percent cut on their CIT. The mixed ownership corporations were granted a permanent 50 percent CIT cut. It is worth mentioning that at that time Romania had basically no Foreign Direct Investments (FDI)¹⁰ and that while these tax facilities did not trigger any relevant FDI influx, they were used as a means of tax evasion and by immigrants from Middle Eastern countries to open various import–export businesses. Also, Law no. 82 from 1991 (*Accounting law*) criminalized the entering of false data in companies' books, an offence punishable with imprisonment from six months to five years. Nevertheless, in practice, the chance that small mistakes would occur was very high, an aspect that generated significant discretionary power for the tax authorities and high incentives for tax evasion. Basically, the widespread norm was that all companies were given small fines and made bribery payments to the tax inspectors.

The initial tax system was so poorly designed that by the end of 1991, with a direct contribution from the World Bank, the progressive taxation of the CIT was scrapped and a system with just two levels was introduced. This changed again in 1995 to a unique 38 percent rate.¹¹ The first comprehensive

regulation concerning tax evasion was enacted through Government Ordinance no. 17 of August 1993, defining the contraventions for breach of financial and fiscal regulation. Subsequently, according to Law 87 from 1994, tax evasion was defined as any avoidance of paying taxes to any of the state budgets or funds by natural or legal Romanian or foreign persons (Virjan 2012: 3). The limited success of the tax system in adapting to new economic conditions is reflected not only in the decrease of tax/GDP revenues from 34 percent to 28 percent by 1995, a percentage that remained constant until 2015, but also a decreased tax effort (Mertens 2003: 548), a situation further aggravated by various tax exemptions and tax breaks that perpetuated *soft budget constraints* until EU accession (Daianu, Kallai, and Lungu 2012: 164). Two important milestones that switched the approach toward a more coherent and predictable tax system came in 2005 with Law no. 241/2005 and Cabinet Decree no. 873 of July 28, 2005. They modified the fiscal regulation with new measures for fighting tax evasion in the areas of alcohol and oil taxation (Daianu, Kallai, and Lungu 2012: 8). The most important institutional consolidation was enacted in 2004 when the National Agency for Fiscal Administration (NAFA) unified the previously fragmented fiscal duties. While the 2014 Report by the Accounting Court shows some noticeable improvement in the NAFA's functioning, a systemic improvement of the tax system is still to be felt. Furthermore, despite the fact that one of the main aims in creating the NAFA was to reduce the widespread corruption among tax authorities, by 2016 four of the five former NAFA general directors had been prosecuted for corruption by the anti-corruption agency.

Even within the context of a region with high tax instability, the Romanian tax system stands out. The initial choices created a locked-in effect that made the Romanian tax system one of the worst in the region, a situation further aggravated by the high level of corruption (Transparency International n.d.). While the Ministry of Finance constantly attempted to clarify the tax code system with the aim of increasing the state's collection capacity, a lack of adequate foresight led to continuous modifications and very low predictability of revenue collection. More than a thousand modifications of the legislation were introduced over a period of twenty-five years, with countless situations where a new modification of the tax code in parliament was further modified by a government Emergency Ordinance just days after it came into force. For example, the 2003 Fiscal Code was modified one hundred times between 2004 and 2013, the number of words tripled to 190,000, and only twenty-five Articles out of the initial 298 remained unchanged (Medrega 2013).

It is no wonder that in 2015 the Romanian tax system still exhibited one of the worst performances: in the Ease of Paying Taxes measure, Romania

ranked 134th out of the 170 countries evaluated, the worst in the EU (PricewaterhouseCoopers 2014). Despite the implementation of the flat tax in 2004, its worst ranking was in the number of different taxes to be paid by businesses annually (including the personal taxes on their employees' salaries), totaling ninety-six in all. Only recently did Romania achieve some perceptible progress in the area of compliance cost, according to World Bank data. Despite the still high number of payments (thirty-nine), the total time necessary to prepare, file, and pay taxes has decreased to 200 hours and come closer to the EU average of 166 hours, better than Italy at 269 hours.

As in other countries, the complex and dysfunctional Romanian tax system goes hand in hand with a low enforcement capability. Although taxation levels reach 43.2 percent, above the EU average of 41 percent (Olescu 2015), due primarily to high social security contributions (SSC) and value added tax (VAT) rates, fiscal evasion for 2013 was estimated at 16.2 percent of GDP, 75 percent (12.21 percent of GDP) related to VAT¹² and 15 percent stemming from unpaid social insurance contributions from workers without an employment contract or paid partially outside a legal contract.¹³ Overall, Romania has the worst VAT collection capacity, with only 56 percent of the income extracted (compared to 83 percent in Estonia or 71 percent in the Czech Republic), and the lowest social insurance contribution collection capacity, reaching only 72 percent, among the worst in the EU (Consiliul Fiscal 2014). A 2015 Report by the Court of Accounts (Bratu 2016; Curtea de Conturi a Romaniei 2015) reveals a huge imbalance in tax compliance between labor and capital, showing that businesses accounted for 96.5 percent of *arrears*, with the top 2.7 percent of companies responsible for 75.7 percent of the outstanding amount. The report also underlines a limited interest by NAFA in cracking offshore tax evasion: firms identified with a high risk of tax evasion and transfer pricing are multinational corporations, a fact widely reflected in mass-media reports. Furthermore, the report also identifies significant shortcomings in terms of procedural equity, with multiple cases in which entities operating under similar conditions receive different treatment. Thus, unlike the older EU member states, where the distribution of income from direct and indirect taxes is balanced, tax revenues in Romania are skewed toward indirect taxes such as VAT and excise duties. For example, revenues from PIT decreased from 5.3 percent of GDP in 1995 to just 2.7 percent in 2002, and then hovered around 3.3 percent, while revenues from CIT decreased from 5.3 percent of GDP to a low of 2.3 percent in 2005, and then recovered to 3.3 percent of GDP. On the other hand, despite high tax evasion, indirect taxes (VAT and excise duties) increased their share of total tax revenue from 33.7 percent in 1997 to 45.2 percent by 2010 and have remained constant since, above the

average of other post-Communist countries (42.3 percent) or the old EU member states (36.2 percent).¹⁴

All in all, despite significant evolution since the fall of the Communist regime in 1989, Romania still ranks bottom, alongside Bulgaria, in almost all relevant indicators of institutional capacity to collect revenues. With an average tax revenue as a percentage of GDP of only 28 percent between 1995 and 2012, Romania is 11 percent under the EU average (Pana 2016b). By comparison, other post-Communist countries are performing significantly better in this dimension: Hungary's tax revenue as a percentage of GDP is 38.6, Slovenia's 37.6, the Czech Republic's 35.3, and Poland's 31.8.

Unlike in consolidated democracies, despite the continuing malfunction of the tax system, as well as the widespread frustration it causes, tax reforms have rarely been the subject of intense political debate or confrontation (Steinmo 1996), regardless of the political coalition in power. The constant modifications of the tax code legal statute were mostly needed to correct various mistakes, clarify incoherencies, or close widely used loopholes. Also, political parties have made no attempt to detail their proposals for tax reforms in their electoral programs beyond generalities; government programs have contained just general aims, such as reducing tax evasion and increasing revenue targets, and have not detailed how to achieve these goals. It is no wonder that Romania was one of the countries where the neoliberal flat tax reform was put on the political agenda by the Ministry of Finance of the Social Democratic Party and gained the support of the prime minister. However, the party abandoned the reform due to opposition pressure from the Romanian president (who was also the ex-leader of the Social Democratic Party). Subsequently, the flat tax was proposed by the right-wing Truth and Justice Alliance as a major electoral theme and was later implemented through a government Emergency Ordinance, without any debate in parliament. The 2015 adoption of the new tax code offers another example of the lack of political debates around fiscal issues. The new law has been adopted twice in parliament through general political consensus, after the president sent it back with objections regarding the reliability of the revenue streams, given the planned tax cuts (especially the decrease of VAT from 24 percent to 19 percent). Despite the presence of parliamentary scrutiny (see Daunton, Chapter 6 in this volume), unlike Italy, Sweden, the UK or the US, where tax reforms involve significant debates and negotiations with a large number of societal actors (unions, business associations, the Church, think-tanks), Romania continues its historical trend of no political debates around taxation and its link with expenditure, especially the welfare state. In the following section I will discuss the link between the fiscal issue and the post-Communist development of the welfare state.

The Welfare State and Inequality

Although during the first decade of post-Communism transition Romania's economic policies were highly inconsistent, especially with the constant friction between internal actors and interest groups aligned with external institutions (Ban 2013; Pasti 2006), after the start of the EU-accession negotiations the Romanian development model became coherent and remained fairly stable under alternate governing coalitions. The move from uncoordinated capitalism (cocktail capitalism) toward a "dependent market economy" relied on multinational banks, FDI, and proactive policies to promote liberalization and the privatization of public utility companies. The move has also influenced the tax system and the functioning of the welfare system (Ban 2013). While this development model was associated with higher than average rates of economic growth (Ban 2013: 7), it also increased the shift of the tax burden toward labor and consumption and increased inequality. The post-2007 economic crisis further exacerbated this shift, as costs of the economic crisis have been transferred away from capital, a change reflected by the fact that the national net income received by wage earners decreased from 48 percent to just 40 percent by 2013, while the average is 65 percent in the US and 60 percent in France (Georgescu 2015).

A direct effect of its low budgetary revenues is the fact that Romania also has one of the lowest rates of public investment and the worst infrastructure in the EU. Furthermore, the efficiency of those expenditures is rather low given the high levels of corruption, especially in public procurement (Consiliul Fiscal 2014: 16). Even though Romania became a member of the European Union in 2007, its socio-economic development lags behind the EU average in almost all areas with no indication that it is catching up. Like some other post-Communist countries, Romania is facing demographic pressures, especially a declining population, high emigration, and a pensioners-to-employees ratio that is worse than in many developed EU member countries and is forecast to dramatically worsen in future decades (Expert Forum 2012).

Like many other Communist countries, Romania started with a low level of economic inequality. During the transition to post-Communism, the Gini coefficient steadily increased, given both the move to capitalism and the limited effect of transfer policies. According to World Bank data, the Gini coefficient increased from 23.3 in 1989 to 31.8 in 1998, ranging between 29.5 and 30.46 by 2006, and increased above 35 in 2008.¹⁵ An analysis of the impact of flat-tax reform on inequality reveals that, as expected, most of the gains from the PIT flattening went to the top 20 percent of income earners, stimulated consumption only within this group, and led to a perceptible increase in overall income inequality in Romania (Voinea and Mihaescu 2009). Thus, while EU accession led to a decrease in inequality, post-2008

financial crisis economic growth was unequally distributed and led to an increase in the Gini coefficient from 33.4 in 2010 to 34.7 in 2014 (Pana 2016a). It is worth mentioning that the Romanian state's social policies have been totally ineffective in limiting this increasing inequality. On the other hand, the massive emigration of three million people (15 percent of the total population) after EU accession (emigration that significantly increased remittances, especially in rural regions), had a positive effect on revenues in many of Romania's poorest regions. Nevertheless, despite this huge emigration, Romania continues to rank the worst of all EU countries in terms of inequality and risk of poverty.¹⁶

As Romania has the lowest tax revenue and GDP in the EU, social protection and education expenditure rank last in the EU. Nevertheless, the total cost of pensions is in third place as part of total public expenditure (Pana 2016b). Overall, "data from Eurostat reflects an increase of spending on social protection benefits from 378.7 Euro/inhabitant in 2002 to 916.57 Euro/inhabitant in 2009 but despite the 2.4 times increase, it is still very far from the 7823.13 Euro/inhabitant, the average spending in the EU-15 (the old EU member states)" (Todor 2015: 81). One of the most important reasons or incentives for citizens to trust the state with their money is that they receive in return good public services or support for social cohesion through an adequate redistribution. Despite the fact that social services expenditure as a percentage of total expenditure has reached a high level in Romania, the area that consumes most resources is the pension system, while the amount of resources spent on other categories such as family and child benefits, or sickness and disability benefits is dismal.¹⁷ This situation was partially caused by the rapid increase in unemployment during the harsh economic adjustments of the 1990s, combined with the mass pension programs designed to alleviate unemployment. Also, through the implementation of special pension programs for those who have worked in the military, police, justice, or secret services, the link between social contributions and the level of pensions became highly distorted, significantly decreasing taxpayers' incentive to report real wages. For example, the special pension system offers an average pension that is three times higher than the regular pension and generates ongoing public outrage.

In May 2010, "Romania enacted one of the most aggressive and regressive fiscal retrenchment programs" (Todor 2014: 39), justified by budgetary pressures triggered by the post-2007 economic crisis. Most importantly, Prime Minister Boc's Cabinet committed itself to the goal of cutting social security costs from 2.9 percent of GDP to 2 percent (the EU average is 5 percent), as mentioned in the *Social Assistance Reform Strategy*.¹⁸ Although these plans were never put into practice because of the results of subsequent elections, it is worth stressing that debates on the future of the welfare state or the link

between taxation and the welfare state were hardly relevant during the 2012 electoral battle. Blyth argues that the REBLL (the Baltic states, Bulgaria, and Romania) group's approach to austerity during the economic crisis under the supervision of the troika (the International Monetary Fund, the European Central Bank, and the European Commission) is unique, given that it was caused by their growth model based on foreign borrowing, high FDI inflows, and dependence on remittances—a model highly vulnerable to external shocks. The austerity measures contained mostly expenditure cuts and only regressive tax increases such as VAT and labor taxes, which led to a significant increase in the levels of tax evasion (Blyth 2013: 129). Even worse, today Romania has one of the highest percentages of working poor, as Eurostat data indicates (14.2 percent compared with the EU average of 5.5 percent or the new member states average of 7.1 percent), a situation that disproportionately affects young cohorts and is explained by the lack of indexing of most personal deductions within the context of PIT flattening (Pana 2015).

All in all, the limited Romanian welfare state is neither truly functional nor based on very clear and predictable rules. Given the country's low taxation capacity, welfare consumes a high proportion of the state budget and is constantly used as a scapegoat for the significant underinvestment in infrastructure or areas such as education. In addition, because the current population decrease will further shrink the future benefits of regular employees, the system is perceived as highly unfair.

Conclusions

This chapter set out to investigate the process of creation of a new post-Communist Romanian tax system, the main characteristics of the efforts to create its rules and institutions, and how these evolutions affected the relationship of citizens with the tax system. The investigation started from the puzzling observation that Romania appears to exhibit two extremes: on the one hand, it has developed the worst tax system in the EU in terms of the quality of its functionality, the tax gap, and its general instability, and on the other hand Romanians appear to have high tax morale and are willing to pay when faced with ideal tax institutions.

To explain this puzzle, I have reviewed the main theoretical approaches on tax compliance and investigated the historical processes that have led to the current situation of the tax system. This investigation allowed me to explain what constellation of various explanatory variables accounts for the gap between observed and manifested tax compliance. Far from being simple, the observed gap is caused by a complex set of factors, most of them related to low institutional quality. Romania's tax system is neither stable nor

efficient, but is burdensome, inefficient, and undermines its own legitimacy as it allows people in powerful and influential positions to easily avoid paying taxes. Romanians do not live, yet, in a well-functioning society and do not, rationally, trust government-run institutions to any degree. Despite the fact that most Romanians do not consider that they receive adequate services and welfare protection for their taxes, they appear to be willing to pay, believe that everyone should pay, and see the fight against corruption as the main aim in trying to improve the current situation. The historical analysis showed that some constants of the structure of incentives created for both those paying mainly PIT and firms paying CIT made it rational to avoid paying taxes. Not only has the legal framework regulating taxation been highly unstable and unpredictable throughout the entire post-Communist period, but these hundreds of smaller or bigger adjustments have not been the subject of significant political debate and negotiation among relevant social actors. The combination of high numbers of taxes, high levels of taxation, significant tax evasion, and corruption, which have led to low spending on infrastructure, public services, and social expenditure, limits the chances of creating an adequate legitimacy for the tax system and the underlying social contract supporting it (see also Volintiru, Chapter 10 in this volume, on the long-term explanations for this situation). All this has led to an increased resistance to direct taxation and increasing reliance on regressive indirect taxes. Nevertheless, it is worth stressing that data reveals that tax avoidance is not widespread in terms of the percentage of the population that participates in paying it. In fact, data reveals that most tax avoidance (CIT and VAT) happens in the corporate sector. Thus, unlike Italy where tax avoidance can be explained along a North-South divide (see D'Attoma, Chapter 5 in this volume) or religious differences (see Hien, Chapter 4 in this volume), these dimensions appear to be irrelevant in Romania. Also, while Volintiru's analysis reveals that the historical legacy significantly differs from successful countries such as Sweden (see Nistotskaya and D'Arcy, Chapter 2 in this volume) or the UK (see Daunton, Chapter 6 in this volume), this chapter shows that almost all relevant causality can be traced to post-Communist Romanian history.

The divergent combination of high tax morale and widespread tax evasion implies that ameliorating tax compliance cannot be undertaken significantly through deterrence mechanisms since strong punishment in less than perfect institutional settings easily transforms into discretionary power that encourages corruption. Both in the Communist and post-Communist period, legal provisions offered tax authorities significant leverage in order to impose harsh punishment on those that evaded taxes. Nevertheless, no data indicates that these mechanisms have been efficient, as the results actually prove the contrary.

This analysis shows that even in the presence of significant tax free-riders, quasi-compliance does not necessarily crowd out compliance if the instruments used to tax different parts of the population differ significantly. Also, the quasi-compliance explanation does not take into consideration the fact that people might crave a change in the quality of institutional operation. These findings also argue against trust-based explanations. By analyzing various opinion polls collected throughout the last two decades, Bădescu (2007) concludes that for the average Romanian, the most important ability of the state is to fight corruption—that is, fight with direct results on limiting the big tax evaders. Another finding reported by Bădescu (2007) using a 2004 survey is that most Romanians favor limited state taxes as a percentage of GDP, especially given the high level of perceived corruption. Bădescu (2007: 312) writes that opinion poll data reveals that many Romanians cannot correctly evaluate the link between the structure of taxation and its impact on inequality. Data consistently shows that Romanians do not have faith in tax authorities in particular and state institutions in general to spend their taxes wisely. Nevertheless, the historical analysis shows that rationally speaking, Romanians do not have many reasons to trust the state in how it fairly collects and spends their taxes, and they are right in their evaluation that those with money are less likely to pay their share of taxes. While Romania is both a low-trust society with comparatively low institutional quality, identifying public policy solutions to exit such social traps (Rothstein 2005) requires an in-depth understanding of causal links among relevant variables, as well as how they can be altered through various government policies. Before anything else, inadequate trust of poorly functioning and corrupt institutions eliminates any relevant triggers and incentives for improvement.

These findings strongly support the conclusion that Romanians might exhibit highly cooperative behavior under ideal institutions, but they experience low tax morale given their perceptions of existing tax institutions and how they operate—these are not contradictory positions. Yes, Romanians are willing to pay if they face transparent and fully functional institutions, but when they recognize a low-trust, low-compliance scenario they defect (Frey and Torgler 2007: 136; Kogler et al. 2013: 176). This brief review of some of the most important historical evolutions shows that based on historical events, rational citizens should manifest a low level of tax compliance given that taxes have been usually used inefficiently. Accordingly, reforms that would increase the fairness of taxation, especially the fight against high-level corruption, directly linked with high-level tax evasion, could generate a virtuous circle that could change the way people relate to institutions, even in the absence of an increased level of interpersonal trust.¹⁹

Notes

1. Research conducted within the “Willing to Pay? Testing Institutional Theory with Experiments” ERC Grant agreement no. 295675, coordinated by Prof. Sven Steinmo. I gratefully acknowledge the assistance of Alexandra Diaconescu, Dinu Guțu, Andrada Nimu, Daniela Panica, Sebastian Țoc, and Andrei Vlăducu in organizing the experiments in Bucharest at the National School for Political Science and Public Administration.
2. Tax morale is defined as the intrinsic motivation to pay taxes in Torgler (2003).
3. Tax revenue as a percentage of GDP decreased from 34 percent in 1992 to 28 percent in 1997 and remained constant until 2015. Daianu, Kallai, and Lungu (2012: 164). Eurostat website (2017) Table: Total tax revenue by country, 1995–2016 (% of GDP). Available at: [http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Total_tax_revenue_by_country,_1995-2016_\(%25_of_GDP\).png](http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Total_tax_revenue_by_country,_1995-2016_(%25_of_GDP).png).
4. The experiments were organized in nine rounds in Bucharest in May 2014 and involved a total of 135 subjects. Participants were selected randomly from an electronic database created for the purposes of that experiment. While most people in the pool were undergraduate students from the National School for Political Science and Public Administration, around 35 percent were recruited following the dissemination of posters in downtown Bucharest.
5. The study involved 1,319 students: 95 percent in Economics or Business Administration, “from the University of Vienna in Austria, the University of Debrecen in Hungary, the Babes-Bolyai University in Cluj-Napoca, Romania, and the National Research University and the Academy of National Economy in Moscow, Russia. 329 students participated in Austria (57.8% female; mean age 22.0, SD = 3.4), 280 students in Hungary (68.6% female; mean age 21.1, SD = 2.1), 400 students were recruited in Romania (62.5% female; mean age = 21.7, SD = 1.4), and 341 students participated in Russia (52.8% female; mean age = 18.82, SD = 1.9)” (Kogler et al. 2013: 172).
6. On a scale of (1)–(10), where 1 = never justified and 10 = always justified, 53.1% answered that avoiding taxes is never justified (1), 10% answered (2), and 8.4% answered (3); while 3% chose (8), 2.2% chose (9), and 7.6% answered (10) = always justified.
7. On a scale of (1)–(10) where 1 = completely unacceptable and 10 = totally acceptable, 59.2% answered (1), 13.4% answered (2), and 7.4% answered (3); whereas 0.8% chose (8), 2.6% chose (9), and 2.6% chose (10) = totally acceptable.
8. Article 2 provided: “The value of assets whose origin is not substantiated is subject to an 80 percent tax. Substantiating the origin of assets means the obligation of the person to prove the licit character of means used for acquiring or increasing the assets.” See <https://cristidanilet.wordpress.com/2011/06/23/opinie-despre-prezumtia-liceitatiidobandirii-averii/>.
9. www.cdep.ro/pls/dic/site.page?den=act2_2&par1=2#t2c2s0sba44: “(8) Avere a dobândită licit nu poate fi confiscată. Caracterul licit al dobândirii se prezumă.”
10. FDI reached \$5 per capita in 1992 and \$9 per capita in 1993 according to IMF data. Romania ranked last throughout the entire post-Communist period in terms of FDI per capita among the ten new post-Communist EU member states.

11. The next major development came in 2000 when the CIT was cut to 25 percent and the tax on profits from exports decreased to 5 percent (Șfetcu 2013).
12. The low VAT collection capacity is a constant of the entire post-Communist period. Romania ranked bottom in its capacity to collect VAT, and by 2014 the VAT evasion rate reached 44 percent.
13. Estimated at 1.57 million people—27.7 percent of the total active labor force (Consiliul Fiscal 2014: 18).
14. Eurostat (2015): Indirect Taxes as % of Total Taxation—Total.
15. See <http://data.worldbank.org/indicator/SI.POV.GINI?locations=RO>.
16. Eurostat data indicate that around 22.5 percent of the population is still at risk of poverty after social transfers. See Table 1: “At-risk-of-poverty rate after social transfers, 2011–13” at http://ec.europa.eu/eurostat/statistics-explained/index.php/Income_distribution_statistics#Database.
17. Although pensions are labeled as social expenditures in Romania, the general perception of the pension is that it is a right earned by paying social contributions during the years when a person is active in the labor market. A 2010 decision by the Romanian Constitutional Court declared pensions a *patrimonial right*, and implicitly excluded them from the sphere of social expenditures (www.ccr.ro/files/products/D0871_10.pdf).
18. Strategia privind reforma în domeniul asistenței sociale 2011–13 [National Strategy for reform in social services]: www.mmuncii.ro/pub/img/site/files/58bd6ffc9844fbc4a8a639672450872b.pdf.
19. I am grateful to Cornel Ban and Bo Rothstein for their insightful comments on the initial draft of this chapter, and to Alexandru Mustață, who helped me with the editing of the text.

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Part VII

Conclusion

12

Taxation and Consent

Implications for Developing Nations

Marcelo Bergman and Sven H. Steinmo

So What?

We conclude this volume with a simple and blunt question: So what?¹ Perhaps the historical narratives in this book are fun to read and interesting for historians, but do they matter? In other words, do these “stories” have anything to teach us beyond the narratives themselves? This concluding chapter is devoted to answering this question. We argue that the analyses offered here are more than simply interesting stories about different countries and instead offer insights into how and why some countries have been better able to build positive relationships between citizens and their states than others. Though the substantive focus here has been on taxes and tax compliance, we further believe that these lessons have significant implications that go far beyond the study of fiscal policy.

Specifically, these analyses teach us important lessons about both citizens *and* states. Many models of development are built on classical economic theory that assumes an essentially hostile relationship between citizens and their states in which citizens and taxpayers are mostly driven by short-term self-interest and their desire to pay as little as possible. The analyses contained in this book demonstrate that this is not the right way to think about this relationship. It is clear that citizens can be intimidated into paying taxes. In societies that are more successful in collecting taxes, however, citizens and taxpayers willingly take a “leap of faith” and pay their taxes because of some sense of public good, common identity, and/or sense of equity. While it is clearly the case that short-term self-interest plays a role in citizens’ willingness

to pay, it is equally clear that citizens are also driven by social norms, a desire for fairness, a sense of belonging, and even their social values.

In recent years there has been a powerful narrative suggesting that markets are better than states and that a key problem in the modern world is that states have become too strong. In our view this is wrong. The analyses contained in this book suggest that the opposite may even be true. We see in several of the previous chapters that strong states can in fact elicit higher levels of *voluntary* compliance. Schneider, Buehn, and Montenegro (2010) estimate that the average of economic activity hidden from tax authorities in the developing world (where the weakest states are found) is 35.7 percent of GDP, while in OECD countries where most strong states are located, the hidden economy is 18.7 percent. It may seem counter-intuitive, but it apparently takes a strong state to deliver the kinds of goods and services that citizens are willing to pay for. Intimidating citizens into paying taxes can be done, but this is the behavior of a weak state. Moreover, heavy reliance on intimidation is an extraordinarily inefficient way of collecting revenue and is likely to generate very high levels of defection and evasion.

Citizens are more willing to take the “leap of faith” and comply with state authorities when the state is sufficiently capable of delivering goods and services that are worth paying for and sufficiently able to reinforce social norms of compliance. We will discuss the relationship between state capacity and social norms below, but the main point here is that a positive compliance equilibrium can be built only where states have high levels of information about their society and have coherent legal rules that are applied to the whole of society fairly.

The analyses in the preceding chapters have clearly shown that it is precisely those states that are strong that have managed to develop a two-way street with taxpayers and thereby move beyond the predator–victim relationship. The lessons from the five cases examined in this book allow us to disentangle the variables that have been shown to work and present a sequence model or phased paths that may lead to better compliance. It is this type of state strength that allows a culture of compliance to co-evolve with state capacity.²

This concluding chapter summarizes several aspects of tax compliance developed throughout this project, highlighting what has worked in tax compliance and what the lessons are for countries worldwide. Rather than recapitulating the narratives themselves, we look to use learned lessons to guide future debates as well as make scholars and practitioners from different latitudes aware of several topics that are not generally developed in the research. Thus, in the last section we offer our conclusions as to what we believe needs to be taken into consideration when countries want to reduce tax evasion and enhance compliance. We stress that in addition to smart taxes, adequate tax rates, and strong institutional capacities, governments should be thinking

how to elicit the “leap of faith” from the population. Only then will tax compliance be sustainable.

The chapter is divided into four major sections. The first highlights the importance of effective states and the emergence of stable institutions in compliance behavior. In the second section we draw from the historical narratives explored in this book and examine the foundation stones for building fiscal legitimacy. In other words, what kinds of general policy have successful states followed in contrast to those that have been much less successful in generating high levels of consent? The third section identifies the “lessons learned” from our studies and the routes taken to improve compliance behavior. Finally, we conclude with a series of policy implications drawn from our comparative narratives, other studies on taxation, as well as from our behavioral experiment research. Our aim here is to offer insights into the kinds of policy that seem to have worked in the more successful cases we have examined and not to make predictions about what exact policies any specific country should follow.

Strong States and Successful Societies

Margaret Levi’s classic, *On Rule and Revenue*, characterizes tax compliance as a relationship between predators and subjects. In this view, governments extract as much as they can get away with by providing services and/or through extortion. States will provide only as much as they have to in order to get the revenues they need and taxpayers will pay only as much as they have to in order to avoid punishment. This “fiscal exchange” can vary from country to country, to be sure, but the basic calculation is always the same. The state’s goal is to maximize revenue and the taxpayer’s goal is to pay as little as possible. In this view, the differences in tax systems around the world and the explanation for different rates of tax compliance are essentially a product of the different bargains that have been struck between adversaries.³

In this book we tell a different story. In our view, in the more *successful societies* people’s willingness to comply with tax authorities transcends the ability of rulers to extract resources from their citizens and has much to do with other variables such as culture, trust, fairness, and social cohesiveness. Formal institutions are important, but they are only part of the story.

Promoting positive social norms

As we have seen in the “Willing to Pay?” experiments, there are a number of motivations that affect individuals’ compliance decisions, just as there are a wide range of individuals in every country (see Andrighetto et al. 2016;

D'Attoma, Volintiru, and Steinmo 2017; Zhang et al. 2016; as well as the forthcoming volume *Willing to Pay?*). To be sure, even in countries such as Sweden some people still cheat the taxman (and maybe even steal from their neighbors), while in countries such as Romania or Italy many people abide by tax laws even when they know there are many others who do not. In all societies there are those who will act according to what they think is “right” (or fair, or just, or equitable, or even altruistic) even when a cost–benefit analysis should lead them in the opposite direction. Finally, a large share of people in any society will try to adjust their behavior to what they believe is expected within that society—the social norms (Bicchieri 2006; Conte and Andrighetto 2013; Elster 1989; Tetlock 2000; Traxler 2010).

This is where institutions become important. Institutions (both formal and informal) are rule systems. High compliance societies have more efficient and coherent institutions that signal and monitor desired behaviors or choices in clear and transparent ways. Low compliance societies have unstable and less efficacious institutions that neither give clear signals nor effectively monitor the behavior of their members. In a society in which violating social rules or laws is rarely punished, people will begin to defect. The more people who defect, the more others will mold their behavior in the same way and eventually defection itself may become the norm (Andrighetto et al. 2013). When a critical mass of defectors is built, it becomes extremely difficult to reverse this equilibrium (Bergman 2009).

This overlooked aspect of taxation has important implications for the enforcement capacities of states. A key reason that Italy cannot replicate the tax administration of Sweden today is because of the large number of self-employed individuals. The self-employed are harder to monitor and more likely to cheat on their taxes everywhere (Gerxhani and Scham 2006; Pisani 2014). Large numbers of small companies and self-employed individuals (who mostly work within a cash economy) make it exceptionally difficult to monitor effectively these millions of taxpayers. Consequentially, nearly everyone in Italy knows someone who under-reports their real income. For example, it is commonplace in Italy for medical doctors and dentists to offer their patients’ two prices: one price if you pay in cash and a higher one if you need a receipt. Eventually this behavior becomes “normal.”

Similar stories are found throughout Latin American countries, where personal income tax is largely evaded (Barreix, Benítez, and Pecho 2017; Ondetti 2015) as well as in Africa (Kedir 2014). On the other hand, Sweden can achieve high rates of compliance in part because for most people taxes are automatically reported and paid by employers. But compliance is also high in Sweden because Swedes themselves monitor for the state. Not only are all citizens’ tax reports available online, but also it is virtually unthinkable that a medical doctor, for example, would offer a patient different prices according to

whether they would like a receipt or not. In fact, Sweden is increasingly becoming a cashless economy. As a consequence, tax authorities need only identify a few tax evaders to maintain a positive equilibrium. Where monitoring is extensive and administration is consistent, norms are easily reinforced. Conversely, where many taxpayers can effectively hide income from the authorities and few are caught, evasion has become a socially acceptable norm—at least among large segments of society.

In sum, compliance co-evolves with efficient administration, effective institutions, and a society in which most people believe that everyone is paying their fair share. Even self-employed people can be encouraged to higher levels of compliance, but this requires states to firmly develop the necessary institutional foundations. Brute deterrence will ultimately get mediocre results. Strong states can generate high revenues at lower cost because their citizens are willing to cooperate and even monitor each other. This kind of relationship is not easy to develop, of course. As we have repeated often in this volume, “Getting to Sweden” is hard. But the key point here is that this relationship must be built upon socially cooperative foundations, not on threats and intimidation.

Building a sense of identity and/or purpose

Humans have a profound and natural motivation to belong (Axelrod 1986; Baumeister 2011; Elster 1989). In this book we have seen multiple cases where state actions have created a sense of belonging and/or helped facilitate a sense that the state and society have a common purpose. Where this happens, citizens are more willing to pay taxes.

Studies in tax compliance have very rarely explored the effect of social cohesion in taxation. Still, the apparent correlation between cohesive societies and levels of tax compliance should not be surprising. In the laboratory we have found that compliance is higher as the group gets smaller. In general one can say that smaller groups increase the level of interpersonal trust and thus the levels of contribution to the common good are higher. More broadly, it seems clear that societies capable of constructing a widely shared national narrative are more able to demand sacrifices from their citizens. Most obviously, in periods of war, national disasters, or external threats, people’s willingness to pay taxes increases.

Cohesiveness is of course a social construction. Cohesiveness is *not* the same thing as homogeneity. The United States, after all, has been since its inception a highly diverse country, with immigrants from all around the world, which enforced slavery until the middle of the nineteenth century. Still, as we saw in Carolyn C. Jones’s analysis (Chapter 9 in this volume), this country managed to manufacture a sense of identity and common purpose in the mid-twentieth century.

There are no a priori salient natural traits that make one country more cohesive than another. Social cohesiveness can stem from, for example, isolation, from sharing common goals, from shared beliefs and/or religion, from shared social mores, or from external threats. Smaller groups have a natural tendency to be more cohesive but it is not a prerequisite.⁴

In Latin America, the two countries with the highest compliance rates are Uruguay and Chile, which are among the most cohesive countries in the region, while Mexico and Brazil (despite having strong tax administrations) exhibit relatively high levels of non-compliance (CEPAL 2016). Central American countries with deep social divisions such as El Salvador and Guatemala collect very little tax revenue while Costa Rica and to some extent Panama have only moderate levels of tax evasion. Here too we see that Latin American countries where people feel they truly belong to a national narrative and common purpose enjoy better rates of tax compliance.

Political considerations also play a role in cohesiveness. Lieberman (2003) has shown that South Africa's elite racial coordination in the first half of the twentieth century allowed it to command great tax sacrifices from its members, whereas in Brazil elite regional fragmentation inhibited the emergence of an upper-class sense of purpose and common identity. As a result, whites in South Africa were able to raise significant tax revenues and compliance, while Brazil lagged significantly behind in that respect.

Building Fiscal Legitimacy

The famous Allegory of the Good and Bad Government painted by Lorenzetti located in the city councillors' room of Siena's fourteenth-century City Hall has been seen as a masterpiece of what constitutes good governance. One of the few texts included with the paintings clearly says that a governor can collect taxes and tributes because he has promoted justice and fairness.⁵ In this painting we see that even as far back as Middle Ages Italy, it was understood that it was the obligation of the state to promote the common good (*ben commune*) through fairness and justice.

In this section of our chapter we will explicitly explore how and why some cases turn toward what we will call "virtuous circles" while others appear stuck in "vicious cycles". First, successful states produce tangible goods. Second, they distribute those goods and raise revenues fairly. Fairness, as we shall see, can be a rather complex concept in which both procedural justice and equity matter. Third, in order for the state to be perceived as fair it must be able to monitor its citizens and enforce its laws. Under these conditions, and perhaps only these conditions, society itself may promote norms of cooperation and cohesion.

Good government, then, can produce a positive feedback loop that may allow the strong state to speak softly even while they may still carry a big stick.

Lennart Wittberg of the Swedish Tax Authority captures the dynamic in this way:

There are also indirect effects of trust that may have a larger meaning. Most taxpayers are willing to do right if others do. A belief that the tax administration has the ability to ensure that others pay the right tax is therefore of great importance for their own will to do the right thing. Another indirect effect is that trust contributes to perceived justice, which in turn affects behavior.

(Wittberg 2010, authors' translation)

We have seen several routes through which this process could happen, including increasing taxes on workers in Sweden in the 1930s and 1940s; lowering taxes in the seventeenth and eighteenth centuries in the UK; and even propagandizing citizens as the country mobilized for war in the 1940s in the US. In each of these successful cases, governments made a case which either connected taxpayers and taxpaying to collective benefits and/or used tax and compliance as a focal point for social solidarity.

The case histories in this volume have also given us several examples in which the state was far less successful in building consent—or perhaps did not even really try. As Clara Volintiru and Arpad Todor each demonstrated in their chapters (10 and 11, respectively) on Romanian history, the Romanian state never built a sense that the citizens belonged together or that the state was an agent of society. Instead the state was seen as a foreign institution at first dominated literally by foreign powers and then later dominated by alien and hostile dictators. Though a variety of different tax collection mechanisms were tried none of these proved effective at convincing Romanians that they and their states had common identities or interests. Todor's work demonstrates that even the move toward a very low, flat-rate tax in the twentieth century could not break this cycle, not because a foreign power still ruled over Romania, but because the state itself was considered a hostile and predatory force.

Italy offers an analogous, if not quite as extreme, example. Here the state was dominated by foreign rulers in the seventeenth and eighteenth centuries. But in this case it appears that it was internal fragmentation that weakened Italy's ability to come together and develop a sense of common purpose. First, as Hien shows (Chapter 4), the Catholic Church did much to undermine the legitimacy of the modern Italian state. But as John D'Attoma also shows (Chapter 5), the continued conflicts between North and South have done nothing but exacerbate these problems. Still today the state and its administrative apparatus are burdened by rules, laws, and legal protections that

prevent the administration—and specifically its tax collectors—from building the coherent administrative tools like those we have seen in Britain, Sweden, and the United States.

Alexander Gershenkron's famous essay, *Economic Backwardness in Historical Perspective* (1962), argues that countries that entered the modern era relatively late can be advantaged by the fact that in late development capital and labor resources can be concentrated in ways that make it possible for them to leapfrog past the early developers (Germany and Japan are the primary examples). The logic here is that late developers could import the institutions, economic structures, and technologies developed outside their country and refine them to suit their local circumstances in sometimes very efficient ways. Consequently, they quickly start up and enter global markets while maintaining relatively low wages and thereby gain competitive advantage and even overtake more established political economies (Gershenkron 1962).

The narratives found in this book and elsewhere lead one to suspect that the advantages of importing administrative technologies are not always so obvious. The Romanian case provides perhaps the best example of this. In their desperate desire to attain revenue efficiency and greater levels of effectiveness after the fall of Communism, Romanian governments introduced one of the most “advanced” and modern tax systems in the world. The idea of a “flat tax” system was at the cutting edge of economic thinking of the day. As we saw in several countries examined here, by the mid-1980s the highly progressive and highly complex tax systems that had developed over the previous fifty years throughout Western democracies have been brought into question. Even the Swedes had moved away from the very high marginal tax rates toward a more “efficient” tax system. A number of Eastern European countries including the Romanians took this idea one step further and introduced a flat (16 percent) tax, the logic being that if it were so low everyone would be willing to pay. As we learned in Todor's chapter, things did not work out exactly as planned. Why? The answer seems to be that simply introducing new technologies requires an administrative and social foundation in which those technologies (whether tax policy or something else) could and would be administered fairly and efficiently. In other words, imposing a flat tax without first having developed efficient monitoring systems for controlling the misbehavior of political and administrative elites did nothing to build the legitimacy of the system as a whole.

The most important lesson here is that leapfrogging usually fails because it does not establish the social and administrative foundations for building consent. Institutions need to perform effectively for the equilibrium to emerge and be sustained. Many countries in the developing world are able to raise tax revenues, yet they are still unable to foster voluntary compliance, and therefore they fall short of generating sustainable, cost-effective systems. The early

state-building project in Central America, for example, rejected tax progressivity and fairness (Schneider 2012). The interests of economic privileged groups were instead protected and this led to the belief that the system was unfair. The result has clearly been to produce weak taxation regimes despite the fact that these countries emulated similar tax structures promoted by international organizations. The post-Communist regimes in Ukraine, Russia, and to some extent Poland, were able to exert coercion and improve tax administrative capacities during the transition to market economies, but so far they have fallen short of building the kind of institutions that enhance trust and equity (Berenson 2017). In all these cases, the virtuous circles of compliance, trust in governments, and valuable public goods has not yet been established. Clever tax policies and large bureaucracies do not replace solid social institutions.

Countries that have long histories of adverse relationships between citizens and their governors face difficulties in raising taxes. This is obvious. What has received less attention is that building a “culture prone to compliance” can take generations. Quick fixes rarely work. Of course, Guatemala cannot be Sweden, but what Guatemala’s officers can do is learn from Sweden’s sixteenth-century experience: building the foundations of a monitoring system through the co-opting of strong groups (in Sweden’s case the Lutheran Church) in order to foster mechanisms of compliance. Guatemala does not need to wait a hundred years to enhance compliance; it can be done in a much shorter time span. Yet it still may be a matter of decades or generations before a new culture of compliance fully emerges.

Lessons Learned

The historical narratives contained in this volume describe how “ecologies of compliance” (or non-compliance) were construed and evolved over time. In all of the 180+ countries in the world today only a tiny handful have achieved anything like the kind of willing compliance we see in Scandinavia in the twenty-first century. Indeed, one might say that even Italy (one of the less successful countries in this study) is significantly better at generating tax revenue than many other countries across the developing world. This section examines what states can do to bolster the foundations for successful compliance: building consent.

Monitoring

Several chapters in this book have demonstrated that consent is built on effective monitoring and measuring mechanisms being in place before a heavy tax burden is imposed. In Sweden, for example, because the cadastral

system was established very early and effectively, the state and the local community developed the capacity to monitor both those who paid taxes and those who did not. As a consequence, the state developed the ability to enforce rules broadly and relatively effectively. In the Italian and Romanian cases, in contrast, the state failed to develop institutions that could monitor its citizens and/or taxpayers effectively. Consequently, many taxpayers defected. This is not because Italians or Romanians are more dishonest than Swedes (Andrighetto et al. 2016). Rather, it is because Italian and Romanian institutions differentiated between groups and regions in such a way that nearly everyone felt that the system was unfair. The result has been a norm of non-compliance.

In countries where tax evasion is prevalent, even good tax laws cannot mitigate the adverse effect of the wide predisposition of citizens to cheat. Citizens can effectively cooperate together to evade the state. In these cases the vicious cycle of non-compliance and ineffective tax authority is hard to break.

What is perhaps most remarkable about the Swedish case is that the state relied on local parishes and church officers to collect the necessary information. Rather than rely on a strongly hierarchical public administration, the king devolved recording and reporting duties to local parishes, which had direct knowledge of local taxpayers, and allowed them to run tax collection.⁶ In other words, tax capacities were developed in conjunction with non-state actors in order to first guarantee the ability to monitor taxpayers and promote fair application since inception.

Other countries took different routes but kept a similar logic: They built capacity to gather information first and then applied the law in such a way that government was perceived as fair. As Daunton shows, England also developed the ability to monitor taxpayers at the parish level with the specific aim of building consent. Similarly, the American state was in a somewhat unique position because as the nation expanded across the continent the government developed sophisticated administrative and technical expertise to monitor and measure the nation. Later in the twentieth century it developed strong administrative capacities in the Internal Revenue Service, which then propagandized citizens with a key unifying message (taxes to fight Axis).⁷

In many societies people are afraid of the state. Consequentially, the state's ability to monitor its citizens or even their financial records is legally limited. In several cases this could be for good historical reasons. Still, if the state does not have the capacity to effectively monitor its citizens it cannot deliver the goods and services, or tax citizens in ways that people feel are fair. There can be no doubt that the enormous amount of information the British, Swedish, and American tax authorities have about their citizens puts them light years ahead of their Italian and Romanian counterparts. This may feel intrusive to those

whom the tax authorities audit, but the fact that the state can do these things means that other citizens can be relatively confident that laws are being abided by and those that should pay, do pay.

Enforcement

Under the classical tax compliance paradigm that evolved from Allingham and Sandmo (1972), enforcement is simply about deterrence. According to this view, self-interested individuals want to maximize rents and therefore they will cheat on taxes unless the perceived probabilities of detection and/or punishment are high.

In our view, this misses the key point about compliance: We generally pay taxes in private, for benefits that are public (Downs 1957). Tax compliance is both a private and a public act because we are social animals who are strongly motivated by social norms. In short, we are more willing to pay if we believe that everyone (or nearly everyone) is paying as well. This is why enforcement is so important. Taxpayers want to know that others are also contributing to the collective, and most citizens will abide by the rules to the extent that they believe that such an environment is maintained. In other words, the main function of solid enforcement is *not* to intimidate the taxpayer into paying taxes, but is instead to help convince citizens that everyone pays and thereby build high tax morale (Wittberg 2010; 2012). Enforcement thus serves first and foremost a social purpose: the creation of “ecologies” of compliance that help people believe that cheats will be caught and punished. Taxpayers need to see that cheats are detected and punished, and that the tax administration is efficient and applies the laws and regulations fairly. Only under these conditions will a culture of compliance prosper.

Once again, individuals are not purely rational estimators of gains and losses. Instead, people anchor expectations on what a social norm dictates. Therefore, when many people cheat (Italy, Romania), that will be the expected behavior. Poor enforcement reproduces these perceptions, and the vicious cycles are hard to break. When a norm emerges (a new tax or a new rule) the state must make sure that most people adhere to it and they will aggressively enforce the norm. Then, when most people already comply, moderate enforcement will maintain the equilibrium. Successful states exert strong enforcement at the outset of a new law and then apply selective and moderate enforcement to guarantee sustained cooperation.

Equity/fairness

Human beings show strong preferences for equity and fairness in the laboratory and in the real world alike (Bowles and Polanía-Reyes 2012; Fehr 2006;

Kastlunger et al. 2011; Nicolaides 2014). Simply put, states that promote equity and fairness have higher compliance rates. Fairness, to be sure, has multiple meanings or interpretations. First, fairness in taxation means that individuals will be more likely to comply if they believe they will be treated equally with others to whom they could reasonably be compared (this is called horizontal equity). Second, the vast majority of taxpayers everywhere believe that the rich should pay higher taxes than the poor—taxes should be built on the ability to pay (this is called vertical equity). Finally, the state should apply its rules equally to all citizens (this is called procedural justice) (Kumlin 2002; Rothstein 2000; 2011).

It may seem obvious, but it is important to note that rulers cannot foster compliance environments where corruption is rampant. No one wants to be a sucker (Levi 1988) and if citizens view elites as tax evaders, there is little reason for them to willingly comply. As Ukraine President Petro Poroshenko noted in his first State of the Nation address in June 2015: “The image of the state is formed in citizens’ eyes by the tax inspector, the customs man, the cop. While they’re on the take, people won’t believe the sincerity of our anti-corruption intentions” (cited in Berenson 2017). We concur and argue that without a strong and independent prosecution office and zero tolerance against corruption, a tax compliance environment will be hard to establish. Chile and Singapore are good examples, demonstrating how low levels of corruption correlate with low levels of tax evasion. Conversely, the Philippines, Indonesia, and Mexico have both high corruption and significant tax evasion.

Citizens’ perceptions of fairness matter precisely because tax compliance is not a simple tit-for-tat game. Instead of being a direct exchange, as in the market, where I only pay for the things I can own, touch, or see, citizens often pay for things that they personally do not want and cannot use. When individuals believe that governments are producing goods that are fairly distributed, this perception can produce more willingness to pay regardless of whether they personally receive the benefits. For example, people are willing to pay for pensions as long as mature adults receive adequate benefits, and most people are willing to pay for children’s education even if they have no children of their own.⁸ In short, the social perception that taxes are converted into shared social equity can transcend the short-term self-interest paradigm. As social creatures, people also care for the common well-being.⁹

In order to foster a fair system, taxes should target a large taxpayer base, be general, and be widely applied. Unfortunately, too many governments in need of resources look for quick revenues usually raised among those who cannot escape enforcement (bank deposits, certain transactions, imports and exports controlled by customs, gasoline taxes, and so on). In our view, this is a sure recipe for failure down the road. People who pay taxes should not feel

they are victims or just the unlucky ones. Fairness is gained when those who pay believe that the tax authorities go the extra mile to tax those who cheat.

In summary, states can enhance compliance if they build their tax systems fairly. Fairness in taxation has several dimensions: It implies: (1) that tax rates are proportionate to the level of income or the ability to pay (progressivity); (2) that people are treated equally; and (3) that rights are granted to the individuals (including courts and institutions) that protect these rights (procedural fairness).

Recommendations for Policies

We conclude with an even narrower and more specific set of recommendations that are drawn from the lessons learned in this book as well as the five-year “Willing to Pay?” investigation funded by the European Research Council. Perhaps unsurprisingly, our recommendations overlap with many ideas and policies that have been promoted by several international organizations including the IMF, World Bank, and OECD. Our emphasis, however, is less on revenue collection from a technical perspective and instead focuses on measures intended to build stronger relationships between taxpayers and tax authorities. We do not suggest that all these policy ideas could be implemented at any one time, but rather that they are goals that we believe would contribute to building better relationships between citizens and their states. Ironically, perhaps, they also imply that measures should be taken that are specifically designed to be—or are dependent upon—stronger states.

The following is essentially a list of several policy guidelines derived from the lessons of this project. By no means do we cover the full range of tax policies that should be considered, nor do we suggest that all of these measures can or should be implemented at once. These are guidelines governments may benefit from, and that have been somewhat overlooked in the literature. We instead list them and make very brief remarks, as they are clearly tied to the central theme of those books.

- *Strong information systems.* This should be top priority. States should develop tools to monitor the incomes and transactions of individuals and corporations both within and outside their national borders. Therefore, tax administration should have access to other information systems such as welfare programs, credit cards, and financial transactions, and invest heavily in capabilities to identify them with taxpayers. Of course they should be used very restrictively to protect individual rights.
- *Build third party payment/information systems.* Successful tax policies combine taxpaying and tax information requirements. Large taxpayers,

employers, corporations, banks, and so on are agents that can provide useful information to the state. Successful cases have shown that compliance increases dramatically when these steps are successfully implemented.

- *Permanently develop monitoring capacities to signal to taxpayers that the tax agency knows a great deal about income and financial transactions.* Tax administrators in large non-compliance societies should privilege wide monitoring over audit policies. Effective monitoring has wide coverage of taxpayers, while tax audits reach very few taxpayers and are usually ineffective in reducing the number of tax evaders. Italy probably audits more taxpayers, but Sweden and Britain have higher compliance rates.
- *Invest heavily to improve cadastral records.* Property taxes are very progressive but they are widely evaded in the developing world. Therefore, an important element in producing legitimacy and fairness is to have a strong property tax. States need to coordinate politically with local governments, which usually levy such taxes; not an easy task.
- *Ensure simplicity.* Complexity breeds evasion. Only levy taxes that can be enforced. Many taxpayers, given the chance to cheat, will do so, even in Sweden. Two variables make the difference in compliance between countries: (1) withholding and monitoring mechanisms; and (2) the individual's willingness to take high risks and cheat. Firstly, policies should promote taxes that are: "compliance friendly"—that is, easy to report, those withheld at source or through a third party, such as VAT; income taxes based on multiple information requirements readily available to the tax administration agency; and property taxes based on accurate land and property registers.
- *Make everyone pay something.* This is a critical point, particularly in the developing world where a significant share of citizens is exempt from personal direct taxes. However, to guarantee fairness and inclusion, and to make demands for state effectiveness, all people should contribute. When everybody pays, people feel included. This means that *even the poor should pay something*. This might be controversial, but as derived from other principles, membership to a community should cost something. Of course, progressivity should be strictly maintained.
- *Start with the rich (they should pay dividends) and monitor your borders.* This is critical, since the middle class through fudging and evasion, and the rich through legal exemption, avoid paying a significant share of their income. All taxation success stories began by taxing the rich and slowly expanding toward the middle class. Countries should not be afraid of capital flight, because the costs of not taxing the rich in the long run are higher. Developing countries might benefit from cooperation with OECD countries and international organizations in closing tax havens and promoting cooperation with countries for releasing financial information. Large

sums of tax-evaded funds from the rich are hidden in banks and assets in OECD countries, as well as in tax havens.

- *Punish severely and consistently.* Send to prison dozens or even hundreds of tax evaders per year. Do not settle disputes with reduced fines, because they incentivize tax evaders. This does not mean that the state only relies on “the stick” to enhance compliance. The main purpose is to signal to compliers that cheats are severely punished, promoting fairness in taxation.
- *Be uncompromising with corruption.* Corruption is perhaps one of the most corrosive factors in compliance behavior. It unravels trust, fairness, and equality. Authorities should send a message that corruption will not be tolerated, despite the fact that initially many agents and taxpayers will be willing to take bribes. Corruption probably will not be completely eliminated, but citizens will know that governments are not complacent.
- *Take as many steps as possible to reduce the cash economy.* Informal economies augment individual incentives to cheat. Temporary reliefs gained through tolerating informal markets tend to undermine development and also tax compliance. Countries with low compliance equilibria tend to produce dual economies or at least large informal markets that have perverse effects and, due to the social cost, are hard to reverse.
- *Fiscal balance matters, but people will comply if they feel they receive valuable goods in exchange.* This is critical for the developing world. The story of Britain, Sweden, and the USA has shown that taxes need to be shown promoting the public good. Paying off national debts might prevent financial crisis but citizens do not perceive this as beneficial. Taxes should produce clear and tangible public goods, either in infrastructure, education, and/or healthcare services, or to fight wars or expel a threat to the country’s security.
- *Raise taxes in good times.* Taxes enacted in prosperous times can produce public goods that enhance wide compliance, nurturing a virtuous circle. Conversely, taxes promoted under crisis might be necessary but most likely they will be quick fixes and not long-term solutions. If governments are forced to raise taxes to alleviate a specific need, they should reduce them once the goal has been attained. Britain in the eighteenth and early nineteenth centuries raised taxes during wars, but returned to previous levels afterwards.
- *VAT should not be the only or most important tax although it should be promoted or kept.* VAT has been the workhorse of tax systems in the developing world because it effectively creates incentives for compliance. Tax authorities should take steps to include the informal economy (through withholdings, reporting, and low rates) into the VAT base.

Conclusion

No one should take these policy ideas and suggestions as absolute maxims that must be applied in any and every case. Indeed, as the historical chapters in this volume demonstrate quite clearly, there are many routes to a modern, efficient, and successful tax system. Surely, the Swedish example continues to be a model that could be emulated, but no one should be so naïve as to believe that the Swedish story could be repeated or copied in full. Still, the central points that can be drawn from the Swedish (as well as the British and American cases) in contrast to the Italian and Romanian examples are that consent is contingent on four basic factors which may seem obvious, but are worth repeating here: (1) the state must develop the capacity to monitor its citizens and lands in order to administer taxes in ways that citizens can consider to be fair; (2) citizens are far more “willing to pay” when they see that they get something in return for the taxes they pay, and that other citizens pay their share; (3) tax revenues finance public programs and institutions that contribute to greater social justice and equality, but a punitive tax system which pretends to tax the rich, but then allows them to evade, generates little revenue but much skepticism toward the state; (4) the more successful regimes have been able to raise taxes while creating a common sense of identity or purpose.

Governments across the world today are under great pressure to finance public programs, improve infrastructure, and satisfy citizens’ expectations. Too often though, taxes are used as sticks to herd the taxpayers into compliance and/or discriminate between different groups in society. When they do so, the state is more likely to be seen as a predator than as an agent. In this case, few taxpayers will be willing to take the Leap of Faith.

Notes

1. A note from Sven Steinmo: As I was coming toward the end of this large project on tax compliance in (mostly) developed nations I grew increasingly interested in thinking about the implications of this research for the developing world. Surely, the routes followed (some obviously more successfully than others) should have some implications for countries which have not yet been able to build sustainable and efficient tax systems? I had recently read the marvelous book, *Tax Evasion and the Rule of Law in Latin America*, by Marcelo Bergman (2009) and had been deeply impressed with this book generally and its obvious links to many of the arguments we have been developing in our European Research Council-funded project. To this end I invited Professor Bergman to collaborate with me on the concluding chapter of this book. My idea here was to see if it would be possible to move from the study of

several historical cases to explicitly examining their implications for quite different countries who very often are struggling now with issues confronted by the more advanced countries decades and perhaps even centuries ago. Especially given the fact that this book will be available “Open Access” to anyone in the world with an Internet connection, we take the somewhat unusual step of moving from history to policy. Of course, it will be up to the reader to decide whether this was a wise move or not.

2. Marc Berenson offers a fascinating comparison of tax policies and compliance in which he makes almost exactly this point. He introduces his book with the following: “Effective governance occurs when the state and society interact with each other in a dualistic process through trust” (Berenson 2017: 2). We strongly recommend this book to those interested in a similar analysis to that found here, but particularly to those interested in the implications for the post-Communist world.
3. Levi indeed recognizes the importance of what she calls quasi-voluntary compliance that is contingent to both the exchange equity (she fully develops this dimension) and horizontal fairness (making sure that others pay). However, she does not really extend the implications of this last dimension, probably because hers is a top-down theory, while we promote an endogenous equilibrium, a co-evolving approach.
4. A comparison between Rwanda and Burundi provides a fascinating example. Both countries have been torn apart due to ethnic conflict and violence. Yet, Rwanda today is noted for having one of the most effective and efficient tax administrations and highest level of tax compliance in the developing world. Burundi, in contrast, continues to suffer from an inability to provide coherent administration and governance. A consequence is very low tax compliance (Bank 2010; Tumwebaze 2013).
5. The text within the lower border of the image reads: “This holy virtue [Justice], where she rules, induces to unity the many souls [of citizens], and they, gathered together for such a purpose, make the Common Good their Lord; and he, in order to govern his state, chooses never to turn his eyes from the resplendent faces of the Virtues who sit around him. Therefore to him in triumph are offered taxes, tributes, and lordship of towns; therefore, without war, every civic result duly follows—useful, necessary, and pleasurable.”
6. Several countries around the world today are experimenting with various versions of “tax farming” in which non-state actors (usually for-profit businesses) are tasked with collecting revenues for the state (Stella 1993). The experiments are ongoing and the results are mixed. In addition, the wide range of withholding systems in income tax and VAT are centered on this basic principle: Let employers or large firms collect the lion’s share of the revenues, and have the tax administration concentrate on controlling these large agencies and firms (Bird 1989: 232–6).
7. Tax capacities therefore are closely linked to the information systems that governments develop. As Jones’s paper shows for the USA, a key element for successful compliance rates has been the W-2 form that employers file for each employee, enabling the IRS to gather information.
8. In Latin America a deep sense of injustice and inequality has hindered the ability of governments to make progressive tax reforms and elicit fair tax regimes (Mahon, Bergman, and Arnson 2015). Elites are hesitant to support redistributive systems

even when they have mustered strong political capacity (Ondetti 2015). In general, whether there are low legal tax burdens, such as in Mexico and Chile, or mass evasion and corruption, such as in Brazil, taxpayers remain skeptical and defiant about the ability of Latin American states to enhance fairness through fiscal policies, and therefore compliance remains low in most countries.

9. Anthony Downs's (1960) classic essay, "Why Government's Budget is too Small in a Democracy," presents the dilemma that citizens are less aware of the benefits they receive from taxation (paved roads, clean air, public safety) than they are on the direct costs of taxation. Consequentially, he argues, citizens overvalue the taxes they pay considering the benefits they wish for. We take this point seriously, but taken too far it ignores the point that many citizens *are* willing to pay for services and goods that they do not directly benefit from *if they believe these goods and services are distributed fairly*.

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