

TAX EVASION, TRUST, AND STATE CAPACITIES,  
Nicolas Hayoz and Simon Hug (eds.), 2007, Peter Lang, Bern, 385 p.

Review\*

Scientists, mostly from Central and Eastern Europe, interested in tax morality and tax evasion gathered at a conference in St. Gallen in autumn 2003. The result of that conference is the book "Tax Evasion, Trust, and State Capacities", subtitled "How Good is Tax Morale in Central and Eastern Europe?" As can be gathered from the title and subtitle, almost all the articles in the book deal in one way or another with the problems transition economies face in collecting taxes. Furthermore, the authors analyze how these problems relate to a state's capacities in performing its functions, and to the level of political and general trust in society. Most authors concentrated on a simple question: why do people pay taxes? Is it because they fear repression? Or is it perhaps because they trust each other? Or is it because the tax burden is reasonable and the tax system transparent? Is it because they believe that state officials are efficient? In searching for the answer, the authors got interesting results.

Apart from an introductory text written by editors, Nicolas Hayoz and Simon Hug, the book contains eleven more articles written by: Eric M. Uslaner, John T. Scholz, Lars P. Feld and Bruno S. Frey, Benno Torgler, Stanisław Owsiak, Gerald M. Easter, Béla Janky, Katarina Ott, Gabriel Bădescu, Jan Hanousek and Filip Palda, David Tumanyan. Besides the transition economies (Romania, the Czech Republic, Hungary, Croatia, Poland, Armenia, and Russia), the book contains one article about the USA and one about Switzerland. Alongside the empirical papers, in the book there are also two papers concerned with theoretical models of tax evasion and the problem of collective action. Instead of giving a summary of each article individually, here the main results and conclusions of the book will be stated.

Firstly, social capital is very important for explaining the extent of tax compliance. It has been shown that tax evasion is smaller in those countries where citizens perceive each other as honest. An individual does not feel like cheating, i.e. not paying taxes, if she believes that other people behave in an honest way.

The second important factor is the efficiency of state institutions, particularly of the legal system. This factor works directly but also indirectly by increasing the level of trust

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in society. The rule of law is correlated with equality and corruption. The more corruption widespread is, and the larger inequality (especially before the law), the more pronounced tax evasion will be. It is very difficult to break this circle of bad public governance - corruption - tax evasion - distrust. Each of these elements changes very slowly and is path-dependant. Even if formal institutions do change, informal ones do not immediately follow.

It has been shown that in strong states, those with a strong element of repression, tax evasion is not necessarily smaller. Where state and economy are separate, like strangers, as is the case in Russia and some south eastern European countries, there are smaller chances for trust to develop because it is determined, among other factors, by the level of citizen involvement and civil rights protection. When citizens can vote on matters of taxes (e.g. fiscal referenda in Switzerland), then they will be more prone to tax compliance. Furthermore, fiscal decentralization increases the willingness to pay taxes because citizens feel that in that way their tax preferences are better met.

When it comes to tax evasion, it is not possible to avoid the question of reciprocity, i.e. to what extent the state is responsible to citizens and how well it satisfies their needs because citizens have the right to demand benefits for the taxes they are paying. Perceptions in transition countries tend to be that benevolent (let alone honest) bureaucrats belong to science fiction; the less money the government has, the less damage it does. Research has shown that if the possibility that the government will provide public goods is large, then tax evasion decreases. Governments that provide concrete benefits like new schools, better roads, better quality services, obtain trust from citizens, which makes them more willing to pay for what they are getting. Tax evasion and public governance quality are strongly negatively correlated. Citizens react rationally to the political, legal, and economic surroundings in which they live. They behave honestly when the system is just to them, when political elites do not steal their money but rather spend it reasonably, and when they have adequate legal protection.

Empirical evidence also shows that simplifying a tax system decreases tax evasion. When it comes to income tax, this refers to, for example, introducing a flat rate. However, one should bear in mind that it is also important whether the government at the same time behaves responsibly towards citizens and successfully delivers public goods. Socio-demographic factors are also important determinants of tax morality; older people, women and people who are not single have a higher tax morality. When Central and Eastern European countries are compared with those of the former Soviet Union, it seems that tax morality is lower in the latter.

Finally, recommendations. Tax regulations should not be changed often, the tax administration should not act arbitrarily and there should not be any exemptions for individual cases. Tax burdens should not be too large, and government should fulfil its financial obligations on time. More direct democracy would enhance tax morale; it would increase trust and honesty, decrease corruption. In post communist countries perceptions about government as a tax tyrant would decrease if: a) a legal framework to make the tax system stable, transparent, simple and close to the taxpayer were set up; b) a rational mechanism for allocating and controlling public expenditure, one that would stress the relationship between the collected taxes and benefits for the local community were formed.

The shortcoming of this book is the obsolescence of its data; the book was published in 2007, the conference held four years earlier, and the data series ends as far back as in 2000. Furthermore, the impression is that these articles would “function” better in journals than in a book; often the same ideas and recommendations are repeated. One article in the book is too long (70 pages) and does not fit very well into the content; it is not clear why the editors did not demand it be shortened.

If we wanted to apply the results of this book to Croatia, we would come to the standard set of recommendations: it is necessary to fight corruption, enhance the rule of law, and develop democracy. The state should be more responsible to citizens and they would, in return, be more ready to comply with their tax obligations.

*Marijana Bađun*