

# TAX AND TRUST

*Institutions, Interactions and Instruments*

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## TRUSTWORTHY INSTITUTIONS: A COGNITIVE THEORY OF TAX MORALE

*Sven Steinmo\**

*It must not be forgotten that although a high standard of morality gives but a slight or no advantage to each individual man and his children over the other men of the same tribe, yet that an increase in the number of well-endowed men and an advancement in the standard of morality will certainly give an immense advantage to one tribe over another. (Charles*

*Darwin [1871]. The Descent of Man, p. 159)*

*The contract is not sufficient by itself, but is only possible because of the regulation of contracts, which is social in origin. (Emile Durkheim)*

### ABSTRACT

This chapter explores the relationship between trust and trustworthy institutions. I build on insights from social psychology, behavioural economics and institutional theory and argue that people are inclined to follow rules and behave in ways that are consistent with those rules if the rules themselves are implemented in consistent and transparent ways. We begin with an examination of why people follow rules in the first place. I argue rule-following behaviour is explained by three basic human motivations: (a) 'self-interest', (b) the desire to belong and (c) the need for logical consistency. The chapter then examines why political institutions that implement tax rules and laws fairly and consistently engender higher levels of compliance than institutions that seek to cater to special interests and/or particular constituencies.

Self-interest has long been seen as a (or perhaps, the) basic motivation for behaviour. I acknowledge this motivation but suggest that traditional economic theory's focus on individual self-interest pushed policy makers towards understanding tax compliance as a bargain between otherwise unwilling taxpayers and public authorities. This starting assumption leads to a 'Predatory' model of tax compliance, which is less efficient than a more cooperative model that acknowledges citizen's desire to be part of a community and to behave according to the community's values and norms. I argue that successful tax compliance strategies account for all three of these basic human motivations rather than simply assume a cost/benefit transaction model. In so doing they build trust between citizens and their states.

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High-quality institutions act impartially and thereby help build and maintain the social norm of compliance. They build on people's desire to be part of a community and to contribute to that community. Tax Morale, then, is enhanced by strong institutions that encourage people's better moral character, *not* by intimidating taxpayers into compliance.

### 3.1 INTRODUCTION

All large complex societies have free-rider problems. Whereas small-scale societies can monitor the behaviour of group members and observe and punish transgressions against the group's rules and norms, large-scale societies are far more anonymous. It is virtually impossible for a large complex society to consistently monitor all of its members to ensure that they behave according to the rules and norms they are assigned. Hobbes' solution to this dilemma was the dictator. He feared that the true 'nature of man' would lead individuals to defect whenever they had the opportunity and thus make complex and efficient societies impossible absent strong authority that could impose order on society (Hobbes, 1651).

This argument certainly makes a great deal of sense if we accept the autonomous self-interested utility maximizing model of mankind. People only cooperate and behave in accordance with public rules if and when this behaviour is in their self-interest. People will cheat on their taxes, for example, when they believe they are unlikely to be caught and/or they will suffer minimal penalties if they are apprehended. In this model the role of the state is to ensure that citizens believe that the price of defection exceeds the benefits gained through defection (Allingham & Sandmo, 1972).

Today, however, there is a massive body of literature demonstrating that people will cooperate with others, sacrifice their individual self-interest at times and follow social rules even when there are no direct incentives for them to do so (Andrighetto, Szekely, Ottone, Zhang & Steinmo, 2017; Boyd & Richerson, 2005; Cook & Levi, 1990; Fehr & Gächter, 2000; Fischbacher, Gächter & Fehr, 2001; Henrich et al, 2001; Levi, 1997; Monroe, 2001; Ostrom, 1998; Torgler, 2002; Tversky & Kahneman, 1974; Weingast, 2005; Yee, 1997; Zhang, Andrighetto, Ottone, Ponzano & Steinmo, 2016). Indeed, for a complex society to succeed and prosper, norms of trust and cooperation must be internalized by the members of that society (Elster, 1989).

There are several (not many, too be sure) large complex societies in the world today that do not depend on the imposition of strong authoritarian rule in order to function. Instead, social life and organization is built – at least to some large extent – on the fact that people wilfully follow the rules of society.

One of the great puzzles in modern social science is the question: how and why does this happen? Why do individuals *choose* to follow the rules – even when they are not being monitored and even when so doing gives them no personal advant-

age? Or even more remarkably, why would people follow rules – even when it costs them personally to do so? From a purely Instrumentalist account, such behaviour makes no sense. People should only follow rules when it is in their self-interest. Of course, what is in a person's self-interest can be quite complicated and is obviously not simply a cost/benefit calculation about whether they 'earn' more or less by following the rules. People have long-term and short-term interests, are embedded in many different social/political/economic networks, have reputations for integrity and honesty to protect, etc.

But, a very large body of experimental evidence has been produced in recent years demonstrating that most people follow legal rules and social norms even when they have nothing to gain (Alm & Torgler, 2011; Boudreau, Coulson & McCubbins, 2009; Cook & Levi, 1990; Elster, 1998, 2009; Fischbacher et al, 2001; Gintis, Bowles, Boyd & Fehr, 2006; Green & Shapiro, 1994; Milgram, 1974; North, 1992; Radnitzky, Bartley & Popper, 1987; Smith, 2008; Tversky & Kahneman, 1974).

I suggest that the puzzle of cooperation is only a puzzle if we accept the classical economic view of human behaviour and motivation. I propose here an alternative theory of human behaviour, which I call a 'Reasonable Choice' approach. This approach is built on a more complete understanding of the human mind as suggested by much recent cognitive theory. This approach is distinguished from a classical rationalist perspective in two ways: First, instead of assuming people are individually rational, we begin from the basic fact that human beings are '*social animals*'. It has been analytically quite useful for scholars to attempt to understand human action when reduced to the individual. But one need not take the intellectual leap to assume that the individual is singularly motivated by their *individual* self-interest. Indeed, I argue here that the very identity of an individual -- that is to say the definition of self -- cannot be separated from the social context in which this self is defined. In other words, even self-interest is a social construct.

Second, in addition to a preference for sociality, *Homo sapiens* has developed strong preferences for 'cognitive consistency'. Our evolutionary past has given us advanced cognitive capacities that allow us to build and communicate theories that help us understand (and transform) the world around us. We often attempt to 'rationalize' both what we see and how we behave, but our desire to rationalize does not mean that we are in fact fully 'rational'. As a number of psychological studies have shown, the human mind is a 'sense-making machine' that tries to build explanations, or theories, for the world around us (Kahneman, 2011). We reason, and we rationalize. It is precisely our commitment to these (sometimes irrational) theories that introduces a variety of commonly known biases in human decision-making.

### 3.2 NORMS

One of the most robust findings observed in both social psychology and behavioural economics is that most people are highly sensitive to the behaviour of others. People pay taxes and engage in all kinds of collective behaviours at least in part because we believe that this is what others around us will do. A huge body of behavioural work by now convincingly demonstrates that people are more willing to contribute to a public good (by paying taxes, for example) if they believe that nearly everyone else is paying as well. Conversely, people will cheat (or refuse to contribute) when they believe that others are not contributing.<sup>1</sup> In short, most human beings frame their own actions in the context of others' behaviour. Why? Because as social creatures we *desire* to do what is expected of us and act according to the norms of the society/group that we are in.

The desire for sociality is one of the most well documented theories in modern social psychology. "The motivation to form and sustain at least a minimum amount of social connections is one of the most powerful, universal and influential human drives" (Baumeister, 2011, p. 121; Baumeister & Leary, 1995). In other words, we do not join groups in order to get more for ourselves. We join in groups, instead, because it is basic to our human nature. We *want* to be part of something. This is why rejection and social exclusion have such profound effects on us and can even trigger aggressive behaviour, emotional numbness and strong hormonal responses (Baumeister, 2011).<sup>2</sup>

Even our individual identity is built in the context of social groups. We are not autonomous actors abstracted outside of our social context. This means more than we want to be around other people. We *desire* to fit into the group and that we *prefer* to associate with others with whom we share some common attributes, behaviours or attitudes and values. This implies that along with our desire to be part of a group, we also have a basic desire to conform to that group's rules and norms. Again, the psychological research on this point is overwhelming. We adapt to and abide by the rules governing our society in part due to the incentives and constraints that confront us, but also because of this deep-seated preference for conformity itself (Janes & Olson, 2000; Mead, Baumeister, Stillman, Rawn & Vohs, 2011). Indeed, violations of conformity can cause physical pain (Kross, Berman,

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1. In a large set of experimental tax compliance studies, which my research team and I conducted between 2014 and 2017 with over 3,000 participants in five countries, we discovered that one of the best predictors of a participant's willingness to contribute to the public good (called the 'general fund') was their beliefs about how others in their group would behave. See "Willing to Pay: Testing Institutional Theories with Experiments" ERC, "Frontier Grant" [www.willingtopay.eu](http://www.willingtopay.eu). For more information on the experimental methods and some findings see also: (Andrighetto et al, 2017; Bruner, Attoma & Steinmo, 2017; D'Attoma, Volintiru & Steinmo, 2017; Zhang et al, 2016).
  2. It is widely recognized that the most effective punishment one can apply in the modern prison is to isolate the individual prisoner and prevent him or her from having contact with other individuals. Some consider this punishment "inhumane".

Mischel, Smith & Wager, 2011). This is what psychologists call, *Social Identity Theory* (Tajfel, 1982; Turner, 1982). This group-related self-definition in turn prompts us to behave according to the norms of the respective groups.<sup>3</sup>

Though more complex than a simple theory which claims that everyone pursues their individual self-interest, a theory that acknowledges that we are *also* motivated by a desire to be part of a group is more in line with the empirical facts. It is also common sense. Ask yourself – are you really a purely autonomous actor who only does what is in your individual self-interest, or do also you like being part of something? Do you really calculate your actions according to maximizing what is good for you alone, or do you sometimes also follow along with the group norms? Most of us (at least if we are not autistic) enjoy being part of a group, doing things with the group and even behaving and dressing like other members of the group. Whether we are Americans, French or Swedish; Chelsea fans or Manchester United supporters, Democrats or Republicans, we often adapt our behaviours and even attitudes in the direction of others in that group. We *want* to ‘fit in’. In short, our decisions are often led by the desire to conform to the tastes and beliefs of others (Cialdini & Goldstein, 2004; Elster, 1993).

This implies, of course, that some kind of national identity or common sense of belonging is particularly important for tax compliance. While virtually all individuals have a desire to belong, they may not feel that they ‘belong’ to the nation at hand. Indeed, it is quite possible for some people to believe that their ‘group’ is separate from the nation... and consequentially, it is not necessarily their responsibility to pay taxes to that nation state.<sup>4</sup>

This fundamental need to be part of a group has significant implications for our understanding for the role institutions play in rule compliance (including tax compliance). In some countries paying your taxes is considered a moral responsibility, in others it is normal and expected to avoid as much as you can. The differences in behaviour, in these cases, is *not* due to differences in citizens’ desire to follow rules or be part of a community, they are instead due to differences in the particular social rules and norms that govern the society at hand. It may be easy to believe that norms or social rules are stronger in some societies than they are in others. But there is no evidence for this. We should instead see that *different* rules and norms are enforced in different societies. When a tourist or a visitor comes to a foreign land they often immediately notice that the norms of behaviour they expect are not enforced. This can then lead them to interpret this to mean that there ‘are no rules’. Indeed, what could appear to be anti-social behaviour (like ignoring stop signs,

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3. The starting point for social identity research was set by Tajfel, Billig, Bundy & Flament (1971) – ‘minimal group paradigm’, a series of experiments showing that individuals tend to favour their own ‘in-group’ at the detriment of an ‘out-group’ – even if the groups consist of unknown others and membership to groups is randomly assigned.

4. I thank one of the anonymous reviewers for noting the importance of sub-groups in the context of these arguments.

throwing trash out the window, or not paying your taxes) then, should instead be understood as examples of rule-following behaviour and, ironically, a product of the 'desire to belong'.

### 3.2.1 *Cognitive Consistency – The Mind as a Theory-Building Machine*

Acknowledging that humans are social creatures and that they tend to follow and adapt to group norms is insufficient for helping understand why so many people actually pay their taxes, however. After all, for the most part we pay our taxes privately. It would be perfectly possible to be part of a community that pays its taxes diligently, but still cheat when you are filling out your tax form all by yourself. So, why do we (or most of us) do it? Why do we pay our taxes if we feel we can get away with hiding part of our income? For that matter, why do we not throw garbage out the car window, even when we know no one is looking?

In order to understand why we behave according to social norms and/or follow rules even when no one is looking, we need to appreciate one of the most unique features about the species *Homo sapiens*: our desire for *cognitive consistency*.

Instead of reducing our motivations to simple cost/benefit calculations (however bounded or limited they may be) recent research in the behavioural sciences has come to see the human mind as a 'sense-making' machine instead of a rational cost/benefit calculator (Kahneman, 2011; Torgler, 2002; Tversky & Kahneman, 1975, 1992). In this view, humans have evolved quite sophisticated logical/cognitive capacities that have co-evolved with our abilities to communicate increasingly sophisticated symbols and theories. These features of the human mind have allowed humans to grow increasingly complex rule systems and increasingly larger and more complex societies.

It is important to note that as societies became larger and more complex, we did not lose our desire to be part of a group, instead we gained the ability to see our 'individual' roles as distinct from one another. We developed a 'theory of mind'. In short, humans evolved the ability to see ourselves and our roles as separate and distinct from the group, but we did not, therefore, lose our need to be part of that group.<sup>5</sup>

The act of following rules – or even being able to know how general rules apply to a particular situation is in fact an act of theory building. The human brain has a remarkable ability to build such theories, or what Walter Lippmann called 'pictures in our heads' (Lippmann, 1922). Indeed, perhaps the most unique feature of human cognition is this ability to apply the general to the specific and to be able to

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5. As Darwin himself noted in *The Descent of Man* (see quote at the opening of this chapter), undoubtedly, there were some groups or populations in which members pursue their self-interest beyond and in advance of their societies to the point at which these populations must have been eventually outcompeted by those societies which developed a more stable balance between the individual and the group.

see how a specific case fits into a pattern that can be generalized. The point here is that not only *can* human beings build theories that help them make sense of the world around them, they also *want* to make sense of the world around them. Our mental models, or theories, are not simply efficiency devises that help make decisions easier. They become preferences. We become committed to these theories (even when they are wrong).

Once again, we find that another large body of psychological and cognitive research demonstrates that humans have strong preferences for cognitive consistency. Indeed, acting in ways that violate these models creates a phenomenon called 'cognitive dissonance' and can create a host of emotional, hormonal and even physical maladies (Abelson & Bernstein, 1963; Festinger, 1957). Why? Because acting in ways that conflict with our models about how we should act undermines our "strong need to enhance their self-concepts by behaving consistently with their actions, statements, commitments, beliefs, and self-ascribed traits" (Cialdini & Goldstein, 2004; Cialdini & Trost, 1998).

This basic drive for consistency has several implications for why we pay taxes, why we follow rules generally, and ultimately how and why complex societies are even possible. First, because our need for accuracy and consistency, we adapt our behaviour as well as our attitudes towards the institutions surrounding us. As we saw above, most human beings want to be part of a group. Indeed, their very definition of self, their identity, is built in the context of their group (or groups). Quite logically, then, if I am part of a group, I will want to behave, look and even act like members of that group. When we consider choices such as whether we should drive above the speed limit, throw garbage out the window or declare all our income to the taxman, we naturally look around us for references to what we are 'supposed to do'. Even when we are outside that social context, perhaps we are alone (or on vacation outside away from home), we will still behave according to the rules/norms of the group with which we identify. This is because acting differently would be inconsistent with our understandings of who we are, and this behaviour is consistent with this identity.

Consider the curious act of tipping in a restaurant. Most people tip according to the norms and customs of their local community – even when they are away from home. This is completely 'irrational' of course. Surely it may be self-interestedly rational to tip at local restaurants since you may return there and hope for good service and/or you want to demonstrate your generosity to others who may observe your behaviour. But why should we tip if we are at a café to which you will never return and where no one who is there will ever see us again? The answer is simply that to not tip at this random café would be inconsistent with what you normally do and what you normally expect of yourself. To act one way while traveling across the country and another way while at home would create *cognitive dissonance* (Festinger, 1957).

James March and Johan Olsen's term 'Logic of Appropriateness' (March & Olsen, 1989) captures many of these insights. March and Olsen argue that in addition to the 'Logic of Consequences' humans operate according to what they feel appropriate. But how does one know what 'appropriate' behaviour is? Certainly, we can and do observe others' behaviour. But if all we did was follow the crowd, we would not know how to behave in novel situations. Due to our developed cognitive capacities and our desire for accuracy and consistency, even when we are totally alone and unobserved, most of us will abide by certain norms and rules. Why? Because to behave differently would violate our need for accuracy and consistency. While there are exceptions to every rule, almost no one wants to think of themselves as acting randomly or behaving inconsistently. Even when we do so, we invent narratives through which we can 'make sense' of our behaviours.

### 3.3 INSTITUTIONS → NORMS → BEHAVIOUR → TRUST

So far, I have argued that humans have a fundamental need to associate. This 'need to belong' motivates our behaviour because we observe others' behaviour in a community (the social and behavioural rules they follow) and have powerful temptations to follow these rules for individual/instrumental reasons. Second, we are motivated to be consistent. Consistency may be 'the hobgoblin of dull minds' as Emerson famously noted, but it is also profoundly human.

In the next section of this chapter I will try to draw a link among our motivations for rule-following behaviour, political institutions and trust. The key to my argument is that while people might prefer to behave according to their group norms, they are also self-interested and rational. Thus, if they believe that everyone, or nearly everyone, is behaving according to a particular social norm, they are likely to do so as well – even if this may mean some personal sacrifice (Andrighetto et al, 2017; Conte & Andrighetto, 2013). But if the individual believes that others are not behaving according to that norm or rule, then neither their social preferences, nor their preference for cognitive consistency will encourage pro-social behaviour.

This is why context and rules matter so much. If you are motivated both by a desire to cooperate *and* by a desire to get the most for yourself, what you actually do in any particular situation depends a great deal on the situation. If the incentives are extremely clear in favour of cooperation, even those who are more self-oriented are likely to cooperate. If the incentives for maximizing your individual self-interest by defecting or cheating on others are very strong, even those who have a preference for cooperation may well 'defect.' If, on the other hand, it is not clear whether you are personally advantaged by cooperation – or behaving in a more self-interested way – then some people are likely to cooperate and others to defect.

It is precisely for these reasons that political institutions play such a powerful role in shaping both our collective identities and individual behaviours. Rules set by our governments tell us what to do. They tell us both what is expected and what is likely to happen if you do not follow the rules. *Trustworthy institutions* are the ones that apply rules fairly, consistently and transparently. When tax rules, for example, are applied fairly and equally across society, citizens and taxpayers are more likely to comply with these rules – even if they have the opportunity to evade the rules.

In short, effective institutions establish and reinforce social norms. Ineffective and/or inefficient institutions, in contrast, apply rules haphazardly and or allow some members of the community to be exempted from or disobey the rules. In other words, they do not establish or maintain consistent norms. When people observe (or believe) that others are not behaving according to the social norm, they are inclined to defect as well. In some ways, you can say that the norm itself becomes ‘it is okay’ to cheat or free ride.

Recent research has shown that there is a very strong correlation between ‘The Quality of Government’ and Trust (Porta, Lopez-de-Silanes, Shleifer & Vishny, 1999; Rothstein & Teorell, 2012; Rothstein & Uslaner, 2005). Why? As Rothstein and Teorell argue, corruption, responsiveness and policy outputs certainly matter, but, it is ‘impartiality’ that is really key.

Our definition of impartiality in the exercise of public power is the following: When implementing laws and policies, government officials shall not take into consideration anything about the citizen/case that is not beforehand stipulated in the policy or the law.

Quoting Geoffrey Culpit’s definition:

To act impartially, is to be unmoved by certain sorts of considerations—such as special relationships and personal preferences. It is to treat people alike irrespective of personal relationships and personal likes and dislikes (Rothstein & Teorell, 2012).

The more important effect of impartiality is ‘psychological’ (Feld & Frey, 2002), because impartial institutions can reinforce positive social norms. They do this because they treat their citizens equally *and consistently* regardless of their status, wealth, political position or group. In short, they enforce rules equally across their constituencies and this in turn reinforces the norm of contribution because tax payers are more likely to believe that everyone (or nearly everyone) is following the norm. Once again, because we are social creatures, when we see people following the rules, we are more likely to follow the rules ourselves – even when our behaviour is done in private. On the other hand, if we find significant defection around us, then we are more likely to defect ourselves. It seems reasonable that where peo-

ple feel that no one else, or very few others, will pay to the public good, it is very likely to think that it is 'okay' to cheat as well.<sup>6</sup>

For the norm of tax compliance to become embedded or generalized in society, it must become salient across that society. In other words, the expectation must be the *most* people abide by the norm – even if there is some evidence that not everyone does.<sup>7</sup>

A growing body of literature on the relationship between institutions and trust supports this view. For example, Tom Tyler in his important study, 'Why People Obey the Law', supports the view that the evaluation of authorities and institutions is shaped by concerns about procedural justice (Lind & Tyler, 1988).

When people generalize about the legal authority based on their personal experiences, they focus most strongly on questions of procedural justice. Similar findings are obtained when one explores the effects of experience on the relationship of legitimacy to compliance. If people have an experience not characterized by fair procedures, their later compliance with the law will be based less strongly on legitimacy of legal authorities. Therefore, not experiencing fair procedures undermines the legitimacy. (p. 172).

Similarly, Stefan Kumlin's fascinating work on the relationship between public institution and trust in Sweden draws very similar conclusions arguing that the design of experienced welfare state institutions affects political orientations. His evidence demonstrates that personal experiences with the welfare state are more important than economic experiences (*e.g.* receiving benefits. In short, people care more about how they are treated and whether they are treated fairly than the ultimate outcome (Kumlin, 2002).<sup>8</sup>

Schneider and Ingram's analysis of attitudes towards the welfare state in America also points in this direction – but makes a broader point:

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6. Of course, norms are not always generalized throughout a whole society (*see*, for example, Traxler, 2010). Indeed, there can be many, even competing, norms within a society or social group. For example, there can be strong expectations that an individual should behave one way to some members of the group, and quite differently to other members or the group and/or non-group members. This suggests that the influence of a norm is crucially related to the degree to which individuals' attention is focused on that norm in the particular context (Bicchieri, 2006; Cialdini et al, 1991; Xiao & Houser, 2011). A strong personal commitment to a general norm does not necessarily predict behaviour in a particular case if that norm or expectation is not activated in the situation at hand.
  7. Andrighetto et al (2013) argue that the *salience* of a particular norm is key to understanding behaviour in specific cases. Whether a particular norm is salient, though, depends on "several contextual and social factors. For example, the amount of compliance, the intensity and frequency of norm enforcement, the enforcement typology, the credibility and legitimacy of the normative source and of the punishing actor are all acts through which it is possible to infer how salient a norm is in a certain community".
  8. *See also*, Rothstein, 1998, 2011.

The theory of design presented here contends that attitudes and participation are influenced by public policy [...] Public policy is an important independent variable that shapes citizens orientations and perpetuates certain views of citizenship (Schneider & Ingram, 1997, pp. 200-201).

Recent work by Israel Marques examines social policy preferences in Russia and draws similar conclusions. He points to the fact that states that are more porous to influence of both internal and external actors are not only less efficient in delivering services, they are also less likely to deliver services equitably. Similarly, they are less likely to distribute the tax burden fairly and equitably. Following Mares, he suggests that this inequality itself can create disaffection with the state. "In other words weak states are less legitimate than strong states in part because they are more likely to be subject to the influence of particular actors" (Marques, 2015). The key point here, for my purposes at least, is that institutions that do not practice unequal enforcement of the rules undermine the legitimacy of the rules themselves. In this context citizens (and taxpayers) can easily believe that the 'norm' is *to evade*. This is clearly a major problem in countries like Italy (D'Attoma, 2017, 2018; Hien, 2018).

Arguing in a similar vein, Marques and Sokey conduct comparative laboratory experiments in study attitudes in Russia and the US and conclude as follows:

Scholars have often focused on how poorly functioning government institutions create losers and, in general depress support for the provision of any public goods. We argue, however, that poorly functioning institutions create winners and losers (Marques & Sokey, 2016, p. 2).

Once again, the point here is that when a citizen/taxpayer sees 'winners and losers' around her, she is less likely to be convinced that norms are being consistently followed. In this event, her self-interest motives are likely to dominate over her sense of social responsibility.

Finally, Rothstein and Uslander argue that inequality can have similar effects.

The policy implications that follow from the authors' research is that the low levels of trust and social capital that plague many countries are caused by too little government action to reduce inequality. However, many countries with low levels of social trust and social capital may be stuck in what is known as a social trap. The logic of such a situation is the following. Social trust will not increase because massive social inequality prevails, but the public policies that could remedy this situation cannot be established precisely because there is a genuine lack of trust. This lack of trust concerns both 'other people' and the government institutions that are needed to implement universal policies (Rothstein & Uslander, 2005).

"On the other hand," as Marques and Sokey have argued, "some actors may be able to take advantage of weak institutions in order to secure privileged access to property rights, favorable policies, or other favors [...]. Weak state capacity, con-

versely, enables those with mobile assets and low visibility to the state to free-ride on others' contributions to public goods" (Marques & Sokey, 2016, p. 4).

When the rules of society are clear and (nearly) universally enforced, most people will comply. When most people comply, more people comply. When more people comply, they create more social goods. More social goods lead people to believe, quite reasonably, that society is fair and just. If society is fair and just, reasonable people will want to behave appropriately and correspondingly behave in a fair manner. You will be more altruistic. If you are more altruistic, the people around you are more likely to behave more altruistic. Also, if you and most of those around you behave more altruistically, you will be more likely to shun those who are selfish.

### 3.4 TAX MORALE, CULTURE AND POLITICAL INSTITUTIONS

Many studies in the past treated 'tax morale' as a black box without discussing or even considering how it is built or maintained.

It is usually perceived as being part of the meta-preference of taxpayers and used as a residuum in the analysis capturing unknown influences to tax evasion. The more interesting question then is which factors shape the emergence and maintenance of tax morality (Feld & Frey, 2002, pp. 88-89).

I submit that tax morale can be understood as a positive social norm that is built and reinforced by effective public institutions and public policies. Instead of viewing all citizens as would-be evaders who will only contribute to the public good for fear of being caught, we should instead consider taxpayers as offering what Margaret Levi calls 'contingent consent' (Levi, 1997). But we should especially note that consent is contingent not only on getting something in return for the tax money put in, but also on the taxpayer's perception as to whether the social norms prevalent in the society are enforced consistently. No one wants to be a sucker, to be sure. But neither do most people want to be a free rider.

Countries with relatively high levels of tax compliance tend to be relatively wealthy, have less poverty, less corruption, less violence and more efficient institutions. In these societies people tend to obey laws, pay their taxes, trust each other and are happier. You do not have to be a rocket scientist, or even a social scientist, to know that these factors are related to one another. But how? Are some societies more successful than others because they have better institutions, or are the institutions better because they have better people? Is the key difference between Sweden and Italy the fact that Swedes are more honest and trustworthy, whereas Italians are more dishonest and untrustworthy? In other words, are the differences between the more successful societies and the less successful societies matters of culture or institutions?

While it is obvious that there is an iterative relationship between institutions and culture over time, our research and analysis convince me that the key to explaining variation cannot be found in basic cultural differences. People do not trust governments when governments are untrustworthy. When governments are untrustworthy, the laws – and more importantly the implementation of the laws – are biased in favour of certain groups or individuals. In this case, citizens and taxpayers have little reason to be willing to sacrifice their short-term self-interest. In other words, if they can cheat and get away with it, they will. And, of course, the more people that shirk, evade or defect, the more this behaviour becomes the expected norm.

Sweden, for example, is widely recognized as having developed one of the most efficient tax systems in the world today. Tax compliance in Sweden is at least as high as, if not higher than, in any other country in the world. Despite a very high tax burden, Swedes have enormous faith and trust in their tax authorities (Wittberg, 2010). This is largely because Swedish political institutions generally, and tax collection authorities in particular, are perceived to be impartial and fair (Wittberg, 2012). Italy, in contrast, is often disparaged for having one of the lowest levels of tax compliance in Europe. ‘Culture’ is quite often presented in both the public media and academic publications as the central explanation for these differences. Quite bluntly, Swedes are perceived to be honest and trusting whereas Italians are often characterized (even by their own governments) as shifty and untrustworthy. Swedish institutions work so well, the logic runs, because Swedish citizens are particularly honest while the Italian state seems rather dysfunctional because it is run by Italians. Our analysis argues differently. Indeed, when given clear and transparent rules in a tax compliance experiment, Italians cheat only marginally more than Swedes (Andrighetto, Zhang, Ottone, Ponzano, D’Attoma & Steinmo, 2016).<sup>9</sup> The key point here is that in the real world, Italians do not benefit from the clear, transparent and impartial institutions that Swedish citizens benefit from. (D’Attoma, Volintiru & Steinmo, 2017; Jansson, 2018; Nistotskaya & D’Arcy, 2018).

Anyone who has spent time in Sweden and Italy will confirm that there is plenty of anecdotal evidence to support these theories. Swedes do appear to be particularly law abiding in general whereas Italians often seem to make up their own rules as the go (or drive). But is this not because Italians cannot follow rules and Swedes are simply compliant? (Try ordering cheese with fish in an Italian restaurant.) Instead Italians nearly universally believe that tax rules will not be

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9. There is insufficient space here to adequately discuss the cross-national experiments we have conducted. Briefly, though we can see we conducted a large set of tax compliance experiments in five countries (Sweden, Italy, Britain, the US and Romania). We ran sessions in 17 different laboratories in these countries and included over 3,000 participants in the study. The interested reader is referred to: (Andrighetto et al, 2016; Pempel, Andrighetto & Steinmo, 2018; Zhang et al, 2016) and the ERC-funded research project “Willing to Pay?” Generally, see: [www.willingtopay.eu](http://www.willingtopay.eu). In this work we show that ‘culture’ is a poor explanation. However, expectations of other behaviour (norms) can be quite a powerful motivator in tax compliance.

enforced equally (if at all) whereas Swedes quite reasonably believe that if a rule applies to them individually, it will apply to everyone equally.

The high levels of compliance found in countries like Sweden are the envy of much of the world. Policy makers and economists alike are often surprised that the Scandinavians – with their very high levels of taxation – also have a very high levels of compliance. This surprise comes from the basic presumption that citizens are purely self-interested utility maximizers. It is ‘rational’ to evade taxes if the tax burden is heavy, their theories argue. If, however, we view human beings as motivated by multiple factors including their desire to be part of a group and cognitive needs for logical consistency, we can then begin to make sense of this otherwise puzzling behaviour. In short, it may not be economically ‘rational’ to contribute to the public good when you believe you can get away with not paying... but it is both human and reasonable.<sup>10</sup>

### 3.5 CONCLUSION AND SOME IMPLICATIONS

I argued above that there is an iterative relationship between institutions and culture. This implies that either vicious circles of vice or virtuous circles of virtue can develop in different contexts. It is quite clear, for example, that it is far easier for Scandinavian countries to collect taxes and thereby provide better public services than it is for developing and/or corrupt countries. If citizens trust the state, they are ‘willing to pay’; if they do not trust the state to tax others fairly, or to distribute public benefits adequately, then they are far less willing to contribute. The most difficult question is then: what should governments do if they find themselves in a vicious cycle in order to move towards a more virtuous circle?<sup>11</sup> First, it must be recognized that there are no easy short cuts to this answer. Second, it is important to recognize that each country has its unique history and story that must be accommodated when trying to build trustworthiness. Having said this, a couple of general policy recommendations do appear to stand out: (1) Due to human’s preferences for procedural justice, tax policies that are nominally progressive, but generally evaded by the wealthy and/or the politically connected, will *undermine* trust in the state. While most people believe that progressive taxation is ‘fair’ and that the wealthy should pay more than the poor, it is sadly the case that very steep taxes on the rich can have the unintended effect of making average citizens believe that the whole system is ‘unfair’. (2) Equally surprisingly, because of our desire for fairness *and* consistency, societies with higher levels of compliance are more likely to require contributions from the poorer segments of society as well as from the rich. At first this may seem upside down. How could it be ‘fair’ for the poor to pay taxes? The simple answer is that if everyone pays something then everyone has a

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10. In our experimental studies, we found that students of economics were significantly less likely to contribute to the community fund than any other group we examined.

11. For a broader discussion of these issues, see: Steinmo, 2018.

right to the benefits of the system. It may be perceived as inconsistent to demand benefits or services if one has not contributed even the smallest amount.

Finally, (3) the relationship between the citizen and the state is often thought of as one of prey versus predator (Levi, 1988). This analysis points in a very different direction. It is quite clear that states often treat their citizens as prey and, as Jean-Baptist Colbert once quipped, “the art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.” The logic of this chapter argues instead that a more effective and sustainable way of generating revenues is to treat the citizen as a reasoning social creature who is generally willing to contribute to the public good if she feels that everyone (or nearly everyone) else is doing so as well... and that she will get something worthwhile in return.

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