ROMANIANS' TAX COMPLIANCE IN A COMPARATIVE PERSPECTIVE

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***Abstract**. Using a comparative database generated through an experimental study on tax compliance and policy preferences ran in five countries (Romania, the US, the UK, Italy, and Sweden), I will evaluate the extent to which the Romanian your people exhibit higher or lower levels of tax compliance when compare with young people from other countries. The historical analysis traces the historical roots of systemic tax avoidance in Romania, while the analysis tests the explanatory power of the theoretical approaches on the causal factors that shape tax compliance can be divided into structural level and individual level theories. The two main streams of structural level theories focus either on culturalist or institutionalist factors. The individual level models, on the other hand, are the economic models of deterrence and the socio-psychological theories of tax morale.*

***Keywords**: tax compliance; trust; tax morale; Romania; experiment.*

Introduction

This article represents an attempt to understand the extent to which the historical inheritance of tax avoidance in Romania influences the contemporary youngsters, when compared with similar generations from other countries. The article is structure as it follows: first, I review the main important theoretical approaches on tax compliance, and discuss their implications. Second, I review some historical milestones that have influenced the level of tax compliance in Romania. Third, using a multivariate analysis, I analyze the extent to which Romania's Millennial generation is still influenced by Romania's past, or resembles more the same generations from more developed countries.

Literature review

The efforts to describe the causal factors that shape tax compliance can be divided into structural and individual level models. The main streams of structural level theories focus either on culturalist or institutional factors. The individual level models, on the other hand, are the economic models of deterrence and the socio-psychological models of tax morale.

One of the most influential structural level approaches to tax compliance, and too many other social phenomena as well, the cultural approach to tax compliance emphasizes norms and values, with a special focus on the meaning of social morality. While in northern European countries social, impersonal, autonomy-based norms are arguably dominant, southern or Latin American countries are argued to have more family-based norms. (Banfield, 1967; Tabellini, 2010; Torgler, 2002) One of the most important implication is that countries like Romania and Italy should exhibit lower level of tax compliance, since they manifest more collectivistic norms.

The other important structural level approach, the institutional trust approach, stresses that people's perceived legitimacy of the state leads to tax compliance and respect for the rules. From Levi's quasi-voluntary compliance argument (Levi, 1989) and Steinmo's analysis of differences in tax systems, (Steinmo, 1996) more recent studies that look at the attitudes towards the welfare state (Edlund & Lindh, 2013) as explanations for tax compliance and institutional trust in general. (Mishler & Rose, 2001; Uslaner & Bădescu, 2004)

The individual explanations of tax compliance based on the deterrence-based model initially advanced by Becker (Becker, 1968), Allingham and Sadmo (Allingham & Agnar, 1972) have developed a various models on the assumption of fully rational utility-maximizer individuals that can adequately evaluate the parameters of the tax game (e.g. the tax rate, penalties and detection risk). In these models, tax compliance depends on people evaluation of the risk of being caught. Instead, the tax morale approach to tax compliance is developed in the work of Schmolders (1959) on tax mentality, or Strumpel1, and hypothesing that the higher the belief in the importance of paying taxes, the higher tax compliance should be. (Torgler, 2002) A recent study by Todor (2018) on the history of tax compliance in Romania voiced that the presence of high tax morale combined with widespread tax evasion implies that tax compliance cannot be improved sensibly through deterrence mechanisms. This is caused by the fact that a less-than-perfect institutional setting easily transforms deterrence into discretionary power that encourages corruption.

Historical milestones in structuring Romanian's attitude towards taxation

To start with, the territory of contemporary Romania has been organized throughout history mostly in three different kingdoms: Moldavia, Wallachia and Transylvania (the fourth province, Dobrogea, was part of Ottoman Empire after 1420 until 1878). One of the most important national collective identity projections is that these kingdoms were generally ruled by peace-loving kings who had to protect their lands from various plundering migratory people like Huns, Tatars, and Turks.23 As in many other medieval states, the nobleman were exempted from paying taxes until very late, for example, in Moldavia until 1636 the noblemen in the province of Moldavia did not pay taxes. The recentralization (decreasing the latitude of noblemen to impose freely taxes on their feuds) of tax system started very late, when in 1740 Constantin Mavrocordat introduced one of the first comprehensive reforms of the taxation system, simplifying it. In Transylvania, during the medieval period most of state's income came from monetary operation, taxes, and income provided by mines and the salt mines. Each household had to pay an annual tax. The servant peasants had their own tax duties towards the noblemen's, but these contributions were more regulated than in Moldavia and Wallachia. While all the three kingdoms have paid tribute towards the Ottoman Empire for most of the period, the overall burden was lower generally in Transylvania compared with Moldavia and Wallachia. The importance of tribute and the presence of an

1 1969
2 Hiding money from various migratory populations during their invasions was very important
3 Marian Vasile, "Evaziunea Fiscală ca Fenomen Monetar Negativ," (Tax evasion as negative monetary phenomenon) An. Inst. de Ist. „G. Bariţ" Din Cluj-Napoca, Seria Humanistică, Tom II (n.d.): 1.

impoverishing tax system designed also to extract money for paying the tribute is a constant feature of portraying this period on most history textbooks.

One of the historical periods that tends to be portrayed in the most negative terms and had a long impact on how the population related to the state institutions is the Phanariot period that lasted between 1711 and 1821 in Wallachia and Moldavia. The most peculiar feature of this period was that a family would buy the right to rule in one of the provinces for a period of 7 years. Given the high amount they had to pay for their position, the rulers had a large room of maneuver to discretionary impose taxes, to alter their level and to sell virtually any position in the State apparatus in order to recover their investments. Those that bought those positions would perpetuate a similar behavior aiming to collect money to cover their investment. While in the first part 1711-1700 the ruling families were of Romanian origin that were Graecized (Hellenized), between 1770 – 1821 period, the ruling families were of Greek origins.4 Especially the second period portrayed the transformation of the state system in an apparatus design exclusively as spoiling the resources of the locals for the benefit of foreign elite that had no interest in developing the provinces. Thus, tax evasion became a virtue as the legitimacy of the state apparatus was totally absent.

Given the continuously decreasing influence of the Ottoman Empire and the rise of Russian Empire, after the 1821 Revolution, the Phanariot regime was abolished. While Romanian rules were reinstalled, their influence was rather limited since Wallachia and Moldavia came more and more under the Russian influence. Subsequently, in 1831 Wallachia and in 1832 Moldavia, under the direct influence of the Russian Imperial Authorities, the first set of proto-constitutional regulations (Regulamentele organice) were promulgated. Subsequently, in 1856 Wallachia and Moldavia unified under the same rule Alexandru Ioan Cuza and after 1866 the political elite installed a foreign ruler, Carol I de Hohenzollern-Sigmaringen, who became king in 1881 after Romania gained its independence. It is worth mentioning that in most history books the references to the prevailing tax systems during this period are only minimal.

The most notable institution evolution that indirectly affected the tax system is the evolution of land property by the Church. Since the medieval period, the only institution that kept its tax privileges was the Orthodox Church (under Romanian or Greek influence). Through constant donations received over several hundred years, by 1863 the Church owned approximately 25% of the land of the Romania5. Thus, in 1863, Cuza proposed to the Parliament, which accepted with 93 to 3, the full confiscation of all land properties of the Church, confiscation that lead to a significant surge in state revenues. This process led to the semi-elimination of foreign influences (especially Greek monasteries held important land properties) and consolidation of the national Orthodox Church.

The official preoccupation with the level of tax compliance started very late, the first law that explicitly forecasted measures against fiscal evasion was introduced only in 1921 followed by an easing in 1923 when the minimal tax obligations and some penalties

4 Anca Dulcinatu, Trasaturi generale ale regimului turco-fanariot in Principatele Romane: Tara Romaneasca si Moldova [Genral traits of Turkish - Phanariot regime in Romanian Principalities, Tara Romaneasca and Moldavia] n.d., 2, https://www.academia.edu/5274436.
5 http://www.historia.ro/exclusiv_web/general/articol/cum-l-sat-cuza-vod-biserica-n-sap-lemn

were eliminated. Under the leadership of the Minister of Finance, Nicolae Titulescu, the 1921 law introduced a progressive tax on the declared global income, and defined a luxury tax and a global business turnover. The 1923 law created significant loopholes (one of the most important forecasts referred to the possibility to over valuate the total value of buildings, etc.), that led to an uneven distribution of the fiscal burden6 and generated some significant negative effects on the direct tax income. Thus, the 1929 Law for repression against fiscal evasion on direct contribution7 represented the first Fiscal Code with detailed instruction for fighting tax evasion. (Vîrjan, 2011, p. 7) The 1929 law imposed more minimal fix contribution based on presumption and external evaluation. Also, for the first time, the attempt to bribe a fiscal public employee became punishable by imprisonment. Subsequently, a new law elaborated in 1933, the Law regarding direct contribution introduced penalties, fiscal offence and fiscal evasion. After World War Two, the Law no. 344 from December 29, 1947 introduced some harsh penalties against tax evasion but also introduced the possibility to pay previously avoided tax in order to avoid prison. While during the communist period the possibility of tax evasion was relatively limited since most direct taxes were withheld at the source, and most economic assets were state owned, the culture of informality and various networks design to access limited resources have nurtured a culture of corruption and rule avoidance.(Uslaner & Bădescu, 2004) Overall, despite the significant changes experienced by Romania in the post-communist period, the level of tax avoidance have remained relatively significant by today. (Todor, 2018) One of the expectation based on this situation is that Romanian's should exhibit lower levels of tax compliance when compared with people from other developed countries, where the overall level of tax compliance is also higher.

Methods and experimental protocol

In this section I will briefly present the main characteristics of the experimental design through which the data for the comparative study has been obtained. The experimental protocol is described in detail in (Pampel, Andrighetto, & Steinmo, 2017; Zhang, Andrighetto, Ottone, Ponzano, & Steinmo, 2016), and thus I will only briefly present the main characteristics of the activity. The subjects were recruited through public announcements and selected using ORSEE software (Greiner, 2015) with similar procedures in all locations. The experiment was run in two to four different locations in different universities that had adequate physical infrastructure for the experiments in each country. In practice, most participants were undergraduate students, and some recent graduates. The instructions were read by native speakers, and the experimental protocol was translated in each language and doubly verified.

After their arrival, participants were randomly assigned an anonymous ID, were directed towards a computer station and were asked not to talk to the other participants until the end of the experimental session. The first three stages started with a five-minute clerical task consisting of copying information from a sheet onto a table. Based on their proficiency in executing the task, each participant earned a number of Experimental Currency Units (ECUs). Each participant had to transmit their earnings after the clerical task with the formula "report your income for tax purposes" under six different institutional scenarios. Each participant was informed during the instruction

6 There was no property tax on the buildings owned by economic entities.
7 "Legea pentru represiunea evaziunii fiscale la contribuţiile directe" (Law for repressing the tax evasion to direct contributions)

that there was a 5 per cent audit probability, an audit that would fine them double the amount of money they under-reported. Whether a participant was audited was revealed only at the end of all stages in order to avoid any effect of the audit from one round to the next. These are the differences among the six scenarios: y1 Participants were told that the tax rate is 30%, with no mention of redistribution of tax revenues; y2 The tax rate remained at 30%, but all tax revenues were placed in a general fund which was subsequently divided equally among all participants; y3 A tax rate of 30% going to a general fund, with the lowest 20% of earners receiving slightly more from the fund than those with average and above incomes; y4 A tax rate of 30%, with revenues going to the national government (Department of Treasury); y5 A tax rate of 30%, with revenues going to the Social Security, Retirement System (National Pension Scheme); y6 A tax rate of 30%, with revenues going to the local Fire Department.

Data interpretation

In figure 1 I present the distribution of tax compliance decisions by participants in all the six rounds of the experiment. As it can be easily seen, the number of decision of full compliance, where a participant report 100% of his income is significantly higher than in any other countries. Furthermore, Romania has the lowest number of participants that reported 0% of their earnings. Thus, Romanian participants do not have the same profile as the rest of the countries, but not in the expected direction, but the opposite.

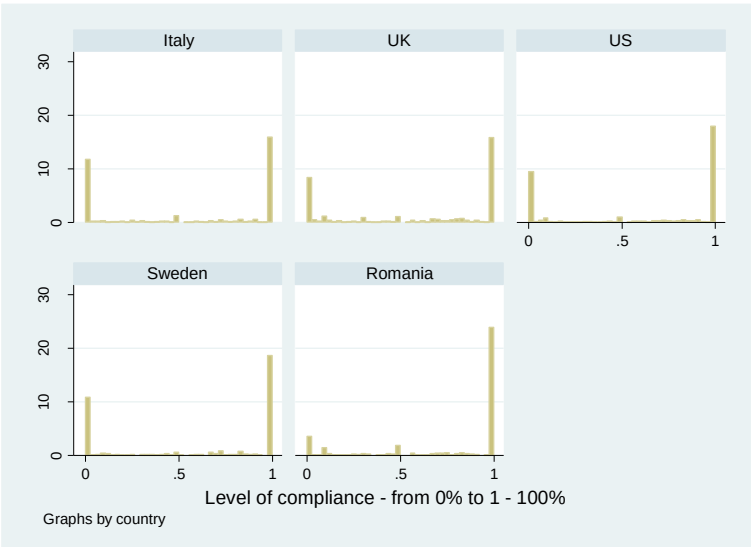

Figure 1. Distribution of tax compliance decisions by country

To understand the factors that explain the higher level of tax compliance under experimental conditions in the case of the Romanian participants, in table 1 I present the results of a regression analysis run separately on each of the five countries. Y2 to y6 represent the comparative reaction in these stages of the experiment when compared with the baseline, y1 choice. Peculiar to Romanian participants is that none of the stages has a positive or negative significant difference when compared with the baseline. Instead, in all other countries at least one of the stages led to statistically different reactions. Compared with the interpretation of the data in figure 1, this implies that means that the default position of the Romanian participants was to fully report their incomes, and not alter their strategy based on the different structure of incentives

presented in different rounds. The questions regarding the preference for free market and opinion towards wealth accumulation does not have a negative effect on the level of tax compliance under experimental conditions. Also, the question regarding the level of trust in the national government does not have an explanatory power on the level of tax compliance. Instead, the Social Value Orientation angle is not a statistically significant predictor of compliance only in the case of Romania. Thus, while in the other countries, people with more prosocial attitudes tend to be more tax compliant, in Romani this feature does not make a difference, maybe also given the high level of tax compliance. As in Italy and Sweden, the level of tax morale does not affect tax compliance. Instead, the tax morale has a positive effect on compliance in the UK and the US. Last but not least, the other variable where the behavior of Romanians is peculiar is the risk aversion. While risk aversion is negatively associated with tax avoidance in all countries, in Romania this is not the case.

Table 1. Explanatory models for tax compliance under experimental conditions

	Romania	**Italy**	**UK**	**US**	**Sweden**
	b/se	**b/se**	**b/se**	**b/se**	**b/se**
y2	-0.023	0.180***	0.006	0.045	0.113**
	(0.04)	(0.03)	(0.04)	(0.02)	(0.04)
y3	-0.036	0.182***	0.055*	0.087***	0.097*
	(0.05)	(0.03)	(0.04)	(0.02)	(0.04)
y4	-0.077	0.037	0.022	0.048*	-0.043
	(0.05)	(0.02)	(0.06)	(0.02)	(0.06)
y5	-0.001	0.098**	0.024	0.084***	0.010
	(0.05)	(0.03)	(0.06)	(0.02)	(0.05)
y6	0.094	0.130*	0.040	0.139***	0.087
	(0.05)	(0.04)	(0.03)	(0.02)	(0.05)
Free markets are good because they stimulate people to work hard and develop new ideas (l) vs free markets are harmful ...	-0.007	-0.000	0.011	0.012	-0.012
	(0.01)	(0.01)	(0.02)	(0.01)	(0.01)
People can only get rich at the expense of others (l) vs. Wealth can grow so that there's enough for everyone (r)	-0.005	0.001	-0.030*	-0.012*	-0.023*
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Trust in the national government	0.016	0.002	0.005	0.010	0.003
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Social Values Orientation angle	0.004	0.007*	0.007*	0.007***	0.006**
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Left – right scale placement	-0.013	0.018	0.004	0.020*	-0.048*
	(0.02)	(0.01)	(0.02)	(0.01)	(0.02)
Tax morale	-0.000	0.006	0.023*	0.019*	-0.007
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)

	Romania	Italy	UK	US	Sweden
	b/se	b/se	b/se	b/se	b/se
Risk attitude	-0.000	-0.031**	-0.057**	-0.011*	-0.026*
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)
Age	-0.004	-0.003	-0.022**	0.009*	0.002
	(0.01)	(0.01)	(0.00)	(0.00)	(0.00)
Male	-0.184**	-0.147*	0.009	-0.212***	-0.251***
	(0.06)	(0.05)	(0.06)	(0.03)	(0.04)
Past participation	-0.124	-0.085	-0.199*	-0.128**	-0.198*
	(0.09)	(0.08)	(0.08)	(0.04)	(0.08)
Study economics?	-0.014	-0.032	-0.235**	-0.078*	-0.092
	(0.04)	(0.05)	(0.06)	(0.03)	(0.08)
constant	0.934**	0.698**	1.629***	0.397**	1.154***
	(0.25)	(0.21)	(0.16)	(0.12)	(0.27)
AdjR-sqr	0.093	0.148	0.359	0.245	0.301
dfres	10	12	6	30	14
BIC	298.7	1562.5	339.6	2172.2	570.8
N	424.0	1426.0	417.0	2313.0	560.0

Conclusions

Base on this short data analysis, I conclude that the Romanian participants in this experiments where much less different than their counterparts from more developed counties than expected. To start with, Romanian Millennials manifest a significantly higher level of tax compliance under experimental conditions, under tight control variables. Overall, their tendency to act strategically given the different tax scenarios are being very limited, and they also do not exhibit variation in tax compliance based on their risk attitudes or social behavior. This data strongly indicates that the historical negative inheritance has apparently no measurable effect on the Romania's Millennial generation, when compared with the similar generations from mode developed countries. Nevertheless, given that this data was obtained under experimental conditions, this does not mean that through socialization their behavior could not be perverted in practice.

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