

# “Willing to Pay?” Tax Compliance in Britain and Italy: an Experimental Analysis - Submission to PLOS Journals<sup>2</sup>

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## Abstract

As shown by the recent crisis, tax evasion poses a significant problem for countries such as Greece, Spain and Italy. While these societies certainly possess weaker fiscal institutions as compared to other EU members, might broader cultural differences between northern and southern Europe also help to explain citizens’ (un)willingness to pay their taxes? To address this question, we conduct laboratory experiments in the UK and Italy, two countries which straddle this North-South divide. Our design allows us to isolate the influence of cultural factors on individuals’ willingness to pay taxes while holding institutions constant. We report a surprising result: when faced with identical tax institutions and audit probabilities, Italian participants are significantly more likely to comply than Britons. Overall, our findings directly contradict “culturalist” arguments that would attribute cross-country differences in tax compliance to the lack of morality amongst southern European taxpayers.

## Introduction

Modern welfare states face a set of difficult challenges as they adapt to the demographic, economic and political strains of the early 21<sup>st</sup> century. States must struggle to maintain adequate support for social welfare and educational programs in the face of growing distrust of bureaucratic institutions, intense pressures to cut taxes for politically powerful constituencies, and fiscal burdens arising from an aging population. The ability of governments to collect revenues in an efficient and

cost-effective manner is of central importance to how successfully states meet their policy goals. And to ensure a healthy fiscal foundation, states must be able to control (or reduce) tax evasion on the part of their citizens.

Yet, while Western European states generally possess tax systems sharing many of the same formal features [1], the actual compliance rate varies widely across these societies [2–7]. Moreover, evasion rates also seem to follow a geographic pattern, with high levels of compliance in northern Europe, and widespread under-reporting in the countries further south. Using the size of the “shadow economy” as a proxy for tax evasion, Schneider and Enste find the lowest compliance rates in Western Europe in Portugal, Spain, Italy and Greece [4].

The literature has advanced several “institutionalist” theories to account for this cross-national variation in tax compliance.<sup>1</sup> In large part, these explanations focus on the relationship between the quality of government and citizens’ willingness to comply with fiscal demands. Specifically, this literature argues that citizens are more likely to pay their taxes if they believe that the government is spending their money honestly and efficiently [3, 7, 13–21]. By contrast, when citizens perceive public institutions as corrupt and wasteful, they are likely to reciprocate by being dishonest in turn [22, 23]. Thus, one explanation for EU-wide differences in levels of tax compliance is that, in southern European countries, people often interact with low quality institutions for which they are (unsurprisingly) unwilling to pay.

A second set of theories links tax compliance to broader cultural norms and values. Within Europe, one important axis of cultural variation concerns how different societies draw the boundaries of moral behavior [22, 24–28]. Specifically, southern European societies are typically characterized as more “familistic” or “collectivist,” and ethical conduct is often assumed to apply only to a small circle of familial or personal relationships, while outside of this circumscribed network, selfish or opportunistic behavior is norm. In the public sphere, individuals follow the rules not out of some internalized sense of “right” and “wrong,” but only when they are coerced to do so [28]. By contrast, northern European societies are often said to emphasize values of “autonomy” or “individualism,” and citizens are presumed to apply the same ethical principals that prevail within familial relations to conduct in the civic realm.

This distinction between what Tabellini [28] has termed “limited” and “generalized” morality has direct implications for the level of tax compliance within a society. As many scholars have noted, in most cases, audit rates and punishment probabilities are insufficient to deter cheating [14, 29–32], and states must rely upon voluntary compliance to collect fiscal dues. However, if “cheating the system” imposes little moral cost, then the willingness to pay is undermined. Thus, a broader cultural argument would lead us to expect greater tax evasion in southern European countries, *independent of institutional performance*.

Our research attempts to test this hypothesis using cross-cultural behavioral experiments.<sup>2</sup> The advantage of this approach is that it allows us to hold formal institutions (e.g. tax rates, audit probabilities, the efficiency of the state, etc.) constant across countries, and thereby isolate the influence of broader cultural factors on fiscal behavior. In this paper, we report results from two countries - the UK and Italy - which we take as “representatives” of northern and southern Europe. For example, Slemrod estimates the evasion rate in the UK to be around 8% or 9% of GDP [35], while comparative figures for Italy can reach as high as 25% to 30% [36]. Culturally, Italy is often vilified - both in the press as well as in popular opinion - as the quintessential

<sup>1</sup>The literature here is vast, and concerns not only the quality of institutions. For example, other scholars have noted the importance of factors such as participation in direct democracy or “fair treatment” at the hands of the tax authorities [8–12]. However, we have no evidence that these factors vary systematically between northern and southern Europe.

<sup>2</sup>Several previous papers have employed this strategy in the tax compliance context [13, 33, 34].

“amoral” society in which people cannot be trusted to behave ethically outside the network of familial and personal relations [24]. By contrast, Britain is rather typical of Protestant, northern European societies in terms of cross-national rankings of “autonomy” and “individualism” [25, 26]

Our tax experiment involved over 500 participants across multiple locations in Italy and the UK. The main experimental task consisted of a tax compliance scenario in which participants earning real money were asked to report their income under a variety of tax rates and redistributive scenarios. By comparing compliance rates across countries, we are able to investigate whether, independently of the institutions, Italians are indeed less honest than Britons when faced with identical fiscal choices.

To preview our results, we find no evidence to support the contention that the morality of tax compliance is weaker in Italy, compared to the UK. Instead, we find that the compliance rate amongst Italian participants is significantly higher than amongst Britons. These results remain robust to the inclusion of a host of demographic controls, and have been reproduced in multiple experimental locations in the two countries. In summary, although stereotypes about the “amorality” of Italian (and, more generally, southern European) taxpayers abound in the popular consciousness, we show that cultural values cannot explain the significant cross-national variation in evasion rates that we observe in the real world. In the concluding section, we discuss several implications of our findings for future work.

## Methods

### Setting

Our experiments were conducted at six universities across the United Kingdom and Italy at various points during the academic year 2013-2014: [locations anonymized].<sup>3</sup> Our team spent over a year designing and re-designing our experimental protocols to ensure the consistency of the laboratory set-ups and selection pools in each of these locations. Everything from the recruitment methods,<sup>4</sup> to the way participants entered the lab, to the final payments procedure was the same in each session.

### Participants

The data we present in this paper are drawn from 31 different experimental sessions involving a total of 671 participants from a variety of academic disciplines. Because we are interested in comparing specifically British and Italian attitudes towards tax compliance, we retain the data for only native students, whom we define as those individuals born in Britain (Italy) to British (Italian) parents.<sup>5</sup> The result leaves us with a subset of 531 participants, of which 281 (52.3%) are from Italy and 250 (47.1%) are from the UK.<sup>6</sup> S1 Table presents descriptive statistics our participant pools. Overall, 56% of our participants were male, with an average age of 23.8 years (s.d. = 7.7 years).

We note that there are several slight demographic differences between our British and Italian samples. In particular, British participants were significantly more likely to be employed and to report a higher willingness to take risks, while Italians were more likely to study economics. On the other hand, we detect no significant differences across

<sup>3</sup>The experiments are programmed in zTree [37].

<sup>4</sup>Participants were all recruited using ORSEE [38].

<sup>5</sup>Because of a misunderstanding at the recruitment stage, one session in [location anonymized] enrolled many immigrants. While we excluded the immigrants’ data, we were also concerned that interacting with a disproportionate number of foreigners may have skewed the behavior of even native-born Britons. We therefore drop this session entirely from the analysis.

<sup>6</sup>Including the entire sample of 671 participants does not substantively change our results.

the two populations in terms of gender, age, or previous participation in experiments. We control for these demographic characteristics in our analyses below.

## Ethics Statement

Experiments conducted in the present research were approved by the Ethics Committee at the University of Colorado, Boulder. Participants signed written informed consent prior to taking part in the study.<sup>7</sup>

## Tax Compliance Experiment

### Procedure

The tax compliance experiment proceeds as follows. Participants begin by completing a clerical task, in which they must copy rows of information from a sheet of paper into the computer. For each correctly copied row, participants earn 10 experimental currency units (ECUs), which would be converted into real money at the end of the session.<sup>8</sup> Next, participants are asked to declare this income for taxation purposes under three different scenarios (an example of the income reporting screen is shown in S1 Fig.). In the terminology of the experiment, each scenario constitutes a “round.” Participants are informed that they are free to declare any amount of their income - from 0% to 100% - in each round, with the knowledge that they would only pay taxes on the reported portion of their incomes. Once participants have made three separate declarations, this entire stage (i.e. the clerical task plus three reporting rounds) is repeated two more times, such that by the end of the experiment, participants will have undertaken three clerical tasks and nine rounds of tax reporting.

In each round, we specify slightly different rules for the taxation and redistribution of declared income. In Rounds 1 through 3, we hold tax rates constant (at a flat 30% rate), and vary how tax revenues are redistributed to all the participants, thus simulating behavior under different levels of “efficiency” in providing public goods. In Rounds 4 through 6, we hold redistribution constant, and vary the tax rate (from a flat 10% to 50%). In Rounds 7 and 8, we introduce two different progressive taxation schemes. In the first scheme, the top 10% of declared incomes pays a 50% tax rate, the bottom 10% of declared incomes pays a 10% tax rate, and everyone else pays a 30% rate.<sup>9</sup> In the second scheme, all income over 100 ECU is taxed at a 50% rate, income between 50 and 100 ECU is taxed at a 30% rate, and all income below 50 ECU is taxed at a 10% rate. Finally, in Round 9, we donate all tax revenues to a real world charity.<sup>10</sup> In each round, participants face a 5% probability of being audited, in which case those who have under-reported their income must pay a fine equal to twice the amount of uncollected taxes. The order of experimental scenarios, as well as the rules in each round, are summarized in S2 Table.

Importantly, in order to encourage participants to treat the decision problem within the experiment as a tax compliance problem, we intentionally incorporated tax language in our protocols, using words such as “income,” “taxes,” and “audit” [13, 39].<sup>11</sup> In

<sup>7</sup>Participants who wished to leave the experiment early could elect to receive a 5 euro / pound show-up fee.

<sup>8</sup>These units were converted into local currencies (pounds and euros) so that at the end of the experiment, the average participant would receive an income of approximately twice the average hourly wage for student employment in the local context.

<sup>9</sup>However, participants do not know exactly where they themselves fall in the overall distribution of declared incomes.

<sup>10</sup>We selected Oxfam for UK participants, and the UNICEF for Italian participants.

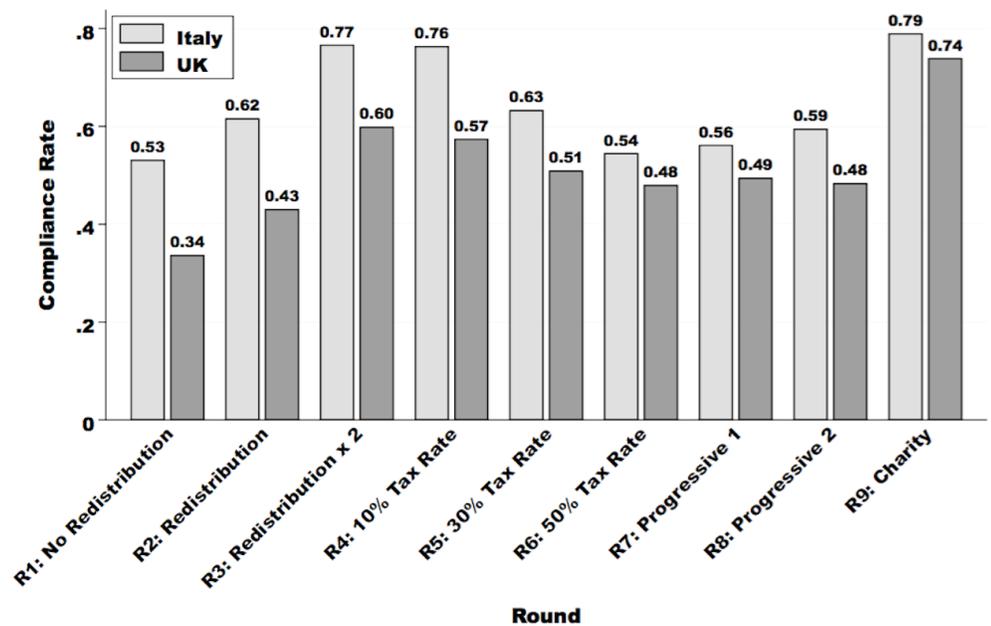
<sup>11</sup>Of course, the issue of framing effects in tax experiments is far from settled [29, 40]. However, we believe this design choice offers an improvement over the use of neutrally-framed compliance games in

addition, participants were not informed of other participants' decisions or performance during the experiment. Additionally, participants had no knowledge of whether they had been audited in the past, or whether their fellow participants were honestly declaring their own incomes. Thus, we can be certain that behavior in the experiment is not the product of reciprocity, conditional cooperation, reputation or wealth effects.

By comparing how income is reported across nine identical taxation and redistribution scenarios, we are able to investigate differences in tax compliance across a range of parameters. Furthermore, because other researchers have also employed similar experimental designs [32,41,42], we are able to use previous studies as an external check on the validity of our results.

## Results and Discussion

Fig. 1 displays the average percentage of earned income that is reported in each of the nine rounds, broken down between British and Italian participants. The vertical axis displays the *average tax compliance rate*, defined as the percentage of total earned income that is truthfully declared in each round. Several points stand out from the graph. First, comparing Rounds 1 through 3, we see that compliance responds positively to the efficiency of redistribution: individuals are more willing to declare a larger percentage of their income when they know that tax revenues produce more public goods. Secondly, individuals respond to higher tax rates by evading their fiscal obligations: compliance falls as we move from Rounds 4 through 6. These results are in line with previous studies [32,41–43], and provide us with some assurance about the validity of our experimental design.



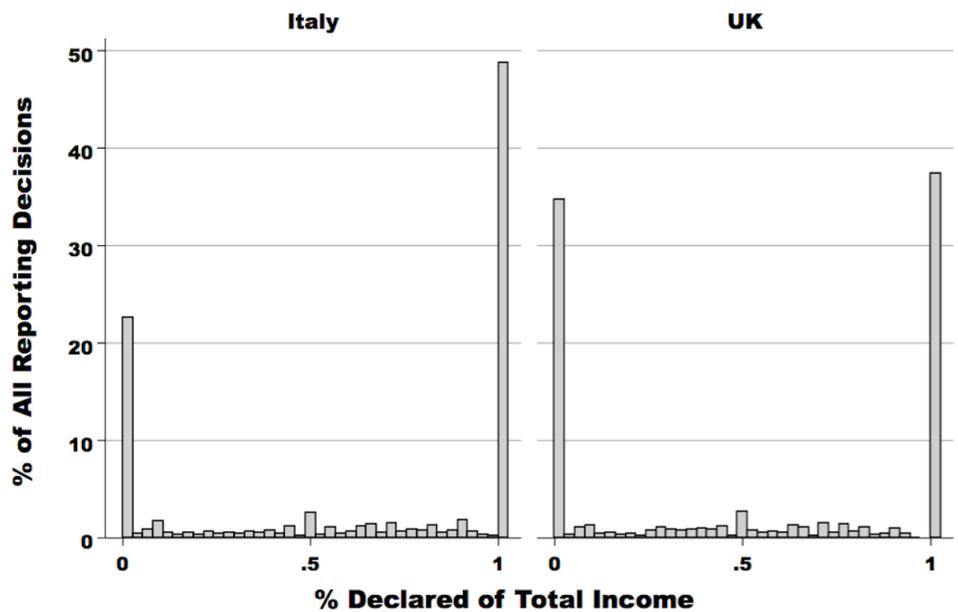
**Figure 1. Average compliance rates, by country, in rounds 1 through 9.** Bar heights represent the average percentage of earned income that is honestly reported. The compliance rate is lower amongst Britons in every single round. Tests of significance for each round are reported in Table 1.

terms of the ability to stimulate taxpayer motivations.

Turning now to our main results, we document a surprising cross-national difference in compliance rates: on average, British participants reported a smaller share of their total income in every round as compared to Italians. As shown in S2 Fig., this finding is also fairly consistent across multiple experimental locations in each country. This result speaks strongly against “culturalist” arguments that would attribute cross-country differences in tax compliance to the lack of morality amongst southern European taxpayers: rather, when faced with the exact same institutions, Italians are actually more willing to pay than Britons!

So far, we have considered broadly how the average compliance rate differs between the UK and Italy, but such a statistic also hides substantial nuance in participants’ decision-making. In fact, if we examine the distribution of compliance rates across *all* reporting decisions, we see that the data are not normal (see Fig. 2). Rather, the average compliance rate actually aggregates three different outcomes:

1. **Complete Compliance:** In over 40% of all decisions, participants honestly declared 100% of their earned income.
2. **Partial Compliance:** In around 30% of all decisions, participants under-reported their income to some degree.
3. **Complete Evasion:** In slightly under 30% of all decisions, participants reported that they earned 0 income.



**Figure 2. Distribution of compliance decisions, all rounds, by country.** Bar heights represent the percentage of reporting decisions in which compliance falls within the ranges [0% - 5%], [5% - 10%]...[95% - 100%]. The distribution is predominately bimodal: in around 40% of all decisions, participants honestly declared 100% of their earned income, while in another 30% of all decisions, participants reported that they earned 0 income.

Table 1 examines how each of these three components differs across the UK and Italy. Columns (1) through (3) estimate the probability that a participant will engage in

complete evasion. We see that in almost all rounds (except 50% Tax Rate and Charity), a significantly greater percentage of Britons declare 0 income. The UK-Italy gaps are substantively large, ranging from about 8% in Round 7 to almost 18% in Round 2.

Table 1. Compliance Gap: Italy and UK

	Pr(Compliance = 0)			Pr(Compliance = 1)			% Income Declared		
	(1)	(2)	(3)	(4)	(5)	(6)	0 < Compliance < 1	(8)	(9)
	Italy	UK	Diff.	Italy	UK	Diff.	Italy	UK	Diff.
R1: No Redistribution	0.330	0.504	-0.174*	0.333	0.192	0.141*	0.586	0.474	0.112*
R2: Redistribution	0.259	0.440	-0.181*	0.479	0.308	0.171*	0.520	0.484	0.036
R3: Redistribution x 2	0.131	0.304	-0.173*	0.660	0.480	0.180*	0.507	0.546	-0.039
R4: 10% Tax Rate	0.156	0.324	-0.168*	0.642	0.476	0.166*	0.599	0.488	0.111
R5: 30% Tax Rate	0.230	0.344	-0.114*	0.468	0.368	0.100*	0.545	0.488	0.056
R6: 50% Tax Rate	0.309	0.380	-0.071	0.390	0.348	0.042	0.512	0.483	0.029
R7: Progressive 1	0.270	0.348	-0.078*	0.394	0.352	0.042	0.497	0.472	0.024
R8: Progressive 2	0.198	0.320	-0.122*	0.385	0.292	0.093*	0.501	0.492	0.009
R9: Charity	0.135	0.168	-0.033	0.695	0.632	0.063	0.552	0.531	0.021

\* indicates whether differences between countries are statistically significant at the 5% level.

We employed Schlag's Z-test to test for country-level differences in columns (3) and (6), and t-tests to check for differences in column (9).

In columns (4) through (6), we see the corresponding totals for the proportion of individuals who were completely compliant in each round. Here, the data tell a similar story: in the majority of rounds, significantly more Italians reported their entire income. The cross-country gaps range from 9% to 18%. Finally, we consider the partial compliance decisions: given that people cheat (but not to the maximum extent possible), by how much do they under-report? Interestingly, here we detect almost no statistically significant differences between Italian and British participants (with the exception of the very first round).

In summary, it appears that the Italy-UK compliance gap is almost entirely driven by differences in *complete compliance* and *complete evasion* between the two countries: Britons are more likely to cheat (under-reporting their income by an average of 3.13 decisions out of 9, compared to 4.45 for Italians), and when they cheat, they are more likely to cheat by declaring zero income (3.45 decisions out of 9, compared to 2.03 for Italians).

To check the robustness of these results, we estimate *separate* individual-level models for complete compliance (S3 Table) and complete evasion (S4 Table) with a country-dummy as the main explanatory variable, and a host of participant characteristics as additional regressors.<sup>12</sup> To be clear, we test whether:

1. Controlling for demographic characteristics that may differ across our participant pools, *Britons are more likely to underreport their income than Italians.*
2. Conditional on the decision to evade taxes (as well as other demographic characteristics), *Britons have a higher propensity to underreport their incomes in a particular way (by declaring absolutely zero earnings).*

To summarize S3 and S4 Tables, we find that while the Italy-UK gap in *complete*

<sup>12</sup>We employ negative binomial models in which the dependent variables consist of counts of the number of decisions (out of 9) characterized by complete compliance or complete evasion. We also ran a series of tobit regressions, taking the average compliance across all nine rounds as our main dependent variable. Substantive results remain unchanged.

*evasion* can be explained by cross-country differences in risk attitudes,<sup>13</sup> the country gap in *complete compliance* remains statistically and substantively significant in all model specifications. In other words, differences in demographic characteristics can help account for why, *conditional upon the decision to evade*, British participants are more likely to declare zero income. However, no observable individual-level differences between our participant pools can explain British participants are more prone to engage in tax evasion in the first place. Importantly, this core finding that Italian participants are systematically more honest (defined as reporting 100% of earnings) in their fiscal decision-making, remains robust across all of our regression models.

## Conclusions

How do we square these results with the fact that, outside the lab, tax evasion is appreciably higher in Italy, as compared to Britain? Undeniably, there are differences in “real world” rates of tax evasion amongst Western European democracies, and compliance levels seem to follow a north-south divide. Further, it may also be true that the family (or personal networks) hold more importance in southern European countries. However, it would be a mistake to attribute these fiscal outcomes to such broad cultural characteristics, and our experimental results demonstrate quite strikingly the danger of confusing correlation for causation.

In particular, popular stereotypes about “generalized” and “limited” morality societies often infer cultural values from observed behavior, without recognizing that both values and behavior may be a function of the institutional environment. For example, Italians may readily cheat on their taxes, and they may also believe that such behavior is not immoral [44], but crucially, citizens in Italy also believe that the state is cheating them! In fact, recent public opinion polls have shown that southern Europeans give their governments consistently low scores on control of corruption and quality of service delivery [45, 46]. By contrast, northern Europeans’ high willingness to pay may be a direct reflection of their beliefs that their taxes go towards important public services which they value and personally consume. And given a vibrant fiscal contract, nonpayment of taxes naturally seems immoral. The point is, in comparing the fiscal behavior of northern and southern Europeans, we may believe that we are observing the influence of different moral systems when, in fact, outcomes may simply reflect variation in the quality of government.

In this paper, we have directly examined a broad cultural argument for why levels of tax compliance differ across European societies, and we find no support for common north-south stereotypes. Rather, we show that when faced with identical tax institutions and audit probabilities, Italian participants are even more likely to fulfill their fiscal obligations, compared to Britons. These results highlight the need to separate institutional from values-driven components in the cross-national study of tax compliance.

<sup>13</sup>We measure risk-attitudes with a survey item which asks participants to rank themselves on a 10-point scale, with 1 signifying a person who “normally tries to avoid taking risks” and 10 signifying someone who is “completely willing to take risks.” The question is very similar to one asked on the German Socio-Economic Panel (SOEP): “How do you see yourself? Are you generally a person who is fully willing to take risks or do you try to avoid taking risks?” The SOEP also asks participants to indicate their risk preference on a 10-point scale running from “risk averse” to “fully prepared to take risks.”

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## Author Contributions

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Conceived and designed the experiments: GA SO FP SS. Performed the experiments: NZ GA SO FP SS. Analyzed the data: NZ. Wrote the paper: NZ.

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## Supporting Information

### S1 Fig.

Example screenshot: Earnings reporting screen.

**S2 Fig.**

Compliance rate across all locations.

**S1 Table**

Summary of participant characteristics: Italy and the UK.

**S2 Table**

Summary of tax reporting rounds.

**S3 Table**

Negative binomial regressions: Complete compliance.

**S4 Table**

Negative binomial regressions: Complete evasion.

**S1 Text**

English Language Instructions.