



## Roots and Remedies for Rampant Tax Evasion in Italy

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Ex-Prime Minister Silvio Berlusconi once famously claimed that the evasion of high taxes is a “God-given right” – especially in Italy! As many European nations grapple with debt crises, the costs of rampant tax evasion are once again at the forefront of public debates in Italy. Reports from the country's revenue agency and major databank estimate that tax evasion costs the Italian government 120 billion euros per year in lost revenue; and when underground economic activities are factored in, the revenue loss rises to about 250 billion euros. Italy is the third largest economy in the European Union and its unsustainable debt has led many to raise questions about national default and Italian exit from the Union.

Tax evasion is not unique to Italy; it is endemic throughout southern Europe. Why is that? Are bad tax policies, many of which favor the wealthiest one percent, to blame for astronomical levels of evasion? Is there a culture of tax evasion in Italy and southern Europe not found in the more northern regions of Europe? What can governmental arrangements and performance tell us about taxpayer behavior? Do inefficient and mismanaged government institutions affect tax compliance?

Research-based answers to such questions are badly needed. Italian politicians often give merely superficial lip service to the fight against evasion and corruption, usually to little avail. Ex- Prime Minister Mario Monti was touted in the international media for targeting evaders who used yachts and luxurious cars as tax shelters, but he lasted in office only two years. Clearly, Italian bureaucrats and politicians need more than symbolic gestures. They need to better understand and act to counter the underlying causes of tax evasion, including institutional and cultural causes, as well as individual criminal acts.

### Social Ties, Civic Attitudes, and Tax Compliance

In his groundbreaking study, *Making Democracy Work*, political scientist Robert D. Putnam argues that a history of republicanism put northern Italy on a stronger path for development than patterns of autocratic governance in the South, because the two regions came to differ sharply in their levels of social capital and civic trust. Interestingly, the same northern regions that registered high levels of social capital and trust in Putnam's study tend to have the lowest levels of tax evasion. The Bank of Italy Survey of Household Wealth and Income provides a set of questions about “tax morale” that give clues to social attitudes that affect tax compliance and evasion. This measure of Italian citizens' willingness to pay taxes shows that, indeed, taxpayer behavior is affected by regional variations in social capital and civic culture.

- When social capital is measured as the number of associations individuals belong to, social capital turns out to have a positive effect on tax morale. The types of social ties also matter, because southern Italians tend to have more inwardly directed ties to families than northern Italians, who are engaged in a wider set of associations.
- Variations in civic culture can also be gauged by how often citizens in the North and South read the newspaper, vote, and discuss politics, or public policy. Such measures show that citizens with greater political interest have higher tax morale as well.
- Italians have also been asked how extensive they think tax evasion is. Interestingly, respondents who see high levels of evasion are also more inclined to pay taxes themselves. This suggests that inexpensive public awareness campaigns might encourage tax compliance.

### Institutional Effectiveness Also Matters

Clearly, social ties, attitudes, and regional cultures do play a role in explaining Italian tax evasion. But leaving the explanation at that would overlook important problems of regionally uneven governance and institutional functioning. In southern Italy, public institutions have been broken for as long as people living in that region have been asked to pay taxes to support malfunctioning arrangements. Stark differences in public

transportation services in the North and South demonstrate this quite well. The *Freccia*, Italy's fastest train, has many more station stops in northern Italy, for example, but all Italians are required to pay comparable taxes to fund trains that serve northern residents much better than southern residents. Southerners may not be so civic minded, but perhaps they have good reason to doubt the value of their tax payments.

## Are Taxes Just Set Too High?

"Of course, people evade taxes, taxes are too high." This is a common refrain, but contrary to popular opinion, tax evasion is not that simple. Patterns of evasion are much more complicated than any simplistic model of tax incidence can explain. In Italy, taxes are actually less progressive – asking lower bites from upper incomes – than in neighboring European countries. Italy has so little revenue to cover its public debts that taxes are often collected haphazardly, with considerable unfairness from person to person as well as across income strata. Of course this can cause many citizens to see taxes as unfair. The fiscally hard-pressed Italian government also spends too little on tax law enforcement. All of these complications and others contribute to tax evasion, not just the overall nominal level of taxes.

## Useful Reforms

In many ways taxation is the linchpin between democratic accountability and citizen responsibility, yet analysts still know too little about why some individuals and sets of citizens pay willingly, while others try to evade obligations. What seems certain is that relying only on criminal penalties and deterrence of "corruption" is not the best way to foster broad tax compliance. Leaders and policymakers need to bolster civic ties and attitudes among citizens and, even more importantly, improve the functioning and equitable accountability of public institutions. Unfortunately, countries with high levels of tax evasion tend not to have enough time or money to undertake such longer-term steps. In the short run, the best place to start may be with public awareness campaigns highlighting the extent and costs of tax evasion. Recently, Italian entrepreneurs released a smartphone application that allows individuals to anonymously report evaders and how much they failed to pay. That is a good place to start!

**Read more in John D'Attoma, "Italian Tax Morale: A Comparative Study Assessing the Regional Effects of Civic Culture," University of Missouri-St. Louis, 2014.**