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A Nation Divided: Assessing the Regional Effects of Institutions, Social Capital, and Civic Culture on Tax Morale in Italy

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A NATION DIVIDED: ASSESSING THE REGIONAL EFFECTS OF INSTITUTIONS,
SOCIAL CAPITAL, AND CIVIC CULTURE ON TAX MORALE IN ITALY

by

John D'Attoma

A dissertation presented to the
Graduate School at the University of Missouri-St. Louis in
partial fulfillment of the
requirements for the degree
of Doctor of Philosophy

August 2015

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ABSTRACT

A Nation Divided: Assessing the Regional Effects of Institutions, Social Capital, and Civic Culture on Tax Morale in Italy

by

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Ph.D. in Political Science,

University of Missouri-St. Louis, August, 2015.

Professor Kenneth Thomas Ph.D., Chairperson

Cross-national social surveys measure tax morale across a wide variety of political cultures, but little research is available investigating the regional effects of institutions, social capital, and civic culture on tax morale in Italy. Since tax evasion, by definition, is difficult to estimate, researchers use the size of the underground economy as a core indicator. Only Greece (27.5% of GDP) surpasses Italy (17% of GDP) in the size of its underground economy among Western EU states. Italy's unique history and regional complexity provide researchers with a multitude of case study options in a single country. Using the 2004 Bank of Italy Survey of Household Wealth and Income, I undertake a comparative study assessing the regional effects of social capital and political culture on tax morale in Italy. I demonstrate that Southern Italy is significantly different than Northern Italy with regards to tax morale, and that social capital and civic culture positively affect tax morale.

To compliment the Bank of Italy survey, I use controlled laboratory tax compliance experiments and a Social Value Orientation task to test if Southern Italians are consistently different than Northern Italians with regards to their tax compliance even when presented with the exact same taxpayer environment. I uncover that when put in the same taxpayer environment, Southerners comply and are just as others-regarding as their Northern counterparts, which supports the framework that institutional context matters.

Finally, by retracing the historical legacy of Italian political and cultural institutions dating back to the Risorgimento (1815-1871) to the beginning of the Second Republic (1994), I closely examine the effects of periodic shifts in institutions on behavior, specifically tax behavior. This allows me to more convincingly establish the contextual setting in which two divergent civic cultures and taxpayer behaviors were formed. In the end, I conclude that both institutions and individual agency (culture) act in tandem to shape taxpayer behavior. They are not contradictory, but rather they interact to determine why some people choose to comply and others do not.

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Figure 1.: Map of Italian Regions



1. Introduction

Ex-Prime Minister Silvio Berlusconi once famously claimed that the “evasion of high taxes was a God-given right” in Italy (Bhatti et al. 2012). Recent scholarship on international political economy has brought new life to the tax evasion debate, precipitated by sovereign debt crises throughout Europe. Reports from Istat, Corte dei Conti, and l’Agenzia delle Entrate estimate that tax evasion in Italy costs the state 120 billion euros per year in lost revenue (Santoro 2010). Prevailing academic discourse revolves around two perspectives: The theoretical models utilize game theory and an economics of crime approach (Allingham and Sandmo 1972); the empirical models draw on simulations mimicking taxpayer/revenue-collector scenarios. Both models rely heavily on the probability of detection and the severity of the punishment. More recently, social scientists have examined different sociopolitical and cultural variables and their impact on evasion and compliance. Their research centers on why taxpayers voluntarily pay, rather than evade the state. Tax morale refers to citizens’ intrinsic motivation to pay taxes.

Cross-national social surveys account for tax morale across a wide variety of political cultures, but little research is available regarding tax morale in Italy. Since tax evasion, by definition, is difficult to estimate, researchers use the size of the underground economy as a core indicator. Only Greece (27.5% of GDP) surpasses Italy (17% of GDP) in the size of its underground economy among Western European Union (EU) states. Italy’s particular

history and regional complexity provide researchers with a multitude of case study options in a single country. This analysis provides a comparative study assessing the regional effects of institutional capacity, social capital (i.e., trust in others, trust in state institutions) and civic culture (social capital, levels of communal interaction) on tax morale in Italy. In addition, it will examine whether institutional capacity postulates a better explanation for tax behavior than the more individual focused classical and neo-classical models proposed by Sandmo and Allingham and the amoral familial argument suggested by Edward Banfield (1958), later expanded upon by Robert Putnam. I make five main hypotheses (see Table 1.1)

Table 1.1: Statement of Hypotheses

-
- H₁** As social capital increases, operationalized as number of associations in the Bank of Italy Survey and various forms of trust in the World Values Survey, tax morale will also increase.
- H₂** As civic culture increases, operationalized as interest in politics and honesty, so will tax morale.
- H₃** Living in Northern Italy will have a positive effect on tax morale, whereas living in the South will have a negative effect on tax morale.
- H₄** Because Italian taxation is structured to favor the Self-employed, these individuals will have lower tax morale than employees.
- H₅** In regions where the government has historically invested in shaping civic consciousness, respondents will be more willing to contribute, and hence, have higher tax morale.
-

According to a 2012 *Business Recorder* Article by Hanns Jochen Kaffsach (2012), “*Evasione* is almost like a sport in Italy, especially for higher-income individuals who declare themselves as poor to the tax authorities.” Using data from ISTAT, Alessandro Santoro demonstrates that in the northern regions, spanning from Lombardy to Lazio, evasion of IRAP (regional tax on production) ranges from 13% in Lombardy to 50% in Liguria; in the southern Mezzogiorno, covering Molise to Sicily, IRAP evasion ranges from 54% in Molise to 94% in Calabria (Santoro 2010). Data collected by Elisabetta Marzano and colleagues exhibiting the amount of irregular work as a percent of regular work, which can be used as an indicator for tax evasion, indicates that the percent of irregular work in the Northern and Central regions of Italy averaged 9.8% in 2009, but 18.8% in the Mezzogiorno (Chiarini and Marzano 2007).

The groundbreaking study, *Making Democracy Work: Civic Traditions in Modern Italy*, by Robert Putnam, Leonardi, and Nanetti (1994), analyzes factors contributing to institutional performance throughout Italy's regional landscape. Putnam and his colleagues argue that due to historical circumstances, the South evinces less civic virtue (a high sense of trust, honesty, and law-abidingness) than the North, but they do not test whether higher civic virtue in the latter positively affects tax morale, compared to levels found in the former. When one superimposes Santoro's chart of "regional evasion differences" onto Putnam's "civic community and institutional performance" map, the result is a profile of Italy in which regional levels of institutional performance and civic community closely match regional levels of tax evasion.

This study updates, synthesizes and expands upon these disparate analyses measuring civic community, institutional capacity/performance, tax morale and actual tax evasion practices in Italy. This research addresses the question: How do non-economic variables, specifically those that represent civic culture and social capital affect citizens' "tax morale"? The social capital (features of social organization, such as trust, norms, and reciprocity, that can improve efficiency of society) and civic culture literature is bursting with examples of increased economic development as levels of social capital and civic participation increase (Almond and Verba 1963; Bigoni et al. 2013; De Blasio and Nuzzo 2006; Fukuyama 1995a; Herreros 2009; Lyon 2005; Woolcock 1998). Social capital reduces transaction costs and increases trust, creating reciprocity between stakeholders, which, in turn can increase development. I argue that the same can be predicted for tax morale. Social capital and political culture are concepts that have taken on many definitions; both have been opera-

tionalized using a variety of unique variables throughout the literature. I am concerned with social capital as a variable that represents trust, leading to the formation of associations and networks amongst citizens.

Individual agency is not solely responsible for tax morale, however. As Putnam rightly points out, institutions and culture form a nexus from which certain behaviors can form. Although the tax morale literature is laden with cross-national studies, few studies have examined how institutions and culture interact to affect tax morale; possibly this is due to the availability of empirical data on social capital and tax morale. These studies address tax morale by making certain assumptions or generalizations about individuals and the cultures in which they live, such as lack of civic virtue. Amoral familial refers to cultures which lack civic-mindedness, and instead, show high levels of familial attachment. It is path dependent, and in that, preserves long-standing cultural stereotypes. Therefore, I will also examine certain public and private institutions and their effect on taxpayer behavior.

Statistically, my results suggest that there are significant differences between tax morale in the North and South using a “difference-in-means” t-test. Tax morale is defined as citizens’ intrinsic motivation to pay taxes and is measured using an index of several questions from the Bank of Italy survey of household wealth and income. The variable is defined more thoroughly below in the methodology section. This test estimates the “true” population means of each group from the sample collected by the Bank of Italy with confidence intervals. The p-value < 0.05 shows that the difference between the two is statistically significant and that the northern mean is definitely higher than that for the South.

The amount of evasion alone is significant enough to trigger a study analyzing what behaviors evoke higher levels of tax morale and if those level of tax morale actually affect evasion. While Italy collects approximately 350 billion euros per year in tax revenue, they lose an estimated 250 billion euros due to tax evasion and underground economy (Citation). Other estimates place evasion rates at 25%-30% of GDP. In the late 1970s and 1980s tax evasion began to climb. In this period, 15-20% of all income was undeclared (Santoro 2010). In the early 1990s, rates started to tic down, but from 2000-2004 those rates began to expand again (Santoro 2010). Estimates suggest that Italy fails to collect around 26% of the income tax its citizens owe due to evasion. Considerable disparities register among different types of workers; self-employed individuals and entrepreneurs evade approximately 60% of their income taxes, while employees only evade approximately 10%. Evasion rates vary in different sectors of the economy as well; estimates suggest the agricultural sector evades 70.57% of regional production tax while the commercial sector evades 54.78% and the business services sector evades 46.41%. Family services such as housekeepers and maids evade approximately 42%. Construction (23.82%) and industrial sectors (9.24%) evade the least (Santoro 2010). At the regional level, IRAP evasion (regional production tax) moves from 13%-50% in northern Italy, while in the south the lowest rate is 54%, while Calabria loses the most at 94% of taxable income. Considering the sheer size of evasion, it is essential that social scientists not only consider economic determinants of tax evasion, but also incorporate holistic approaches which incorporate variables that account for deterrence and detection (game theoretic economic models), as well as variables that represent citizens' social characteristics.

On the one hand, increased levels of tax morale should lead to higher rates of compliance, which could have significant practical implications. Social capital is subject to increasing returns, thus establishing a long trajectory of civic culture and virtue theoretically will have lasting effects on tax morale and hence, compliance. Putnam's central premise and conclusion is conditioned on this path dependent relationship between historical institutions, social capital, and development. Conducting research that leads to an improved understanding of how social capital and civic culture induce more robust tax morale will allow social scientists to pinpoint behaviors that foster social capital, and thus, tax morale. On the other hand, by studying tax evasion and morale at the institutional level, we can better understand what constitutes institutions that foster behaviors that lead to evasion.

The study is laid out as follows: In chapter two, I discuss my theoretical framework, historical institutionalism, civic culture, and social capital, followed by a discussion of the current debate on tax evasion/compliance, and tax morale. Chapter three is dedicated to assessing the effects of civic culture and social capital on tax morale quantitatively through use of survey data provided by the Bank of Italy and experimental data provided by the "Willing to Pay" project at the European University Institute ¹. I confirm that social capital and civic culture do indeed positively affect tax morale, and the North has significantly higher tax morale than the South. I also consider other control variables such as religion, sex, and age that are commonly examined in the literature. By employing laboratory experiments I am able to control the institutional environment while isolating similar type of

¹The research leading to these results has received funding from the European Research Council under the European Union's Seventh Framework Programme (FP7/2007-2013)/ERC Grant Agreement n. [295675]. An online appendix with replication data are available at [www.willingtopay.edu].

individual and cultural traits. My results suggest that culture is important; however, culture is construed within a particular institutional environment. In chapter four, I present my case for historical institutionalism, analyzing how the Catholic church and political parties have helped to shape distinct taxpayer behaviors.

Finally, chapter five is the culmination of the study. I integrate the two theories to determine a holistic approach to tax morale and evasion. I consider what possible policy prescriptions can be taken to foster better taxpayer behavior and ensure that the appropriate taxes are being collected.

2. Literature Review

2.1 Historical Institutionalism

The past is never dead. It's not even past (Faulkner 1951,73).

I utilize an historical institutionalist (HI) framework to argue that unique institutional complexities have led to higher levels of social capital and a different civic culture in the North than in the South, generating positive tax morale and greater compliance in the North. Institutions and culture (social capital/civic culture) are often used as opposing variables, rather than complimentary. Both culture (i.e. Putnam and Fukuyama) and institutions (Pierson, Steinmo, and Skocpol) are regularly employed to explain why societies are the way they are, but rarely are they used together to explain social phenomena. Institutionalism needs culture, just as culture demands institutionalist explanations. Oftentimes, institutionalism ignores individual agency in shaping institutional outcomes, whereas culturalists neglect the institutional setting in which culture is constructed. Instead of developing a purely institutionalist or culturalist analyst, I treat the two theories as a nexus from which an individual tax behavior is formed. It is thus not only that one's level of civic-mindedness affects their behaviors, but it is rather a combination of culture and institutions. This is not a tale of what comes first, the chicken or the egg; instead, I argue that institutions and culture interact to develop tax morale. Exploiting survey data, experimental laboratory data, and

historical analysis, I bridge the gap between culture and institutions to produce a deeper and more thorough understanding of taxpayer behavior.

Although not explicit in their terminology, Putnam and his team use a similar framework to explain diverging levels of social capital and civic virtue between the North and South of Italy. Instead of emphasizing specific actors shaping political outcomes, institutionalists stress the role of systematic factors in structuring behavior (Steinmo 2008, 159). Institutions are the rules that shape and constrain behavior; they are both formal and informal (i.e. The Revenue Agency and clientelism) (Steinmo and Longstreth 1992). HI examines the historical record to determine why certain outcomes occurred and in what context. Three important features characterize HI, according to (Pierson and Skocpol 2002,3),

1. Historical institutionalism addresses big, substantive questions that are inherently of interest to broad publics as well as fellow scholars.
2. Historical institutionalism takes time seriously, specifying sequences and tracing transformations and processes of veering scale and temporality.
3. Historical institutionalism analyzes macro contexts and hypothesize about the combined effects of institutions and processes, rather than examining just one institution or process at a time.

Historical institutionalists strive to answer big questions. In *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State*, Steinmo explores three industrialized democracies —the United States (US), Great Britain, and Sweden — and their diverse tax regimes and welfare states. Others have investigated how the US has established many of its institutional features or why countries have developed stable democracies over time (Katzenstein 1978; Pierson and Skocpol 2002; Steinmo 1996; Steinmo and Tolbert 1998; Thelen 1997). Historical institutionalists often embark on com-

parative studies, analyzing a small number of cases and focusing on rich descriptive data that emphasizes the role institutions play in structuring behavior.

Structures, norms, and ideas develop differently between like actors depending on the historical and political context in which they are situated. Italy is an ideal case to demonstrate how divergent political paths can be followed under a unitary political system. Because Northern and Southern Italy developed in two politically and historically distinct contexts, the outcomes are considerably different as well. HI scholars consider question such as, why do similar actors' policy choices differ in response to similar events? (i.e. oil shocks of 1979, tax policy, neoliberal globalization) (Katzenstein 1978; Steinmo 1996; Thelen 1997). Our expectations are often shaped by our past experience, and thus, norms and behaviors (tax morale) in Northern Italy might seem irrational in Southern Italy where the political context differs substantially (Steinmo 2008, 164). Interests are created and evolve within particular contexts, thus taxpayer objectives might be to provide adequate revenue in Lombardia where public services are provided efficiently; however, a taxpayer in Southern Italy might evade taxes in Campania where public services are often the result of clientelistic politicians and low incomes.

Along similar lines, critical junctures or formative moments, usually during policy formation, guide a policy down a certain path which produce particular outcomes (Capoccia and Kelemen 2007; Collier and Collier 2002). They need not affect all institutions of a system equally; in fact, a critical juncture might occur in one aspect of a system, but at the same time remain relatively stable throughout other arenas. Reemerging structural constraints are then directly correlated to the duration of a critical juncture. Relatedly, Orren

and Skowronek (1996) describe intercurrency as different political orders overlapping or coexisting, sometimes as a result of lingering vestiges of an older political system. Substantial events in Italian history, such as Unification, do not necessarily constitute a critical juncture throughout the entire political system, but can affect individual aspects of the system. According to Copoccia et al. (2007),

While relevant events happening at one of these levels of analysis may influence others, analytically it is important to keep them separate and to identify the critical juncture clearly with respect to the development of a specific unit of analysis.

Two features of politics are particularly important, according to Orren and Skowronek: 1) Institutions arise at different times and out of different historical circumstances. Emerging out of two different political circumstance, the institutions of Northern and Southern Italy have developed different configurations; and 2) interaction between different institutional orders is an important source of change. (Orren and Skowronek 1994; Thelen 1997). Therefore, change is possible within path dependent systems. Path dependency, according to Thelen (1997, 334), “involves elements of both continuity and (structured) change; and institutional arrangements cannot be understood in isolation from the political and social setting in which they are embedded.”

Specific timing and sequences of events can mold present political situations, suggesting that path dependency, often used by historical institutionalists, offers a relevant lens for examining Italian public spirit and taxation (Pierson 2000). Borrowed from economics, HI scholars suggest that once a path is taken, it becomes increasingly difficult to deviate from that path. One possible explanation for regional disparities in Italian taxpayer be-

havior is a history of republicanism and good governance in the North, dating back to the thirteenth century, shaped present levels of social capital and civic virtue. As the North continued down this path of republicanism and civicness, the chance of deflection became increasingly narrow. In regards to autocratic governance and amoral familialism, the same deterministic trajectory can be predicted. Pierson and Skocpol (2002) suggest that citizens' way of thinking about the world becomes self-reinforcing. In other words, once a pattern and a path is established it becomes difficult to stray from that path, affecting even citizens' behaviors. A multitude of scholars use path dependency to demonstrate diverging outcomes in similar policy arenas; Hacker (2000) demonstrates diverse developmental paths of employer-based healthcare policies vs. public-based healthcare policies in the US; Others have used this approach to compare policy outcomes of like cases across countries. From a path dependent framework political institutions are acutely resistant to change. (Ertman 1997; Gerschenkron 1962; Kurth 1979; Steinmo 1996, 2010).

Path dependency indicates that state development is largely constrained by certain key punctuations in a states' institutional formation. Within a state's particular historical context they continue to evolve with multiple interacting variables producing emergent outcomes (Steinmo 2010; Thelen 1997). This is not to say that institutions can only go down one path, but rather can proceed across a number of different paths contingent on the interaction between the actors and their environments (Steinmo 2003). Two different levels of taxpayer behavior can thus be the result of northern institutions taking one particular path, whereas Southern institutions took a separate path determined by the interaction of certain actors in their given environments.

In other words, once a path is taken at a critical moment in a policy's or an actor's history, that path becomes increasingly costly to diverge from. The metaphor of a tree climber and the possibility of choosing several different branches on a single trunk has often been evoked to explain that a climber's best option to move back down the tree is to continue on the same branch, instead of changing branches (Levi 1997; Steinmo 2010). As an individual, an institution, or a policy moves further down a particular path, the cost of changing paths greatly increases. The history of the "QWERTY" keyboard, presented by Paul David (1985), is a classic example of *lock-in*. The "QWERTY" keyboard is largely inferior to the keyboard created by August Dvorak, but we are locked into the "QWERTY" keyboard because very few people have ever heard of the Dvorak keyboard. But very few people have ever heard of the Dvorak keyboard because it is hard to find, and it is hard to find because very few people have heard of it. In this case, timing was more important than efficiency (Liebowitz and Margolis 1995).

A less deterministic interpretation of path dependency uses feedback mechanisms instead of lock-in. For Pierson and Skocpol (2002) "outcomes at a 'critical juncture' trigger feedback mechanisms that reinforce the recurrence of a particular pattern into the future." Much of the political costs associated with increasing returns are the result of institutions generating a set of beneficiaries, which renders diverging from the *status quo* burdensome on particular political allies. Social Security and Medicare in the United States are programs that are particularly resistant to change because those who benefit from these programs constitute such a large voting block. Policies that generate strong emotional attach-

ment and cultural attitudes, ranging from ideological understandings to the way we perceive our government, tend to be persistent (Pierson 1994).

Therefore, not only are institutions and policies subject to increasing returns and path dependency, but political cultures and ideas are difficult to change once established (Pierson 2000). This is particularly relevant to the study of tax morale and differing cultural attitudes towards taxation found between Northern and Southern Italy. Northern attitudes concerning taxation and their compliance rates can be attributed to path dependent attitudes regarding the government, in general. For example, Siena, a city that was a symbol of republicanism, is home to the Sala della Pace, a painted room in the city's town hall. The painted room depicts two different settings: The Well-Governed City and the Ill-Governed City. In the illustration of the Well-Governed City, dancers, artisans, and industrious and prosperous farmers are seen together. In the Ill-Governed City a tyrant rules over the violent landscape, while soldiers are seizing a woman (Gilmour 2011). The idea of a well-governed city dates back centuries in Siena to the classic Northern republics, while the South had a very different experience with government. An idea or the perception of *good* government – whether or not it was actually *good* – can be as important as the reality of *government*. The belief that public institutions benefit the individual can translate into a high degree of social trust and solidarity; all of which contributes to a more civic-minded citizenry.

Many HI scholars argue that change is the result of punctuated equilibrium; policies remain in equilibrium until actors in a specific environment shift the path and a new equilibrium is formed (Baumgartner and Jones 2010). Sudden punctuations then become the intervening variable affecting political change. Peters and King (2005) examine work-

fare reform, administrative reform, and states' shifts from Keynesianism to Monetarism, suggesting that a path dependent relationship in each of these policy areas, driven by specific economic and political punctuations, was the driving force behind the policy changes. Steinmo (2008) suggests, however, "from an evolutionary perspective, change is the normal state — not something that is punctuated occasionally." Political systems evolve constantly, adapting to contextual change.

Evolutionary theory and HI share many theoretical components, including the centrality of history. Like HI, evolutionary theory implies that change and adaption are a constitutive aspect of political life. The idea that change is more likely than equilibrium contrasts with the punctuated equilibrium theories mentioned above. In both evolutionary theory and HI, what happens at one point in time can have considerable effects on what happens at a later point. History, therefore, is non-linear and is contingent on the ways in which human agents adapt to their environment (Steinmo 2003). Considering tax morale, evasion, and compliance as an outcome of institutional capacity shaped by a specific historical context, provides a fruitful compliment to the more individualistic social capital and cultural frameworks that I will discuss next.

This study fulfills the characteristics outlined by Skocpol and Pierson and expands on it by not only studying taxpayer behavior at the macro-level, but rather at the micro-level, as well. Historical institutionalists' large catalogue of research, employing historical institutionalism, often addresses tax policy comparatively; however, they have not, until recently, addressed the more micro-level issues concerning why taxpayers do or do not pay, and how this can affect institutions. Explaining not only how institutions shape and constrain

behavior, but also how individual and societal rules and norms impact deeply engrained institutions, such as clientelism in Southern Italy is typically neglected in the HI literature. Historical institutionalists have a difficult time explaining the micro-level approaches. Studies, such as this, are necessary for a more multidimensional understanding of political life. History, institutions, citizens' preferences, and policy all interact to shape certain policy choices (Steinmo 2014). In the following section, I outline the more micro-level aspect of this study: civic culture.

2.2 Civic Culture

Since Almond and Verba's influential study, which investigated distinctive features of national and regional populations, also termed civic culture, a plethora of literature has drawn from their study suggesting civic culture affects democratic and economic performance. The "civic culture" represents those cultures that demonstrate high civicness, share a basic consensus for the legitimacy of political institutions and public policy, while demonstrating political competence and a trust in others (Almond and Verba 1963). A democratic civic culture should further support beliefs and attitudes that increase civic participation (Docherty, Goodlad, and Paddison 2010).

Based on survey questions concerning levels of political participation, openness, and political awareness in Great Britain, United States, Germany, Italy, and Mexico, Almond and Verba conclude that civic culture varies significantly between countries, which in turn, affects their likelihood of a successful democratic future. As expected, the US, Great Britain, and Germany perform quite well, while civic culture in Italy and Mexico is much

lower. Analyzing Great Britain and Italy, Great Britain was more civic than Italy on every measure in 1959. Only 16% of Italians read newspapers weekly in 1959, compared to 43% of Britons. 68% of Britons and 36% of Italians followed politics regularly. Only 3% of Italians suggest that they have pride in their institutions, whereas 46% of Britons were proud of their institutions. However, 25% of Italians and 10% of Britons were proud of the countries physical attributes. In fact, Almond and Verba (1963,103) ,

Americans and the British with greatest frequency take pride in their political systems, social legislation, and international prestige. Italians in the overwhelming majority take no pride in their political system, nor even in their economy. To the extent that they have national pride at all, it is in their history, the physical beauty of their country, or in the fact of being Italian. Thus the picture of Italian alienation is deepened.

Italians overwhelmingly did not believe that taking part in the local community was an important aspect of citizenship, but neither did the Britons. Regarding national and local civic competence, Italians fared much worse than the Britons. The same is true concerning the numbers of associations in which respondents belong. A major claim of this dissertation is that Italians are alienated from the political process, rendering them a low trust (especially outward trust), fearful, and highly traditional familial society. Great Britain, on the other hand, is differential, but highly participatory. They support political activity and emotional involvement in elections. They are also proud of their system of government and government performance.

The culturalist, “amoral familism”, argument proposed by Banfield (1967,83) to explain diverging civic culture and quality of government between Northern and Southern Italy suggests that the Southern ethos is to “maximize the material, short-run advantage of the

nuclear family; assume that all others will do likewise.” Putnam, Leonardi, and Nanetti (1994,88) referring to the civic culture found in the North states, “Participation in a civic community is more public-spirited than that, more oriented to shared benefits. Citizens in a civic community, through not selfless saints, regard the public domain as more than a battle-ground for pursuing personal interests. ” Though the *moralist/culturalist* argument is extensively used throughout the literature, it overlooks the role institutions have in shaping a particular culture.

From Almond and Verba’s 1959 study, the argument can be made from survey responses that Italians demonstrate a severe distrust in their institutions, and thus choose not to participate. In 1989, Almond and Verba edited a volume for which they invited country scholars to update *The Civic Culture*. Thirty years of growth and democratic stability shaped Europe in ways which were not necessarily foreseen by the original authors. Sani suggests that institutions go a long way in explaining political and civic culture in Italy. When weighting the sample for partisan preference, civic culture, measured by Almond and Verba, increased in Italy. Similarly, religious affiliation predicts a wide range of attitudes on issues related to civic culture and partisan preference. Sani (1989) presents survey data from 1975 of respondents who assign great responsibility to the government on a host of issues from health care to inflation. The percent of respondents range from 67.4 on care for elderly and 81.1 on inflation; however, the percent that evaluate government action positively ranges from 7.1% on inflation to 32% on taking care of the elderly, indicating that although Italians believe it is the government’s responsibility to tackle certain issues, they are pessimistic towards the possibility of the government actually addressing

them efficiently. More recent studies that investigate civic culture briefly mention Almond and Verba's *The Civic Culture*, though they are more concerned with the more timely and relevant concept of social capital. The following section will survey the social capital literature.

2.3 Social Capital

There is a nexus between culture or individual aspects of behavior that influence whether an individual obeys certain tax laws and norms. At the individual level, I will use social capital and civic/political culture to explain divergences in tax morale between Northern and Southern Italy. Conceptualization of the term social capital can be traced back to Alexis De Tocqueville's "Democracy in America" and Carlo Cattaneo's account of Italian cities in "La Città come Principo Ideale delle Istorie Italiane." Throughout the 1900s, it was used by scholars such as John Dewey, although it lacked a clear, identifiable definition.

However, it was not until 1977 that James Coleman popularized the term and introduced *social capital* to many academic disciplines. For Coleman, social capital was a necessary and often overlooked counterpart to physical and human capital. Physical capital is the result of changes in physical materials (i.e. tools); human capital is created by changes in humans that induces increased skills, while social capital is the outcome of changes in social relations which facilitate action (Coleman 1988). According to Coleman (1988,S101), "Just as physical capital and human capital facilitate productive activity, social capital does as well." Through trustworthiness, which is closely linked to social capital, transaction costs, associated with any type of relationship between two or more actors, decreases.

In 1986, Pierre Bourdieu compared *social capital* to cultural and economic capital, widening the academic scope of the concept to include more critical/Marxist explanations. Bourdieu's interpretation of social capital emphasizes the durability of networks and what he refers to as collectively owned capital. He contends that differential access to economic, cultural, and social capital determine societal relations (Bourdieu 1986). Bourdieu's conceptualization is more structural in nature and related to the "aggregate of resources" associated with being part of a network.

The most well known studies on social capital, amongst political scientists, have been conducted by Robert Putnam and his colleagues. According Putnam, Leonardi, and Nanetti (Putnam, Leonardi, and Nanetti 1994,1), social capital comprises "features of social life networks, norms, and trust that enable participants to act together more effectively to pursue shared objectives." Putnam's conceptualization of social capital is more similar to Coleman's than Bourdieu's in that he borrows from the rational choice school of thought. For Putnam, social capital is both private and individualistic. Individuals form networks and associations out of pure self-interest, which in turn, can produce positive externalities for the entire community. This can take many forms, but one example, might be joining a local cultural association as an immigrant to better integrate oneself into the local community, at the same time, familiarizing the community with outside cultures and increased tolerance (Putnam 2000). The basic premise for the relationship between social capital and development is that a participatory environment which fosters shared norms and reciprocity is likely to create a circular pattern where repeated interactions increase one's reputation, and one's reputation increases one's interactions (Sabatini 2006).

Specific reciprocity occurs when an individual does something in return for someone doing something for him. A does a favor for B, thus B returns the favor. This is a valuable form of social capital, but *generalized* reciprocity provides an even greater utility. *Generalized* reciprocity relates to the *Pay it forward* principle; A does something for B without the expectation of B returning that favor, but with the belief that someone else will eventually do something for A (Putnam 2000). This takes a considerable amount of *generalized* trust from person A as well. Let us step back to the immigrant who joined the local cultural community and assume that this is an American with Sicilian ancestry joining a local Sicilian cultural association. Before he joined the group there was a distinct *individualized* trust. Each member of the group trusts each other, because they come from the same community, but have a general distrust of outsiders, especially immigrants; however, once an immigrant joins the groups, a *generalized* sense of trust begins to form as greater tolerance and understanding is fostered through cultural exchange. Before the immigrant joined the community, the association can be characterized by having a high amount of social capital, but a type of social capital leading to the exclusion of outsiders and punishment of those who deviate from the communities social norms (Portes 2000). Therefore, social capital does not always lead to optimum outcomes, but can rather lead to strong out-group antagonism. As generalized trust grows, so does generalized reciprocity, producing a sense of mutual “obligation and responsibility” (Putnam 2000,21). Promoting a sense of mutual obligation and responsibility has important implications for cultivating responsible taxpayers, and hence, increased levels of tax morale.

Since Putnam, scholars have used social capital to explain a multitude of different social phenomena from micro-finance in economics to the quality and quantity of Facebook friends and connections; probably most significant has been its emphasis in development studies. Political scientists often employ the term to label a group of citizens within a nation as virtuous or embodying *civic virtue*, especially in regards to voter participation, law abidance, cooperation, and honesty of public officials (Fukuyama 1995*b*; Guiso, Sapienza, and Zingales 2010; Putnam, Leonardi, and Nanetti 1994). Eric M. Uslaner (2009), in a *Handbook of Social Capital*, argues that social capital, operationalized as trust, has a significant affect on corruption by reducing inequality. For Uslaner (2009), operationalized trust is “the value that is predicated upon the belief that many others are part of your community. This is the foundation of a ‘well-ordered’ society.” The opposite of this, which I defined as individualized trust above, he defines as particularized trust. Diego Gambetta (1996) argues that the Sicilian mafia materialized in Southern Italy as a result of an excessive amount of in-group ties, and weak out-group ties. This relates back to Banfield’s “amoral familial”, which has made a large, albeit controversial, contribution to the scholarly literature and the *southern question* (Banfield 1967).

For Fukuyama (2001), social capital is an “instantiated norm that promotes reciprocity between two or more individuals,” and therefore, many of the concepts often used to represent social capital (i.e. trust, networks, civic society) are outputs of social capital. Because political scientists often use certain variables, such as trust, as a proxy, the political science literature has drawn heavy criticism from other fields (Guiso, Sapienza, and Zingales 2010). The critics argue that endogeneity arises when many of these proxy variables are

considered. For example, does trust create less crime or does less crime initiate greater trust? There seems to be confusion between inputs and outputs or as Edwards and Foley (1997) put it, this “makes it impossible to separate what it is from what it does.”

Although using these variables to represent social capital has evoked criticism, readily available survey data renders those projects feasible and valuable when coupled with other methodological techniques. Francisco Herreros (2009) makes two novel hypotheses. First, the state can actually promote social capital by acting as an enforcer of agreements. Many who study social capital argue that the state actually reduces social capital or has no role in fostering it (Padgen 1988; Putnam 2000; Putnam, Leonardi, and Nanetti 1994). Second, by fostering equality the state can promote trust. Under circumstances in which there is an efficient state which can enforce contracts, social capital and trust is much more likely to flourish than in regions in which there is an inefficient state; Italy is a good representation of this. The inefficient state creates a situation in which high trusters and trustworthy actors are crowded out and low trusters and opportunistic actors will survive. In Herreros' (2009) multilevel model, using trust from the World Values Survey as a dependent variable and country indicators as contextual level variables, he demonstrates that the more efficient the public institutions, the higher level of interpersonal trust the respondent will have. In addition, by controlling for the type of welfare state, he finds that respondents in social-democratic, universalistic welfare-states are more trusting because of the relative equality that it provides. This is in strong contrast to the fragmented welfare state found in Italy. Italy, being a single nation-state, provides optimal conditions for researches to study institutional effects on social capital, and thus, tax morale. Because Italy is a single country

with universal norms and customs, one can control for many societal and cultural factors that might influence social capital, but let institutional performance vary by region, parsing out the effects of institutions on social capital.

Herreros' study mirrors what Michael Woolcock (1998) calls the liberal social capital enthusiasts school of thought. The enthusiasts argue that the state can actively foster social capital and a more civic culture by implementing programs that support such communitarian behavior. Skocpol (1996) proposes that the state actually works in lockstep with civil society, instead of contrary to these organizations. For example, the government of Bogotá has recently implemented programs aimed at fostering a more virtuous civic culture and "taxpayer culture" designed to teach citizens about their responsibilities as citizens. Several slogans were adopted that embody communitarianism: "*110% with Bogotá and all pay, all gain*". State revenues have increased 29% since these measures were taken, suggesting that the state can play an active role in enriching social capital; however, as both Putnam (2000) and Fukuyama (2001) observed, social capital is not always positive (Ferro 2011).

Banfield (1967) noted very early and later Putnam, Leonardi, and Nanetti (1994), strong inward facing connections can affect development negatively. Bonding ties, as Putnam defines them, "emphasize family relations to the exclusion of all others" (Fukuyama 1995a). Non-familial ties, rather, create trust and tolerance, which is a crucial aspect of development. Fukuyama (1995a) proceeds to classify Italy as a society characterized by deep-seated familial ties, however, weak outward linkages, which in turn, has undetermined the growth of a strong civil society.

Putnam's distinction between bridging and bonding social capital distinguishes negative from positive social capital: Bridging refers to associations between people of different socioeconomic and ethnic groups, whereas bonding relates to inward facing organizations such as ethnic fraternal organizations and country clubs. Putnam (2000,22-23) illustrates as "bonding constitutes the kind of sociological superglue, whereas bridging provides a sociological WD40." Because bonding can result in strong out-group antagonism and distrust, tax morale could be negatively affected; bridging should have a positive effect on tax morale. Since it is difficult to separate differences in levels of bonding and bridging through survey data, social capital literature distinguishing between the two is quite scarce. However, since *Making Democracy Work*, a multitude of more recent studies have improved on Putnam and his colleagues' work, utilizing more advanced methodological techniques and more up-to-date data, while reaching similar conclusions. Many of these studies not only look at common measures of social capital (i.e. trust), but also the less often studied "structural" aspects of social capital such as bonding and bridging.

Fabio Sabatini (2005*a,b*, 2006) has erected a large catalogue of work uncovering a novel approach in testing the theoretical foundations of Putnam et. al's research. The analyses in many of his social capital studies are based on a dataset constructed by the author, including approximately 200 variables, which measure the "structural" dimensions of social capital. According to Sabatini (2005*a*) "an operational definition of social capital as formal and informal networks of agents sharing definite interests is provided, thus excluding from the measurement toolbox the concept of trust and all indirect indicators popularized by the empirical literature." Exploiting a set of surveys from the Italian National Bureau of

Statistics (ISTAT), he performs Principle Component Analyses to build measures of bonding social capital, bridging social capital, and linking social capital. Linking social capital is an area that is not typically mentioned in the literature, but for Sabatini is an important type of social capital. Linking social capital refers to weak formal ties linking different socioeconomic backgrounds mainly through voluntary organizations. Sabatini establishes that higher bridging in the North of Italy was positively correlated with several indicators of development. In the South, higher levels of bonding were negatively correlated with those same indicators. Strong family ties exert a negative influence on human development and economic performance. Weak ties may act as bridges across differing communities fostering knowledge sharing and the diffusion of trust, and therefore, benefiting the process of economic development. Bridging negatively affects income and development, while linking has a positive effect (Sabatini 2005*a,b*, 2006).

Guido De Blasio and Nuzzo (2006), using the Bank of Italy Survey of Household Wealth and Income and Putnam et. al's regional data for the period following the 1870 unification, provide empirical evidence to support Putnam et. al's findings. They conclude that there is strong support for a relationship between Putnam et. al's 19th century variables (turnout in local elections between fascism and the density of local elections) and current social capital, reinforcing the path dependency argument. To further buttress Putnam's claims, the authors find that 19th century variables are unrelated to economic performance (labor productivity, likelihood of becoming an entrepreneur, and the probability for a woman to participate in the labor market), except through the persistence of social capital. Specifically, they conclude that moving from the the average southern province to

the average northern province will increase labor productivity by 12%, the likelihood of becoming an entrepreneur by 4%, and the probability of a woman joining the labor force by 13%, when all other variables are held constant. They also find evidence to support that the northern communal republics were significantly more endowed with social capital than the Kingdom of Sicily.

Guiso, Sapienza, and Zingales (2008) suggest that the path dependent nature of social capital can be linked to intergenerational transmission of priors regarding the trustworthiness of others. They, however, define social capital as “good” culture, or a set of beliefs and values that facilitate cooperation among the members of a community (Guiso, Sapienza, and Zingales 2008,296). In other words, parents transmit values about trust and cooperation to their children, who then experience these values for themselves and pass them on to their own children; this is one explanation for the persistence today of a gap in social capital found between what were once free-city states in Northern Italy and autocratic states in the South during the medieval period. Guiso, Sapienza, and Zingales (2009) further find that culture does indeed affect trust, which in turn, affects trade and investment. Guido Tabellini (2010) probes even further by exploring the effects of certain cultural traits on economic development through institutions. Tabellini argues that cultural differences bring about regional disparities in the same formal institutions with culture being key interacting variable between past institutions and the functioning of current institutions. Specifically, he finds evidence to support that trust (i.e. social capital) and respect seem to be the most favorable to economic development. In addition, the author uncovers control of one’s life and obedience to positively affect development.

Another unprecedented study conducted by Maria Bigoni et al. (2013), entitled “Cooperation Hidden Frontiers: The Behavioral Foundations of the Italian North South Divide,” utilizes in-depth experiments in four Italian cities (two in the North and two in the South) representative of the Italian population. The authors examined whether differences in cooperation rely on differences in individual traits (i.e. Banfield and Putnam) or are the result of properties of society (values and norms). Typically these studies are conducted within a university setting making them unrepresentative of the entire population; however, the authors were able to capture a far more representative sample for this research. The measures were based on a three-player trust game, a public good game, and a set of dictator games. This coupled with an historical record about the quality of institutions, renders this study a highly valuable contribution to the literature. They demonstrate that trust and contributions are higher in the North than in the South; however, the observed gap is more due to properties of society, than due to individual “moral flaws”. Bigoni et al. (2013,17) suggest, “The fact that 150 years of common history in terms of formal institutions and language have failed to achieve full convergence in cooperation levels suggests that the source of persistence is to be sought in values and norms.”

Although the political science and economics disciplines have been largely supportive of *moralist* arguments, several authors have argued that politics and the quality of institutions are more important for economic performance and good governance (Levi 1996; Sabetti 2000; Tarrow 1996). Sidney Tarrow (1996) points out that throughout the 1990s there had been a large growth in civic associations and civic culture throughout the South, while at the same time the North was flush with corruption scandals. He further argues

that Putnam et al. oversimplifies the regions of the North by collapsing Northern regions with long republican histories with regions with relatively short republican histories into one variable. Tarrow (1996,393) argues,

it would have been interesting to know by what rules of inference he chose the late-medieval period as the place to look for the source of northern Italy's twentieth-century civic superiority. Why not look to the region's sixteenth-century collapse at the hands of more robust European monarchies; at its nineteenth-century conquest of the South; at its 1919-21 generation of fascism; or at its 1980s corruption-fed economic growth? None of these phenomena were exactly "civic" by what rules of evidence are they less relevant in "explaining" the northern regions' civic superiority over the South than the period 800 years ago when republican government briefly appeared in its cities?

Tarrow (1996,304) further suggests instead of civic culture shaping government performance, the more likely correlation should be between progressive politics and government performance.

It has been argued elsewhere that Putnam and colleagues confound explanations with outcomes, suggesting that civic-minded public officials are responsible for a civic citizenry. Levi (1996) suggests that governments' ability to protect property rights and merit based societies (opposed to the clientelism or nepotism found in southern Italy) instill a generalized trust in society. In a Hobbesian world in which there is an absence of an effective state a power vacuum is left behind in which non-governmental actors (i.e. the Mafia) often fill that void, leading to highly corrupt (low-trust) societies. Filippo Sabetti (2000) contends that examining the North and the South at such a macro level is also problematic. The regional intricacies of Italian governance cannot be broken down into only two parts, rather one must study each regions' rich historical diversity. In addition, Putnam's

twelve indicators of regional performance cannot be applied to all regions reliably. Sabetti (2000) contends that the growth of institutions and ecclesial infrastructure since the eighteenth century better explain the Italian political economy than the “amoral famililism” of Putnam. By locating my study within these two frameworks, institutions and culture, I can examine the historical relevance of institutions in building social capital and civicness, while at the same time, breaking down tax morale into its constituent parts.

2.4 Tax Evasion, Compliance, and Morale

The relationship between taxpayer and government rests on an exchange relationship as well as coercion (Spicer and Becker 1980). Taxpayers contribute to the revenue stream in return for certain government benefits; the state, in turn, uses its coercive powers to assure citizens are contributing to the public good. Becker’s economics of crime model gave rise to a deterrence/coercion model, originally applied to tax compliance and evasion by Allingham and Sandmo (1972). They argue that tax evasion is negatively correlated with the probability of detection and the degree of punishment, that is, as a result of utility maximizing. When taxpayers gain richly from noncompliance, see little threat of detection, and will receive weak punishment, many will evade taxes. Spicer and Becker (1980), suggest that inequity does contribute to evasion because citizens who feel they are being treated inequitably are more likely to feel angry, while those who perceive themselves advantaged by inequity are more likely to feel guilt. Spicer and Becker hypothesize that if taxpayers perceive inequity in their terms of trade with government, they will attempt to restore equity by adjusting the amount of taxes they evade. Their taxpayer simulation

showed perceived relative tax rate as statistically significant and positive, with females evading less than their male counterparts.

Using IRS data, Dubin and Wilde (1988) use classical tax evasion theory to examine the effects of auditing on compliance. They theorize that the IRS is a strategic actor in the taxpayer-government relationship; audits have a deterrent effect on noncompliance; several socioeconomic factors have significant hidden costs for compliance; and increases in the unemployment rate reduce the level of compliance (Dubin and Wilde 1988). Their analysis evoked criticism from scholars arguing that coercion models greatly over-predict evasion. Evasion is rarer than compliance, even with relatively low risk of detection. Scholars began to examine other explanations for compliance.

Erard and Feinstein (1994) utilize game theory to challenge the dominant coercion/deterrence model, arguing that including honest taxpayers alters the tax compliance game. They identify perceptions of fairness of the tax code and a taxpayer's reactions to government policies as significant factors in this game. In a subsequent study Erard and Feinstein (1994) explore taxpayers' moral sentiments about tax compliance. They demonstrate that the United States had an average audit rate of 2.7% but that the mean expectation among respondents predicted a 72% audit rate and that guilt and shame are important determinants of tax reporting behavior.

Although utility maximization approaches have begun to account for small instances of moral sentiments, many scholars denounce the idea that individuals are amoral utility maximizers. Pyle (1991,173) asserts, "Casual observation suggests that not all individuals think quite like that. Indeed, it seems that whilst the odds are heavily in favor of evaders

getting away with it, the vast majority of taxpayers behave honestly.” Economic psychologists have used different experimental methods to predict the likelihood of tax evasion. Typically, economic psychologists confront a small sample of individuals (usually college students) with a specific financial scenario. *In Tax Evasion: An Experimental Approach*, Webley et al. (2010) use cross-national experimental simulations and come to the conclusion that competition between taxpayers, alienation, and social orientation are significantly related to tax evasion; however, inequity shows no correlation. Building on the classical model and improving on the framework, Traxler (2010) establishes that tax compliance can remain high with weak tax enforcement. In addition, beliefs concerning other individual taxpayer behavior affect tax compliance.

Since the 1990s, the tax compliance/evasion scholars have utilized a variety of datasets, mainly surveys that ask questions that can be used as proxies for tax morale. Using a British Social Attitudes Survey, Orviska and Hudson (2003) determine that law abidance has a positive effect on tax morale. Benno Torgler’s recent work on tax morale examines a variety of different scenarios in a number of different countries, using a variety of surveys and taxpayer scenarios (Schaltegger and Torgler 2007; Torgler 2002, 2003, 2005). Schaltegger and Torgler (2007) use the World Values Survey, the Latinobarometer, and a controlled field experiment in Switzerland in which a test group of citizens receive a letter from the Swiss government outlining the importance of paying taxes. They found that rate of taxation is generally not significant while trust in the legal system is highly significant. This fits the argument of Putnam, Leonardi, and Nanetti (1994), who find an association between high levels of social capital and stronger economic performance. Similarly, direct democracy

and referendum voting increase citizens' information, which, in turn, affects tax morale. Citizens who take an active role in policy decisions might also be more likely to contribute to their communities (Alm and Torgler 2006; Feld and Kirchgässner 2000; Hug and Spörri 2011; Torgler 2005).

A high level of governmental autonomy also has significant effects on tax morale. As governments approach more decentralized forms of government, the likelihood of evasion decreases, demonstrating that institutional structures can shape taxpayer behavior. Exploiting the Latinobarometer and European Social Survey, scholars find that trust in the president/politicians and pro-democratic attitudes are also associated with high tax morale; As tax protests during the Vietnam War reflect, tax evasion can be a form of political protest (Lago-Peñas and Lago-Peñas 2010; Torgler and Schneider 2007a). These findings suggest that citizens' perceptions of their government institutions and those regimes that control their political system affect their willingness to pay taxes.

Many socio-demographic variables are statistically significant for tax morale as well. Field and experimental research has shown that women in advanced and industrialized societies are less likely to evade taxes (Giese and Hoffmann 2000; Torgler 2002)). In a study that uses Albania as a case study, Gërxhani (2007) notes that most explanations for these differences reference biology or socioeconomic conditions. Building on the work of Ferber and Nelson (2003), she argues that "gender differences, together with class, ethnic, and age differences, relate to legal arrangements, power differences, the historical division of labor, economic incentive patterns, and institutional arrangements" (120). She argues that biology and socioeconomic conditions blend in institutions that are not gender-neutral, but

are rather a reflection of centuries of biological and socioeconomic arrangements, and that therefore explanations that make reference to only one of these factors are insufficient. This work begins to unravel the complexity of the relationship between gender and institutions, which may reveal the significant of other prominent socio-demographics.

Research exploring the effects of education and income on tax morale have had varying results. Some find a positive relationship between educational levels and tax compliance (Friedland, Maital, and Rutenberg 1978; Wallschutzky 1984). One study, which samples 426 Swedish males, establishes a negative relationship (Wärneryd and Walerud 1982). Yet Milliron (1985), who samples 34 randomly selected adults from a jury duty pool in Las Angeles, performing taxpayer simulations, finds no relationship. Lago-Peñas and Lago-Peñas (2010) concur with Wärneryd and Walerud, finding negative results for education. Ross and McGee (2011) utilized survey methods to examine the relationship in six countries, the United States, Brazil, Russia, India, China, and Germany, with varying results. China was the most adverse to tax evasion, possibly due to strict enforcement by the state, followed by the United States and Germany. US women were the only women surveyed to have a statistically significant, consistent opposition to tax evasion across education levels. Opposition to tax evasion and correlations between tax morale and education also varied from country to country. In the United States and India, the most educated had the greatest opposition to tax evasion. In Brazil, Russia, and China, it came from the least educated. Ross and McGee conclude that culture, history, politics, and economics contribute to diverging attitudes toward tax evasion. Using the 2004 Bank of Italy Survey of Household Wealth

and Income, Filippin, Fiorio, and Viviano (2013) suggest that education is an important predictor of tax morale and positively correlated in Italy.

Studies that address the relationship between tax evasion and income show more consistent results. The literature reflects a consensus that there is typically a negative relationship between relative income and tax evasion and that taxpayers will be risk averse. Utilizing a reference-dependent approach, which stipulates that a behavior depends on a reference point, Rablen (2010) analyzes income distribution of tax evasion, finding that heterogeneity and income distribution plays an important role, with evasion tied to the provision of the public good. Since taxes typically reduce an individual's take-home income, studies have revealed that, particularly in federalist countries, individuals living in high-income regions are more likely to evade taxes. High tax burdens are often associated with lower tax morale as well (Lago-Peñas and Lago-Peñas 2010).

Another socio-demographic factor that interacts with tax morale is age. Older people have a more positive tax morale than younger people (Ross and McGee 2011; Torgler and Schneider 2007*a*). Nordblom and Žamac (2012) argue that effects of age reflect evolving norms throughout the life cycle. Braithwaite and Ahmed (2005) utilize cross-sectional data from a survey of 447 recent college graduates in Australia, also making the claim that greater tax morale is a function of age; Torgler and Valev (2010) use panel data to buttress the connection.

Religion also has an effect on tax morale (Torgler and Schneider 2007*a*). In their six-country study, Ross and McGee (2011) found Catholics were more opposed to tax evasion than other religious groups, and Buddhists were least opposed. Stack and Kposowa

(2006) utilized the World Values Survey, analyzing data on 45,728 individuals in 36 nations; they controlled for other predictors of tax fraud acceptability (TFA), social bonds, economic strain, and various other demographics. Presenting mixed aggregate results, they concluded that within individual nations, “the presence of a ‘moral community’ (majority of the population identifies with a religious group) explained 39 percent of the variation in the presence or absence of the expected religiosity-TFA relationship.” Gentry and Kahn (2009) utilize IRS and zip-code level data to examine the relationship of ideology and tax morale, constructing a spatial understanding of tax sheltering in the United States. They find places with voters who are either more conservative actually shelter less income (Gentry and Kahn 2009).

The present study focuses on Italy, and existent scholarship suggests income, age, education, and occupation type are all associated with Italian citizens’ perception of the seriousness of tax evasion. These studies show that higher tax morale correlates with increased age and education and that self-employed individuals have the lowest levels of tax morale (Barone and Mocetti 2011; Filippin, Fiorio, and Viviano 2013; Fiorio and Zanardi 2008; Luigi Cannari 2007). Fiorio and Zanardi (2008) find similar results, except that residents living in Southern Italy do not recognize tax evasion as a serious concern. Another significant deviation from broader findings reveals that Italian females tend to have lower morale than males, although this finding may reflect the large income gap between men and women, since it also shows a correlation between income and tax morale (Filippin, Fiorio, and Viviano 2013). Barone and Mocetti (2011) reveal that public sector inefficiencies negatively affect tax morale, which has important implications for state capacities. Filippin,

Fiorio, and Viviano (2013) find that not only do respondents' individual characteristics affect tax morale, but contextual variables, such as tax enforcement, also predict tax morale. These findings prompt the present study's attempt to provide more holistic research into the interaction of these variables and tax morale. The following chapters will uncover the nexus between history, institutions, and civic responsibility and how these ties interact to shape taxpayer behaviors.

3. Testing the *Amoral Familism*

3.1 Bank of Italy Survey of Household Wealth and Income Data

This chapter examines individual level data to assess the regional effects of social capital and political culture on tax morale. I am interested in confirming the existing literature that suggests Southern Italy is significantly lower than Northern Italy with regards to tax morale, while adding several individual level hypotheses, most importantly that the South evinces lower levels of civic culture and social capital. I argue, however, that cultural backwardness, often referred to as *amoral familism*, cannot explain the intricacies of a person's tax behavior alone. Tax morale is constructed within a specific institutional environment, reflecting the particular quality of institutions with which a citizen associates. In other words, if the quality of institutions is so poor that circumventing laws is necessary to accomplish simple functions, such as paying taxes, side-stepping the state is legitimized, while the state itself is deligitimized. This then becomes a question of institutional effectiveness, rather than cultural deficiency.

To test the hypothesis that tax morale is shaped by institutions, I use tax compliance experiments conducted in Milan, Rome, and Bologna for which participants partook in simple clerical tasks and were paid based on how well they performed those tasks. They were then asked to report their incomes under three different scenarios, mimicking different

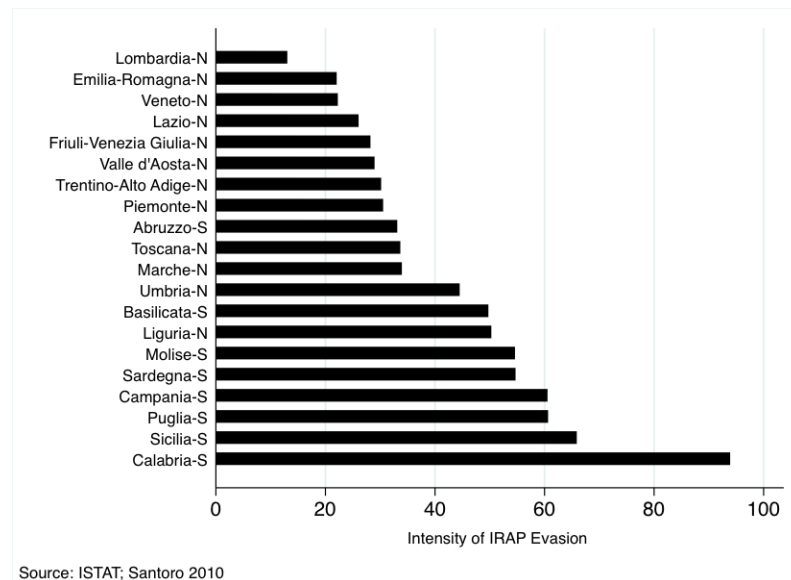
types of tax regimes. Institutions were held constant throughout the experiment allowing us to isolate cultural variation. Challenging the culturalist argument, we find no difference in tax compliance when controlling for the institutional environment. Using Social Value Orientation as a proxy for an individual's civic consciousness we discern no differences between the two regions.

Italy presents a crucial case for study tax morale because of the sizeable level of evasion in the country. While Italy collects approximately 350 billion euros per year in tax revenue, it loses an estimated 250 billion euros due to tax evasion and underground economy (Santoro 2010; *World Development Indicators* 2014). Other estimates place evasion rates at 25%-30% of GDP. Some estimates of VAT evasion reach 40% of the taxable base, and corporate evasion makes up approximately 27% of taxable revenue (Santoro 2010).

Estimates suggest that Italy fails to collect around 26% of the income tax its citizens owe due to evasion. Considerable disparities register among different types of workers; self-employed individuals and entrepreneurs evade approximately 60% of their income taxes, while dependent workers only evade approximately 10%. Evasion rates vary in different sectors of the economy as well; estimates suggest the agricultural sector evades 70.57% of regional production tax while the commercial sector evades 54.78% and the business services sector evades 46.41%. Family services such as housekeepers and maids evade approximately 42%. Construction sectors evade considerably less, 23.82%, and industrial sectors evade the least, 9.24% (Santoro 2010). In addition to industry variation, research reveals regional variation. IRAP evasion ranges from 13% and 50% in northern Italy, while southern regions vary from 54% to 94% (Calabria). Figure 3.1 presents all

regions by level of IRAP evasion. Considering the sheer size of evasion, its economic determinants have grave importance, demanding holistic approaches that account for deterrence, detection, and citizens' social characteristics.

Figure 3.1.: Intensity of Evasion of IRAP by region 1998-2002



Scholars such as Edward Banfield, Francis Fukuyama, and Robert Putnam have all employed cultural arguments to explain divergences in economic performance and government effectiveness between the Italian regions (Banfield 1967; Fukuyama 1995b; Putnam, Leonardi, and Nanetti 1994). In his influential study *Making Democracy Work*, Putnam suggests that a long history of civic virtue and social capital in the Northern regions of Italy is reflected in their past republican governments and their current institutions, whereas the Southern regions can be characterized by strong familial, inward facing ties which mirrors

their autocratic history and present development. Since Putnam, a multitude of studies have tested the *Southern Question*.

If we apply this logic to taxpayer behavior, a more civic oriented individual would gain utility by paying taxes because the increased wellbeing of their fellow citizens, as well as the state would also increase their utility. A person who is less civic and has strong inward facing ties would actually lose utility by paying taxes by decreasing the income of the family unit, while benefiting others, including a state which is far removed from the familial unit. We can express this in a basic utility function similar to that used by Murphy, Ackermann, and Handgraaf (2011), but with an added family unit:

$$U(\pi_{self}, \pi_{other}, \pi_{family}) = \pi_{self} + \alpha \pi_{other} + \alpha \pi_{family} - tax \quad (3.1)$$

where π_{self} denotes the taxpayers payoff, π_{other} indicates the payoffs to another person, π_{family} signifies the payoffs to the taxpayers family, α measures the weight a taxpayer puts on others or family's wellbeing, and tax represents the amount of tax to be paid. More balanced weights between family and other exemplifies a citizen with a high level of bridging social capital. This is compared to a taxpayer who sacrifices the utility of others, favoring a heavily weighted family utility.

To preview my main results, estimates from the Bank of Italy Survey suggest that tax morale in the North is significantly higher than tax morale in the South, confirming the existing literature. Social capital and civic culture are statistically significant and positive, and a t-test supports the hypothesis that the North is endowed with higher levels of

both. There is a large body of literature demonstrating that the self-employed have lower tax morale than employees, and I indeed determine this to be representative of the Italian population as well. However, when controlling the environment in a controlled laboratory setting, I discover no difference in tax compliance and other-regarding preferences between the North and the South.

3.2 Methods

In the first part of this chapter, I use OLS models to examine the effects of social capital and civic culture on tax morale. The Bank of Italy Survey of Household Wealth and Income, 2004 (BI), which analyzes wealth and income in Italy dating back to 1970, provides the data. The survey is conducted every two years with a sample size of approximately 8,000 respondents. Based on the survey, this study examines three main hypotheses about the effects of social capital and political culture on tax morale, listed in Table 3.1.

Table 3.1: Statement of Hypotheses

H₁	Because social capital, operationalized as number of associations, increases an individuals other-regarding preferences, tax morale will also increase.
H₂	As civic culture, operationalized as interest in politics and honesty, increases so will tax morale.
H₃	Respondents living in Northern Italy will have greater bridging social capital, thus living in the North will have a positive effect on tax morale, whereas living in the South will have a negative effect on tax morale, because of their preference for protecting the wellbeing of the family unit, while sacrificing other's wellbeing.

The 2004 BI survey has a section pertaining exclusively to public spirit and taxation. The study generated a random sample of 3,798 from its broader sample by selecting those respondents who owned a home with an odd year of birth to partake in this section. It posed a variety of questions regarding honesty, number of associations, perceptions of the extent of evasion, and a number of questions referring to tax morale. I operationalized the concept of tax morale by creating an index from Cronbach's alpha using several questions, which provided statements about Italy's tax system and asked respondents to indicate their level of agreement with the statements:

- The more someone earns, the more (in percentage) he/she should contribute to Government spending
- Paying taxes is one of the basic duties of citizenship
- Not paying taxes is one of the worst crimes a person can commit because it harms the whole community
- Even if someone thinks a tax is unfair, he/she should pay it first and then complain if necessary
- It is right to pay tax because it helps the weak
- If everyone paid taxes, in the end we would all pay a little less

1= not at all; 5 = very much

I also used a variable to represent evasion, based on a question which requires respondents to assess the seriousness of the problem of tax evasion in relation to other problems facing the government, asking respondents to rate it as 1. Very serious, 2. Serious, 3. The same as any other, 4. Marginal, or 5. Non-existent. The alpha score is .72 for the scale as a whole, signifying a reliable scale. The index has a minimum value of -2.92 and a maximum value of 1.13. At the 10th percentile, tax morale has a value of -.85, and a value of .75 at the 90th percentile.

The twenty Italian regions have been collapsed into two regions representing the traditional north and south divide in Italy. It could be argued that the regions of central Italy, once controlled by the papacy, should also be represented here. I find no statistical difference between the once papal states and the more northern regions, therefore I believe there is a strong argument for using the dichotomous region variable. My independent variables are centered on the concepts of social capital and civic culture. I operationalize social capital and civic culture as interest in politics and number of associations. In addition, I have created an index for honesty, consisting of not paying for public transportation and not returning money found by accident. The alpha score is .82.

I control for self-employed respondents reflecting their consistently higher level of evasion in Italy. Lastly, I will control for individual demographic variables. All descriptive statistics for variables in the multivariate analysis are outlined in Table 3.2.

Table 3.2: Summary statistics

Variable	Mean	Std. Dev.	Min.	Max.	N
Tax morale	0	0.617	-2.92	1.133	3798
Interest in Pol	1.877	0.894	1	4	3798
North	0.589	0.492	0	1	7687
Associations	1.141	0.348	1	2	3798
Sex	0.39	0.488	0	1	8012
Education	3.445	1.639	1	8	8012
Log income	10.086	0.66	5.521	13.838	8008
Self-employed	0.107	0.309	0	1	8012

Survey responses are not without bias, however. Self-reporting may cause respondents to overstate their actual degree of compliance. Various studies addressing this upward bias find that the average person tends to exaggerate his or her willingness to pay for a

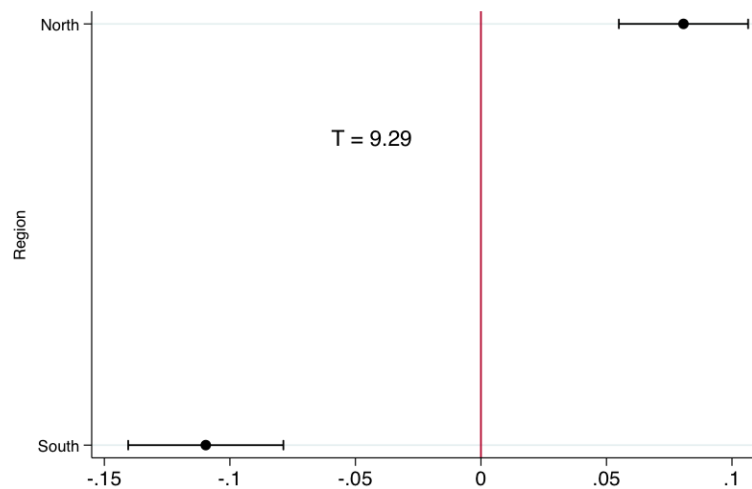
variety of goods and services when given hypothetical situations. Hypothetical bias applies more strongly to private goods than to public goods, which could be related to an even greater upward bias on tax morale questions. Hillman (2010) argues that survey responses represent inconsequential expressive behavior because respondents are aware that answers to survey questions will benefit them expressively, but have no effect on their material utility. This can result in biased responses to tax morale questions because respondents' material utility is not affected, as it would be in real world taxpayer situations. However, the use of a multi-item scale increases the reliability of the measure by capturing the diverse aspects of tax morale. The multi-item scale also tends to compensate for error in any single item (Alm and Torgler 2006). Asking about tax morale is also less invasive than asking about tax evading behavior, and should thus evince a higher degree of honesty. The fact that the BI reveals significantly higher tax morale in the North than in the South further verifies the validity of the measure, since this is consistent with other non-survey data on tax evasion in Italy.

3.3 Results

Figure 3.2 represents significant differences between tax morale in the North and South using a “difference-in-means” t-test. As the methodology section above describes, the tax morale scale exploits several questions from the Bank of Italy survey of household wealth and income to define citizens' intrinsic motivation to pay taxes. This test estimates the “true” population means of each group from the sample collected by the Bank of Italy with confidence intervals. The $p - value \leq 0.05$ shows that the difference between the two

is statistically significant and that the northern mean is definitely higher than that for the South.

Figure 3.2.: Tax Morale Index: Mean Comparison between Respondents from Northern and Southern Italy



Source: Bank of Italy, 2004

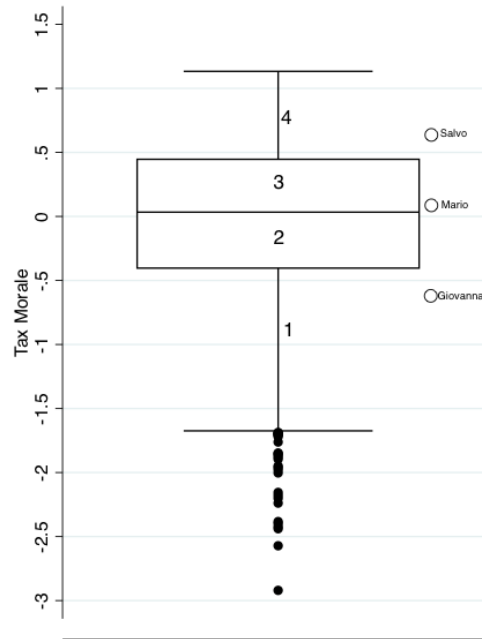
To increase the intuition of the tax morale measure, I have also created three fictitious names for three respondents at the 15th, 50th, and 85th percentiles: Giovanna, Mario, and Salvo. Giovanna represents the 15th percentile with a tax morale score of -.64. She was born in a city of less than 20,000 people in Abruzzo (South) and has a high school degree. She believes that tax evasion is a serious crime; she does not think that people who earn more should pay more; and she believes strongly that paying taxes is one of the basic duties of citizenship. Giovanna also believes that not paying for your taxes is a very serious crime. She responds 3, neutral, with respect to her level of agreement that a person should pay a tax bill he or she considers unfair and then complain if necessary. Similarly, she does not

agree that it is right to pay taxes because it helps the weak. Giovanna does feel very strongly that if everyone paid their taxes then taxes would be lower for everyone.

Mario's tax morale score of .02 represents the 50th percentile. He is 45 years old, from a small town in the South, and has a high school degree. He believes that tax evasion poses no significant problem for Italy. He also opposes progressive taxation, but believes strongly that paying taxes is a basic duty of citizenship. Like Giovanna, he considers tax evasion a serious crime. He feels very strongly that an individual should pay his or her taxes, regardless of the consideration that they are unfair, and then complain later. He indicates he feels neutrally about the statement that an individual should pay taxes because it helps the weak. Lastly, he believes strongly that if everyone paid taxes it would reduce the collective burden.

Salvo from Emilia Romagna (North) represents the 85th percentile with a tax morale score of .61. Salvo is 57 from a small town and he has a bachelor's degree. He thinks that tax evasion is a very serious problem facing the country and he believes strongly in progressive taxation for the wealthy. Like Mario and Giovanna, he feels very strongly that paying taxes is a basic duty of citizenship and in the seriousness of evasion as a crime, and agrees with Mario as to the strong obligation to pay a bill the taxpayer considers unfair. Like Mario, Salvo is neutral about the statement that individuals should pay taxes because it helps the weak, but feels very strongly that if everyone paid their taxes, it would reduce the collective burden. I illustrate where each of these respondents fall on the tax morale index in Figure 3.3.

Figure 3.3.: Tax Morale Scale Measures



Source: Banca D'Italia, 2004

To test the impact of region on tax morale I use a bivariate model, only analyzing the effect of region on tax morale. The first column of Table 3.3 shows the North is robust at the .05 level and positively correlated with tax morale, meaning respondents born in the North have higher tax morale scores than respondents in the South. The coefficient implies living in the North increases tax morale by .19 tax morale units. In other words, looking at Figure 3.3 living in the north moves tax morale from the second to third quartile when all else is held constant.

Table 3.3: OLS Regression: Tax Morale

	Dependent Variable: Tax Moral			
	(1)	(2)	(3)	(4)
North	0.19*** (0.021)	0.13*** (0.02)	0.16*** (0.021)	0.12*** (0.020)
Associations		0.15*** (0.029)		0.15*** (0.029)
Interest in Politics		0.06*** (0.0114)		0.05*** (0.0122)
Honesty		0.16*** (0.011)		0.16*** (0.011)
Sex			-0.09*** (0.0211)	-0.08*** (0.0205)
Log income			0.05*** (0.018)	0.02 (0.018)
Education			0.03*** (0.00676)	0.02*** (0.00682)
Self-employed			-0.22*** (0.03)	-0.21*** (0.03)
Constant	-0.11*** (0.016)	-0.37*** (0.036)	-0.67*** (0.170)	-0.5*** (0.166)
N	3,660	3,660	3,658	3,658
R-squared	0.023	0.104	0.050	0.118

Standard errors (in parentheses)

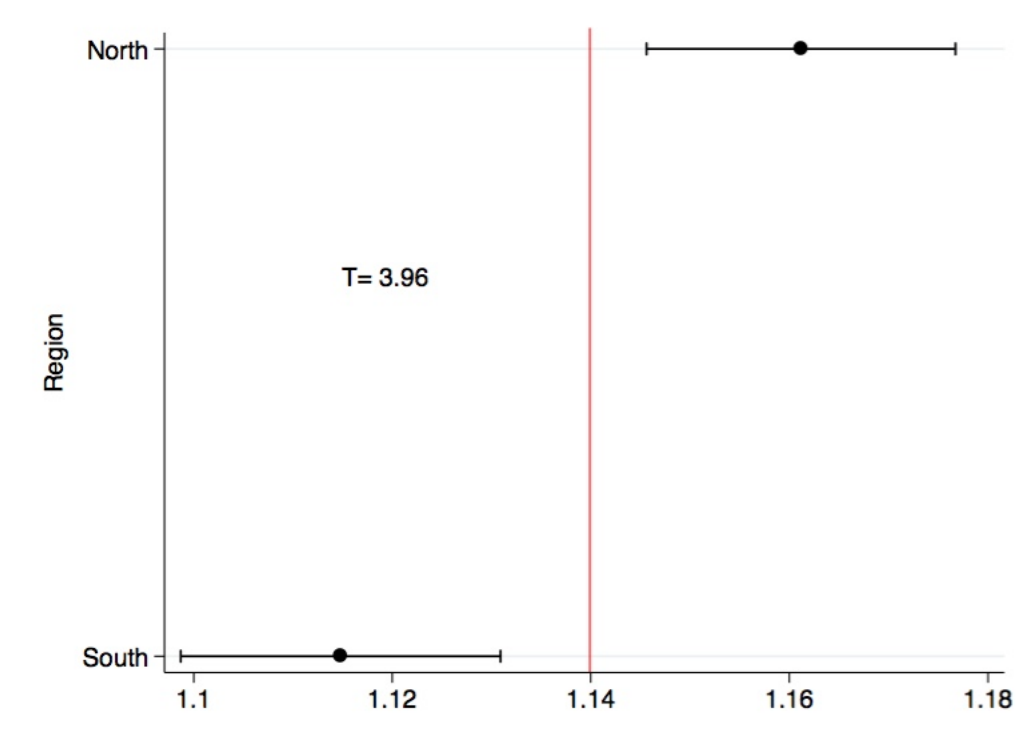
*** p<0.01, ** p<0.05

Column 2 of Table 3.3 exhibits the results of my multivariate model adding my social capital and civic culture variables. All social capital and civic culture variables are robust and moving in the predicted direction; however, when controlling for social capital and civic culture there is only a modest decrease in the North variable, suggesting that social capital and civic culture account for only a small amount of the variation in the region variable. Interest in politics is an important indicator of civic participation. Interest in politics represents a general awareness and engagement with the political process; in this regard, it is an important aspect of civic culture. The more a citizen is involved in the political process the more likely they are to follow norms and rules, therefore increasing their tax morale. The positive coefficient predicts that a one-unit increase in interest in politics increases tax morale by .06 tax morale units. This implies that moving across the range of interest in politics from not at all interested in politics (1) to fairly interested in politics (3), tax morale moves from the second to third quartile when all else is held constant. Honesty (see appendix for explanation) also proxies for civic culture, because it indicates ones level of civic virtue and feelings about reciprocity. Here honesty has a coefficient of .11, predicting as honesty increases by one unit, tax morale will also increase by .16 units. More substantively, this means that as honesty moves from the 10th percentile (-1.3) to the 90th (.64), tax morale changes from the second to the third quartile *ceteris paribus*. These tests all support the hypothesis that increased social capital increases tax morale, while also increasing tax morale across regions.

Social capital, represented by the number of associations to which a respondent belongs, is assessing the cooperative nature of a respondent and their outward ties, which can

improve the efficiency of society (Putnam 1993, 126). The more an individual associates with other individuals as part of a formal or semiformal organization (i.e. unions, environmental clubs, etc...), the more emphasis will be placed on π_{other} in formula 1, and hence tax morale will also increase. It is important that the weight is on outward facing ties (bridging), instead of inward looking ties (bonding). Bridging represents associations between people of different socioeconomic and ethnic groups, whereas bonding relates to inward facing organizations such as ethnic fraternal organizations and country clubs. Because bonding can result in strong out-group antagonism and distrust, tax morale could be negatively affected; bridging should have a positive effect on tax morale. In the difference-in-means t-test shown in Figure 3.4, Northern respondents frequent associations significantly more than their Southern counterparts. I propose that Northerners' social capital is not only quantitatively different, but also qualitatively as demonstrated by Sabatini (2005*a,b*, 2006).

Figure 3.4.: Number of association a respondent attends per year: Mean comparison between respondents in Northern and Southern Italy



In my individual level model, the coefficient is .15, indicating that a one unit increase in associations increases tax morale by .15 tax morale units when all other variables are held at their mean. The results suggest that social capital and civic culture variables have a significant impact on tax morale. Specifically, knowledge sharing and the diffusion of trust increases the more often a person attends formal or semi-formal associations, which in turn, positively affects tax morale. If my tax morale is linked to the amount of utility that I get from the betterment of societal position of others + family, taking part in associations should, in theory, increase my tax morale.

In column 3 and 4 of Table 3.3 I add a set of demographic control variables: education, self-employed, and income are all statistically significant, moving in the predicted direc-

tion. Field and experimental research has shown that women in advanced and industrialized societies are less likely to evade taxes (Giese and Hoffmann 2000; Torgler 2002). In a study that uses Albania as a case study, Gërxhani (2007) notes that most explanations for these differences reference biology or socioeconomic conditions. Building on the work of Ferber and Nelson (2003), she argues that “gender differences, together with class, ethnic, and age differences, relate to legal arrangements, power differences, the historical division of labor, economic incentive patterns, and institutional arrangements” (120). However, contrary to previously reviewed studies, sex is negative, signifying that women have lower tax morale than men in Italy. This is possibly the result of two situations. First, income is positively correlated with tax morale, thus as income increases, so does tax morale. The mean income for females is €24,675, whereas mean income for males is €33,187. This large income gap is one explanation for the lower tax morale among women. Second, males make up more than half the respondents surveyed.

Research exploring the effects of education and income on tax morale have have varying results. Some find a positive relationship between educational levels and tax compliance (Friedland, Maital, and Rutenberg 1978; Wallschutzky 1984). One study, which samples 426 Swedish males, establishes a negative relationship (Wärneryd and Walerud 1982). Yet Milliron (1985), who samples 34 randomly selected adults from a jury duty pool in Las Angeles, performing taxpayer simulations, finds no relationship. Since self-employed individuals make-up a large portion of the Southern Italian workforce, this might further explain the differences in tax morale.

The results of the OLS regression models have many important implications for tax policy in Italy. I have demonstrated that variables which represent social capital and civic culture are significant predictors of an individual's tax morale. Tax morale varies significantly between the North and South, as do social capital and civic cultural. Tax morale, however, is sensitive to the context in which behaviors are formed. It is probable that tax morale is largely a product of the public institutions with which citizens associate. If public institutions in the South are less efficient than in the North and are run by corrupt officials, chances are that they will also be less willing to support those institutions with their tax dollars. Using tax compliance experiments I can test this hypothesis by holding the institutions constant

3.4 Experimental Overview

Our experiments were conducted in three universities throughout Italy during the 2013-2014 academic year. These universities use an electronic database to which the students or past students voluntarily submit their information for participation in experiments. The participants are then randomly selected and invited by email to partake in the experiment. Once the participants arrive at the laboratory they are given an anonymized identification number and assigned to a partitioned computer to limit the interaction between themselves and other participants. We link participant pay to id number thus ensuring complete anonymity.

We began the session by reading a short script introducing the participants to the experiment. They were told that they will be asked to perform a series of simple clerical tasks and make a series of decisions for which they will receive real Experimental Currency Units

(ECUs) which will be converted into real money once the experiment is completed. Participants could also choose to leave the experiment receiving a small show up payment of 5 euros. Once all tax compliance and SVO tasks were completed, respondents were asked to complete a short survey.

This study is part of a larger cross-national project in which we perform experiments in Italy, the United Kingdom, Sweden, the US, and Romania. Since I am only concerned here with Italy, I have dropped a large portion of our observations. Our Italian participants were specifically asked to state in which region they were born. For our study, there were 270 Italian subjects. In Table 3.4 I report the characteristics of our participants. The participants in the North are demographically very similar to those in the South. In our pool the average age was 23.87, 53% were male, just under a quarter were employed, and about 40% were economics majors. Because there is a high proportion of economics majors, we control for those participants in our individual models. The vast majority, 84%, of our subjects had participated in experiments before. Northerners, however, are significantly more likely to be employed and economics majors.

Table 3.4: Summary of Participant Characteristics: North and South

	Obs.	Mean	Std. Dev.	Min.	Max.	North Mean	South Mean	Diff. in Means
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Male	277	0.54	0.50		1	0.53	0.57	-0.05
Age	277	23.87	3.57	18	73	23.96	23.72	0.24
Employed	276	0.21	0.41		1	0.26	0.12	0.14*
Past part	275	0.81	0.38		1	0.80	0.84	-0.04
Econ major	267	0.40	0.50		1	0.44	0.31	0.13*
Risk	268	5.23	2.36	1	10	5.28	5.19	0.09
Prosocial	278	0.35	0.48		1	0.35	0.38	-0.03
Individualist	278	0.61	0.49		1	0.61	0.61	0.00

I tested for differences in population means using Schlag's Z-test (for dummy variables) and t-tests (for continuous variables). An asterisk (*) indicates whether differences between countries are statistically significant at the 5% level.

To earn money, our subjects were asked to copy rows of data from a sheet of paper to a computer. They would receive 10 ECUs for each row copied correctly, followed by reporting round. In the reporting round, participants are asked to declare their income under three different scenarios, mimicking actual tax regimes. Individuals are given free-reign to declare anywhere from 0% - 100% of their income with a 5% probability of being audited. There are a total of three clerical tasks, each followed by three reporting rounds. With each reporting round the rules and redistribution vary slightly.

Figure 3.5.: Example Screenshot: Reporting Your Earnings

REPORT YOUR EARNINGS

We now ask you to report your income for tax purposes. The tax rate is 30%.

Based on the number of rows you copied during the clerical task, your earnings are 0 currency units.

Report your earnings for tax purposes here:

In the rounds 1-3 we maintain a 30% flat tax rate, but vary how the money is redistributed reflecting behaviors under different levels of efficiency. We hold redistribution constant in rounds 4-6, but we introduce new tax rates. Lastly, rounds 7 and 8 are progressive taxation rounds. In the first progressive round, the top 10% of incomes paid a 50% tax rate, the bottom 10% paid a 10% tax rate, and everyone else paid a 30% tax rate. The progressive taxation round 8 is similar to a marginal tax system in that all incomes over 100 ECUs were taxed at 50%, incomes between 50-100 were taxed at 30%, and any income under 50 was taxed at 10%. In the ninth and final round, we donate all revenue to a real world charity.

Table 3.5: Summary of Tax Reporting Rounds

Task	Description
Clerical 1	Earn income that is reported in Rounds 1 through 3
Round 1: No Redistribution	Flat tax rate of 30% on all reported income Tax revenues are not redistributed
Round 2: Redistribution	Flat tax rate of 30% on all reported income Tax revenues are collected into a common fund, which is redistributed on an equal per capita basis to all participants
Round 3: Redistribution x 2	Flat tax rate of 30% on all reported income Tax revenues are collected into a common fund, the amount in the fund is doubled, and then redistributed on an equal per capita basis to all participants
Clerical 2	Earn income that is reported in Rounds 4 through 6
Round 4: 10% Tax Rate	Flat tax rate of 10% on all reported income Tax revenues are collected into a common fund, the amount in the fund is doubled, and then redistributed on an equal per capita basis to all participants
Round 5: 30% Tax Rate	Flat tax rate of 30% on all reported income

Continued on next page

Table 3.5 – *Continued from previous page*

Task	Description
	Tax revenues are collected into a common fund, the amount in the fund is doubled, and then redistributed on an equal per capita basis to all participants
Round 6: 50% Tax Rate	<p>Flat tax rate of 50% on all reported income</p> <p>Tax revenues are collected into a common fund, the amount in the fund is doubled, and then redistributed on an equal per capita basis to all participants</p>
Clerical 3	Earn income that is reported in Rounds 7 through 9
Round 7: Progressive 1	<p>Top 10% of earners in Clerical 3 pay 50% tax on reported income</p> <p>Bottom 10% of earners in Clerical 3 pay 10% tax on reported income</p> <p>Everyone else pays 30% tax on reported income</p> <p>Tax revenues are collected into a common fund, the amount in the fund is doubled, and then redistributed on an equal per capita basis to all participants</p>
Round 8: Progressive 2	<p>participants pay tax of 10% on all reported income under 50 ECU</p> <p>participants pay tax of 30% on all reported income between 50 and 100 ECU</p> <p>participants pay tax of 50% on all reported income over 100 ECU</p> <p>Tax revenues are collected into a common fund, the amount in the fund is doubled, and then redistributed on an equal per capita basis to all participants</p>

Continued on next page

Table 3.5 – *Continued from previous page*

Task	Description
Round 9: Charity	Flat tax rate of 30% on all reported income Tax revenues are collected into a common fund, the amount in the fund is doubled, and then donated to charity

3.5 Methods

My dependent variable is the average compliance rate across all rounds. Because it is censored at 0% and 100%, I perform a series of Tobit analyses represented by the following equation:

$$Y_i = \alpha + \beta_1 North_i + \Theta X_i + \varepsilon_i$$

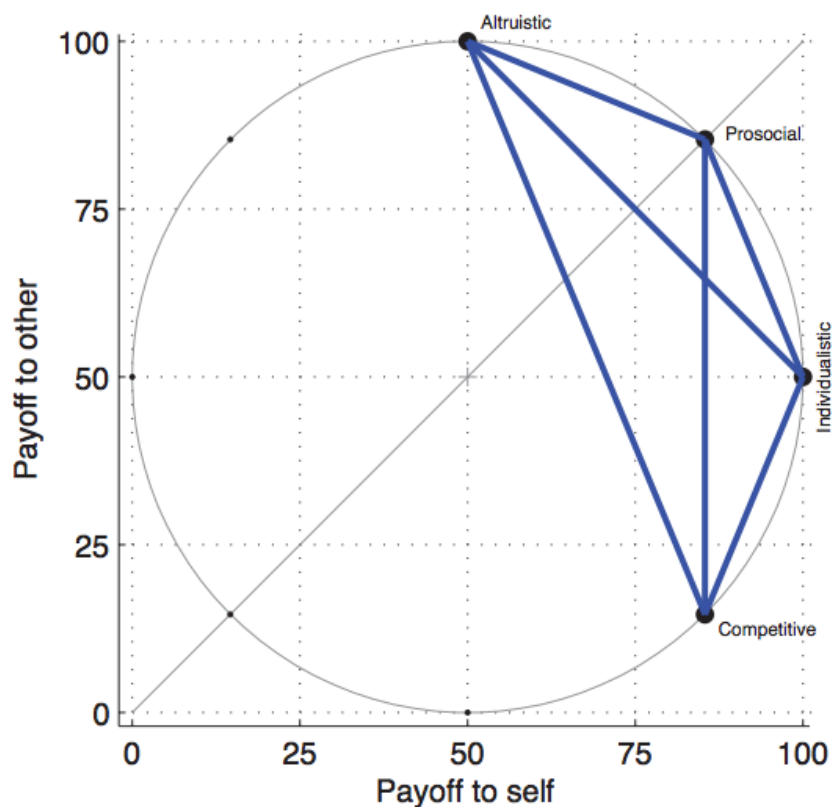
where Y represents the percentage of earned income declared by subject i , averaged across all nine decisions (with an upper bound at 100% and lower bound at 0%), $North$ is a dummy variable for Northern Italian subjects, X represents a vector of individual characteristics, and ε represents an individual-specific error term, clustered within experimental sessions.

I am interested in how participants from Northern Italy play our games, compared to those from the South. I therefore use a dummy variable for our respondents from the North. Since our experiments were conducted only in the Northern regions, there is reason to argue that those participants who left the south might behave differently from southerners who remain in the South. Feldman and Rice (1997) suggest, however, that civic culture is usually retained from one location to the next and from generation to generation. To examine the effects of civic culture on tax compliance, I use *Social Value Orientation* (SVO), which gauges how interested a person is in guaranteeing the welfare of other participants, as a proxy for civic culture.

Murphy, Ackermann, and Handgraaf (2011) represent SVO as a basic utility function:

$$U(\pi_{self}, \pi_{other}) = \pi_{self} + \alpha \pi_{other} \quad (3.2)$$

Figure 3.6.: Constructing the SVO Angle



From Murphy, Ackermann, and Handgraaf (2011), Figure 2, p.773.

To measure SVO, our participants perform a series of mini-dictator games in which they allocate decisions between themselves and a randomly selected partner. The decisions are then assembled on a coordinated plane with the x-axis displaying allocation to self and the y-axis revealing allocation to other (see Figure 3.6, and the six blue lines corresponding to the six items in Figure 3.7). The six allocations can then be averaged into a single angle with a range from -16.26 to 61.40. If we were to arrange these numbers on a scale, -16.26 would represent a participant who is highly competitive, even willing to sacrifice their own income to lessen the welfare of their partner, whereas 61.40 would represent a complete

altruist willing to sacrifice their own income to increase the wellbeing of their partner. The following ideal types can be drawn from the SVO angle:

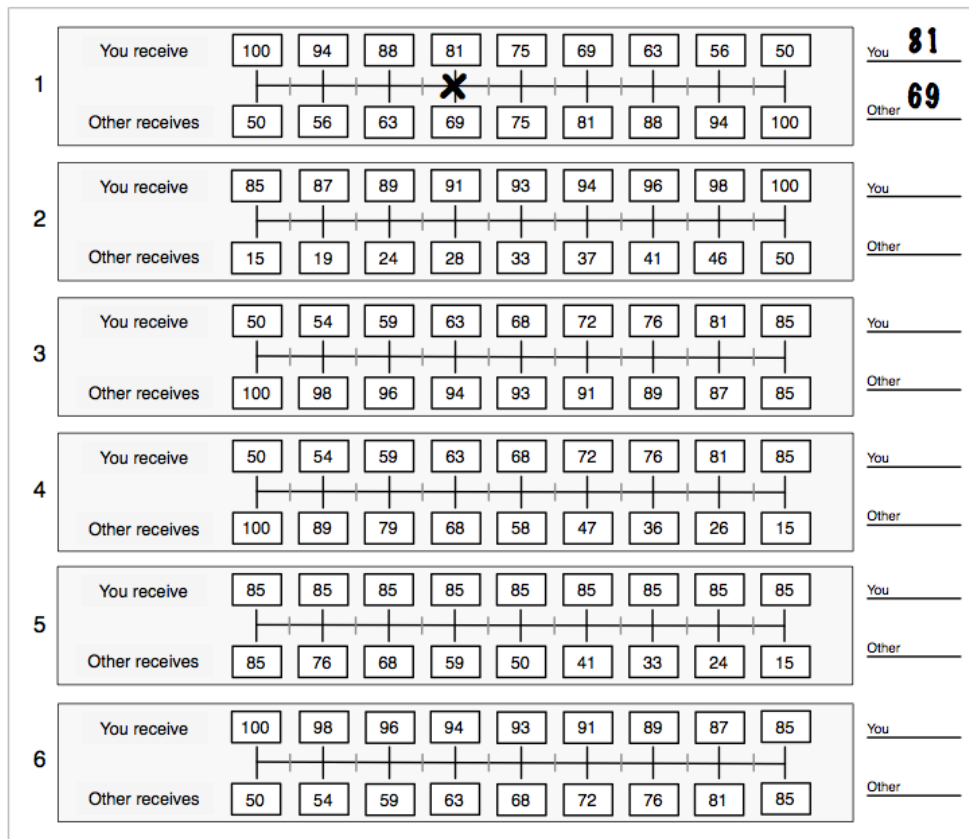
- **Individualists** prefer to maximize their own income across the six items ($-7.82^\circ \leq SVO^\circ \leq 7.82^\circ$)¹
- **Prosocial** people prefer to maximize joint income between themselves and the other ($37.09^\circ \leq SVO^\circ \leq 52.91^\circ$)²
- **Altruists** prefer to maximize the other's income ($SVO^\circ = 61.39^\circ$)
- **Competitive** people prefer to maximize the *relative distance* between the their own income and the other's ($SVO^\circ = -16.26^\circ$)

Most people lie somewhere in the middle as either an individualist to the left side of the scale or prosocial to the right. Finally, I control for sex, employment status, past participation in experiments, whether the participant is an economics major, and their willingness to accept risk.

¹There is a range because the decision maker should be completely indifferent with respect to the vertical line represented by Item 5.

²Again, the range results from the fact that the decision maker should be indifferent with respect to the constant-sum line with -1 slope, representing Item 1.

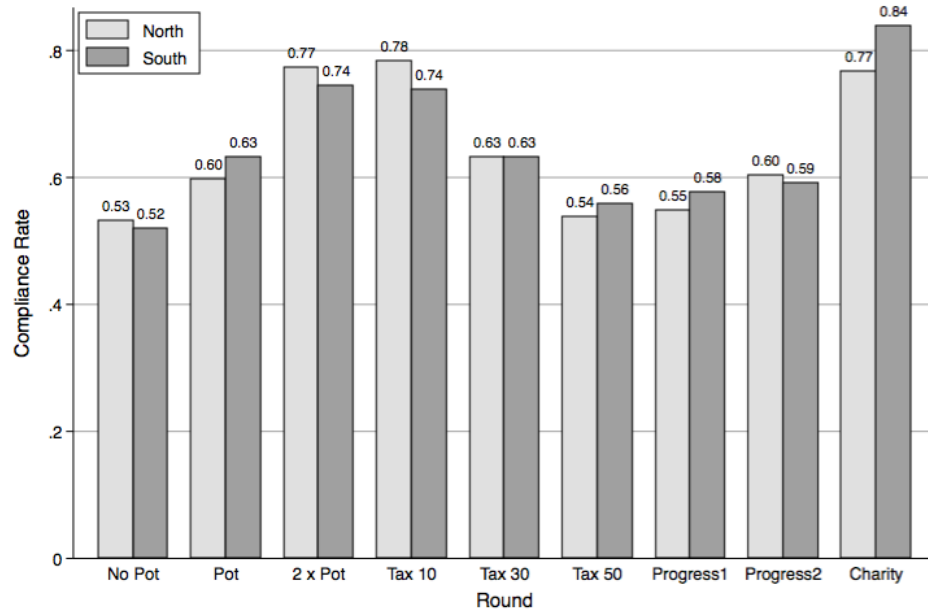
Figure 3.7.: SVO Mini-Dictator Games



From Murphy, Ackermann, and Handgraaf (2011), Figure 1, p.772.

3.6 Results

Figure 3.8.: Overall Compliance: North vs. South



Survey data only allow researchers to test the determinants of tax morale within a given institutional environment, while tax compliance experiments enable us to control the environment. I therefore have a good reason to believe that my results reflect actual taxpayer behavior under an *ideal*, constant tax regime. Figure 3.8 illustrates the average percent of earned income in all nine rounds by Northern and Southern participant. On the vertical axis, I display *average compliance rate* with each particular round of the experiment on the horizontal axis. At first glance it seems as if there is not a significant difference in overall tax compliance between the North and South.

The results of my individual level Tobit models are exhibited in Table 3.6. Column I displays the results of a bivariate analysis of the effects of living in Northern Italy on tax

compliance. Contrary to the results found in the BI³, when respondents from the North and South are given the same institutional environment, the model uncovers no difference in their tax behavior.

In column II of Table 3.6, I demonstrate that SVO angle is a significant predictor of tax compliance. Unlike the BI models where civic culture and social capital vary significantly in the North and South, the experimental models unveil no significant divergence in SVO between residence of North and South. Figure 3.9 shows the almost identical distributions between North and South. When controlling for several demographic variables shown in column III, SVO remains statistically significant. In the BI survey, we found women have less tax morale than men, which came as a surprise. In the experiments, we find that men are less compliant, corresponding with the vast majority of tax compliance studies. In addition, risk acceptance is consistently significant and negative in both models.

³Filippin, Fiorio, and Viviano (2013) demonstrates the North to be positively correlated with tax morale using the BI.

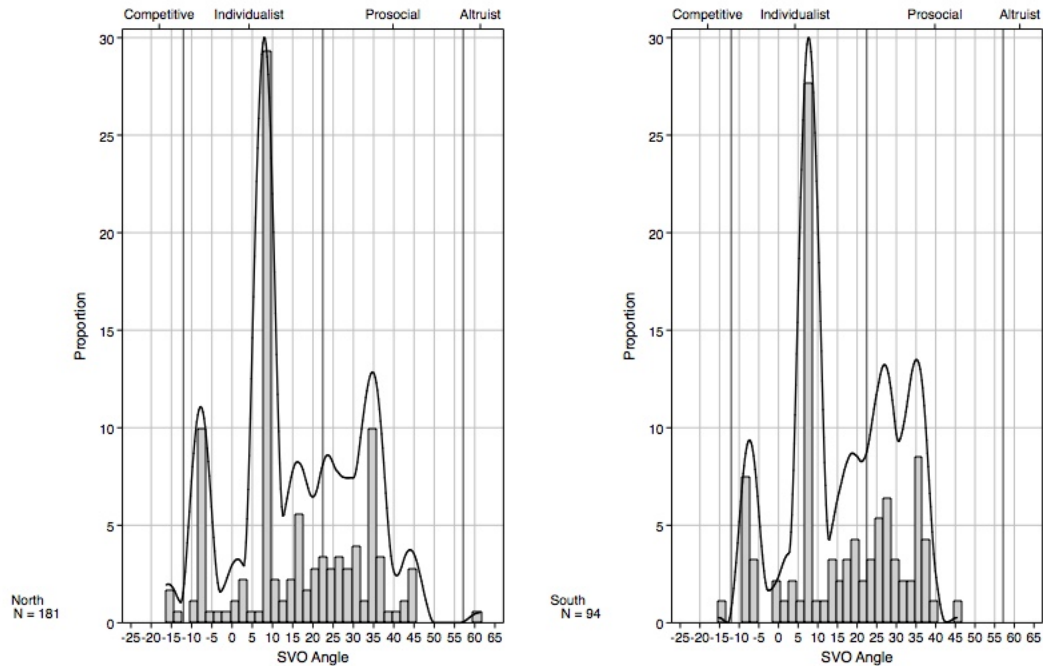
Table 3.6: Tobit Analyses: Average Compliance

	Dependent Variable: Average Compliance Rate, All Rounds					
	(1)	(2)	(3)	(4)	(5)	(6)
North	0.00467 (0.0456)					
SVO angle		0.00757*** (0.00151)	0.00684*** (0.00140)	0.00664*** (0.00151)	0.00734*** (0.00147)	0.00639*** (0.00146)
Age			0.0134* (0.00750)			0.0104 (0.00706)
Sex			-0.231*** (0.0404)			-0.199*** (0.0400)
Employment Status			-0.116** (0.0513)			-0.0633 (0.0496)
Econ Major				-0.0961** (0.0437)		-0.0599 (0.0420)
Past Participation				-0.0772 (0.0553)		-0.0808 (0.0552)
Risk Acceptance					-0.0370*** (0.00906)	-0.0243*** (0.00862)
Constant	0.665*** (0.0355)	0.550*** (0.0322)	0.393** (0.186)	0.667*** (0.0649)	0.742*** (0.0609)	0.653*** (0.201)
sigma						
Constant	0.363*** (0.0159)	0.346*** (0.0148)	0.319*** (0.0153)	0.341*** (0.0146)	0.333*** (0.0154)	0.309*** (0.0158)
No. Uncensored Observations	275	278	276	275	268	265
No. Left Censored Observations	7	7	7	6	7	6
No. Right Censored Observations	40	40	40	40	38	38
Pseudo R ²	3.44e-05	0.0955	0.246	0.113	0.175	0.297

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Figure 3.9.: SVO Angle: North vs. South



When the state lacks the capacity to govern and redistribute goods efficiently, citizens will often pursue other means of redistribution (i.e. clientelism). This is not to say that southerners are less civic or culturally deficient. I demonstrate above that when the institutions are efficient, they are just as altruistic as their northern counterparts. Instead, to receive a fairer distribution of benefits and incomes, Southern Italians must sidestep the state.

To sum up these findings, when controlling for the institutional environment I find no significant difference in tax compliance between the North and South challenging the often employed *moralist* argument. Confirming the BI, I display that civic culture and social capital are indeed important in shaping tax morale. In addition, the experiments tell us

that institutions play a large role in how social capital and civic culture is materialized. Individuals from southern Italy may be less involved in the formal organizations to which the BI was referring, but this could largely be the result of institutional capacity, not a lack civic conscience in the South (Sabetti 2000; Tarrow 1996). I believe that the similar SVO angles provide further evidence to contradict the culturalist argument. In the following chapter, I explore this argument further by examining the historical evolution of Italian institutions and its affect on Italian tax behavior.

4. Italy's Complicated Past

4.1 Church, State, and Clientelism

One of the claims of this study is that civic culture and social capital do indeed shape tax morale, but a tax behavior is formed within a specific historical and institutional environment. In the previous chapter, I proposed that more social capital and civic culture in the North is linked to higher levels of tax morale than in the South. However, when confronted with the same taxpayer environment, participants from the South are no different than respondents from the North with respect to tax compliance and other-regarding preferences (SVO). I argue that the moralist argument, which scholars often employ to explain Italian tax behavior, fails to account for the institutional environment in which a particular culture may manifest. By retracing the historical legacy of Italian political and cultural institutions dating back to the *Risorgimento* (1815-1871) to the beginning of the Second Republic (1994), I can closely examine the effects of periodic shifts in institutions on behavior, specifically tax behavior. This will allow me to more convincingly establish the contextual setting in which two divergent civic cultures and taxpayer behaviors were formed.

Europeans perceive Italians as the least trustworthy of Western European nations and are Italians themselves rate other Italians as untrustworthy (Mackie 2001).¹ But it seems more likely that due to the lack of a well-functioning bureaucracy, rather than inherent qualities, spurs Italians to bypass certain legal barriers. Italy consistently ranks near the bottom on the Quality of Government index compared to other European nations and Southern Italy ranks considerably lower than the North (see Table 4.1 and Table 4.2).

Table 4.1: Quality of Government: 14 Western European Countries

Country	Quality	Impartiality	Corruption	Average
Finland	1.657	1.296	1.266	1.406
Netherlands	0.956	1.445	0.912	1.104
Denmark	0.723	1.004	1.560	1.096
Ireland	0.705	1.046	1.252	1.001
United Kingdom	0.507	0.797	0.871	0.725
Sweden	-0.030	1.128	0.897	0.665
Belgium	1.440	-0.229	0.054	0.422
Germany	0.265	0.322	0.651	0.413
Austria	0.320	0.133	0.359	0.270
Italy	0.187	0.187	-0.634	-0.087
Spain	0.083	-0.229	-0.115	-0.087
France	0.210	-0.758	0.074	-0.158
Portugal	-0.259	-0.848	-0.745	-0.617
Greece	-1.287	-0.655	-1.304	-1.082

Nationally-representative public opinion surveys were conducted by the Quality of Government Institute about perceptions of local education, health and law enforcement institutions provide the data. Researchers asked participants to rate each of the three institutions on quality, impartiality, and corruption. For more information, see Charron, Dijkstra, and Lapuente 2013, 2014.

¹The Italian perception of one another varies across regions. See Putnam, Leonardi, and Nanetti 1994: Tabellini 2010).

Table 4.2: Quality of Government: Italian Regions

Region	Quality	Region Score	Rank
Trento	1.043	1.981	41
Valle d'Acosta	0.653	1.603	82
Friuli-Venezia	0.373	1.331	109
Veneto	-0.186	0.788	146
Emilia-Romagna	0.217	0.757	149
Umbria	-0.495	0.488	168
Toscana	-0.495	0.450	170
Marche	-0.535	0.448	172
Lombardia	-0.542	0.442	174
Piemonte	-0.652	0.335	182
Liguria	-0.848	0.144	190
Abruzzo	-1.097	-0.097	200
Sardegna	-1.307	-0.302	204
Basilicata	-1.423	-0.414	208
Lazio	-1.512	-0.500	211
Sicilia	-1.588	-0.575	213
Puglia	-1.604	-0.590	216
Molise	-1.6609	-0.645	220
Calabria	-1.687	-0.671	222
Campania	-2.242	-1.210	232

Nationally-representative public opinion surveys were conducted by the Quality of Government Institute about perceptions of local education, health and law enforcement institutions provide the data. Researchers asked participants to rate each of the three institutions on quality, impartiality, and corruption. For more information, see (Charron, Dijkstra, and Lapuente 2013, 2014). Southern regions are in bold.

Italians, and to a greater extent, Southern Italians, live in an institutional environment which legitimizes “furbizia”, a term meaning *sly* or *cunningness*, but which often takes on a positive connotation. If Europeans have come to think of them as dishonest, and Italians themselves have come to agree, this may be a byproduct of this environment. This chapter

will consider the historical circumstances and institutions which have contributed to the regional variation in taxpayer behavior. I cover the two most powerful institutions in Italy – the state and the Catholic church – and their entangled web of relations which often results in clientelistic propensities and particularistic politics.

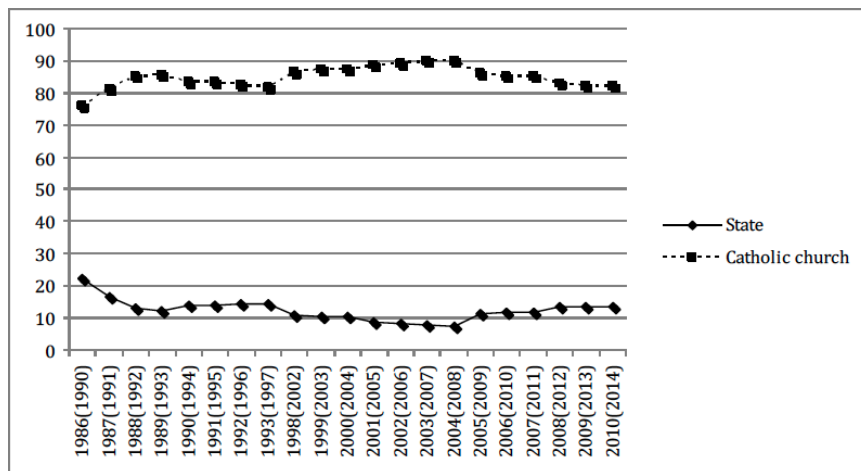
4.2 Church vs. State

Politics and behavior in Italy are inseparable from the institutional relationship between the church and state. The Catholic church's unique position, geographically and historically, inescapably influences political processes and individual attitudes regarding certain institutions. In fact, studies confirm that Italians have considerably more trust in the Catholic church than they do in their political institutions. A poll conducted by Demos & Pi in 2014, 2013, 2012, and 2010 that gauges trust in institutions indicates that 48% of Italians consistently consider the church very trustworthy. The number of respondents who say they trust the Pope very highly has stayed steady at 85% while high trust in the State has shrunk from 21% to 19% in 2013, and 15% in 2014. Strong trust in political parties was at 8% in 2010 and has only slipped in subsequent survey data (*Rapporto Demos, Gli Italian e Lo Stato* 2014).

A unique feature of the Italian tax code further demonstrates the direct relationship between the church, state, and taxpayers. The *otto per mille* allows taxpayers to allocate a portion of their tax dollars to the Catholic church, local communitarian organization, another church, or the state for the purpose of providing certain social services. The fact that 82.24% of citizens utilized the *otto per mille* option to contribute to the Catholic church,

vs. 13.35% of taxpayers who allocated these funds to the state, suggests the depth of their discrimination between the two institutions (see Figure 4.1). The proximity of the *Holy See*, as well as the church’s moral authority, exaggerates its role as a political actor and an institution that constructs and legitimizes certain moral and political norms. This often conflictual relationship between the church and state in Italy has undoubtedly shaped Italian attitudes towards the state, and in that, Italian willingness to pay taxes.

Figure 4.1.: L’otto per Mille, 1990-2014



Source: Presidenza del Consiglio dei Ministri 2014

Putnam, Leonardi, and Nanetti (1994,107) suggest the Catholic church is an antithesis to a civic community. Their survey determines that religiosity correlates negatively with all measures associated with civic engagement. My interview with Stefano Pisani from the Italian Revenue Agency affirmed the continued applicability of Putnam’s statement (1994, 107), of Italians that “[t]hey seem more concerned about the city of God than the city of man.” Indeed, the contrast between the Italian state and Vatican City, a recognized independent nation-state within its borders, creates a conflict between loyalty to the state

and devotion to the Church for Catholics. Vatican City's connection to spirituality and universality give it unique power above the state.

4.3 Church-state relations since the *Risorgimento*

The *Risorgimento* (Resurgence) refers to a period of political consolidation in Italy from 1815-1871, ultimately culminating in Italian unification.

For Italy's nationalists, then, the most daunting obstacle was not the Austrian occupation of northeastern Italy, nor the tottering Bourbon monarchy that ruled all of the South and Sicily, nor the assorted dukes and their duchies. No, there was a far greater power, a far more imposing foe, one that cut the peninsula in two, blocking North from South, its capital the legendary city of Romulus and Remus, the symbol of Italy's ancient greatness (Kertzer 2006,2).

The founding of the nation-state system ushered in a new form of civic duty which demanded loyalty to the nation-state. The new European nation-state embraced political and economic liberalism, challenging the church's monopoly on institutional obedience. Pope Pius IX (1864), *Syllabus of Errors* and Pope Leo XIII (1891), *Rerum Novarum*, both reflect the assumption that the church was the center of societal prosperity, private, and social life. The two documents were as political as they were doctrinal. This *Syllabus of Errors* presented the Vatican's rejection of liberal democratic principles and, therefore, of a unified Italy. The book rejects the notion that the Pontiff should uphold freedom of speech, freedom of press, and freedom of religion, and forbids Catholics from subscribing to them (Kertzer 2006). Pope Leo XIII legitimized the avoidance of unfair taxes in the *Rerum Novarum*. In his discussion of fair wages he declares XIII (1891,Article 47),

The right to possess private property is derived from nature, not from man; and the State has the right to control its use in the interests of the public good alone, but by no means to absorb it altogether. The State would therefore be unjust and cruel if under the name of taxation it were to deprive the private owner of more than is fair.

While this clash between church and state played out throughout Europe, it was most evident in Italy, the home of both the Holy See and unbridled political ambition. Borutta (2012,191) says of *Rerum Novarum*, “Not only did it cause a culture war, but also a ‘real’ war between the nation and the papal state, and its divided society not secularist (bourgeois, male, urban) and Catholic (clerical, female, rural) blocks.” For a half century the greatest obstacle to a unified Italy was the Vatican, which generated tremendous rifts not only through the Italian landscape, but also through the Italian psyche. Although temporal power was greatly reduced, the Pope sought to assert his influence through spiritual decree. In what was thought to be one of the most controversial aspects of his papacy Pius IX declared papal infallibility and *Non Expedite*. Controversially at the time, Pius IX declared himself infallible, denounced the unified state as incompatible with Catholicism, and, with non expedite, rendered any political involvement – be it public office or voting – a sign of support for the illegitimate state. When the Italian army finally conquered Rome in 1870, liberals and papal supporters tore Rome apart. Borutta (2012,203) describes the situation: “Italian patriots turned this discourse not only against Southern Italy after 1848, but also against papal Rome.”

Regarding unification, Cardinal Giacomo Bifi said,

The fusion precipitated by two realities so distant and disparate like the area of Lombardo-piemontese and the meridian area was a political and social drama.

It was an administrative drama with the sudden centralization of governments founded in antique states. But above all else, it was a spiritual and moral drama to motivate and conclude unification which was an ideology deliberately anticlerical (Teodori 2012,15).

Sabetti (2000) describes the *chiese ricettizie*, the clerical system in Southern Italy, as much less hierarchical than the Northern clerical system. Southern dioceses had limited resources and fewer parishes each than their Northern and Central counterparts. The North had a centralized, clearly defined unit of ecclesiastical jurisdiction, which the South did not. The Southern ecclesial community usually consisted of a single parish priest who was funded by the *massa* community (collection of landed property) (Pollard 2008). Southern Italians viewed the church as highly democratic, whereas, in the words of Sabetti (2000,232) secular civil society consisted largely of “rapacious landlords, tax collectors, conscription officers and police officials”. Southern Catholicism had a mysticism not present in the North; New World missionaries even referred to Southern Italy as the “India Italia” (Saunders 1998,185). Saunders (1998) describes the spirit of the South, “as a form of practical wisdom, a fountain of energy for social transformation, a domain of autarky and of resistance to domination, but also as ignorant superstition, debilitating fatalism and futility, a source of social divisiveness, and anarchism.” All of this suggests an anti-statism in the South.

The disestablishment of church lands at the time also led to the expansion of the mafia. This mediatory class exploited lands formerly reserved to the collective for private gains (Walston 1988). In the absence of an effective local state under the influence of the *non*

expedit, non- governmental actors often fill that void; in Southern Italy both the church and the mafia gained power.

Sabetti (2000,232) argues that the *non expedit* affected Southern civic participation less than in the North. In the South, literacy requirements denied the franchise to 98% of the population, and churches were often the center of organizational life. Contrary to Putnam et al.'s claim that the Catholic church hobbled the civic community in Italy, Sabetti (2000,233) argues that "far from negating or opposing civic involvement, the *non expedit* ban actually encouraged committed Catholics to renew their grassroots efforts just at the time when central government was bent on dissolving social civic assets from the *ancien régime*." At the same time, while Northern and Central Italy were clearly becoming increasingly anti-clerical, the South embraced Catholicism. Later, Southern Italians embraced Catholicism as a form of resistance against Northern dominance. Antonio Gramsci (1973,94) describes the mezzogiorno as being

reduced to the status of a semi-colonial market, a source of savings and taxes that was kept "disciplined" by measures of two kinds: First police measures: pitiless preparation of every mass movement, with periodical massacres of peasants. Second, political police measures: personal favors to the "intellectual" stratum or *pigliatta*—in the form of jobs in the public administration.

Consistent with Gramsci's explanation, Nick Carter (2004,11) describes the industrialized North as exploiting the South by imposing high taxes and by offsetting the North's large trade deficit against the South's positive balance. Gramsci (1973,70-71) further argues,

[U]nity had not taken place on a basis of equality, but as hegemony of the north over the Mezzogiorno...the north concretely was an "octopus" which enriched itself at the expense of the south, and that its economic-industrial increment

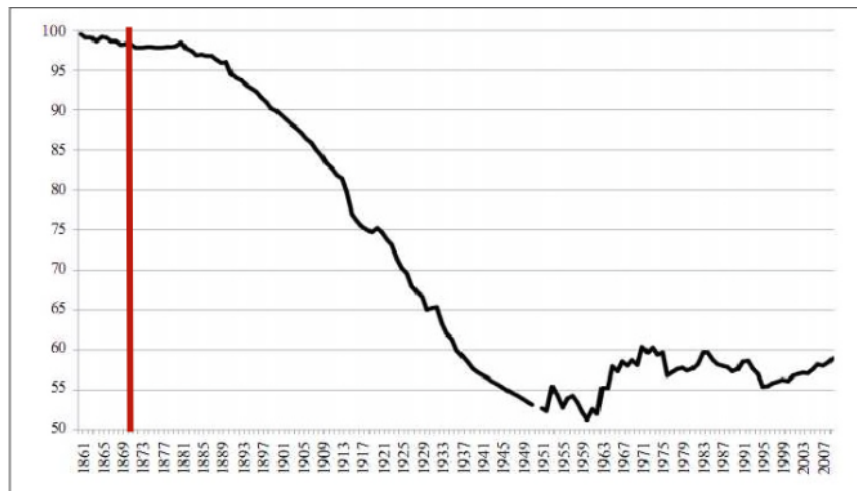
was in direct proportion to the impoverishment of the economy and the agriculture of the south.

Due to the agricultural base of the South, Italy's taxation system hit southerners hard, while the North benefited the most from public spending (Carter 2004). However, Carter (2004) argues evidence does not support claims of exploitation and high taxation. Nonetheless, Clark (1996) notes the state imposed an unprecedented tax burden in the South at the time of unification which funded the development of the North. For example, between 1862 and 1897, 455 million lire were spent on landfills in Northern and Central Italy, while only three million was spent on such resources in the South. The majority of school and railway spending was also concentrated in the North. The North was politically dominant, which meant it was also the decision-maker with regards to tax revenue (Clark 1996,24-25).

Even if the claims of exploitation were exaggerated, unification certainly had a negative effect on development in the South. Graph 4.2 illustrates Southern per capita GDP as of per of the Northern per capita GDP since the Risorgimento and a rapid decline in the South. If exploitation was a legitimate concern of Southern residents post-Risorgimento, they naturally would embrace the Church and the mafia as a form of protection. The disturbing state of local government affairs also alienated the populace from the official government. In many cities, the mayor, who was also the largest landowner, provided jobs to his allies and his friends decided who paid taxes. Tax riots in which locals burned down government buildings holding tax records were common (Clark 1996).

Unification posed a distinct threat to the church. State land reclamation and the disillusionment of ecclesiastical corporations largely destroyed the church's political and social

Figure 4.2.: GDP per capita in the Mezzogiorno as a Percent of Northern GDP per Capita



Source: Bianchi, Miotti, Padovani, and Pellegrini 2011
Redline represents unification.

foundation. The church's influence remained strong, however. As Bakunin states in *Manacorda* (1975,119-120),

Your peasants are superstitious, but not at all religious. They love the Church because she is very dramatic and interrupts, with her theatrical and musical ceremonies, the monotony of country life. The Church for them a ray of light in a life of hardship, backbreaking toil, grief, and poverty.

Another consequence of the disestablishment of church lands was the exploitation of the collective for private gains, which then led to a large expansion of a mediatory class known as the mafia (Walston 1988). When there is an absence of an effective state, a power vacuum is left behind in which non-governmental actors (i.e. the Mafia and the church) often fill that void, leading to highly corrupt (low-trust) societies (Levi 1996).

If the taxation system was exploitative, they naturally seek ways to avoid paying taxes they saw as illegitimate (Carter 2004). When the state lacks the capacity to govern and redistribute goods efficiently, citizens will often pursue other means of redistribution (i.e.

clientelism) (Bergman 2009; Fargion 1997; Hopkin and Mastropaolo 2009; Rothstein 2011). By contrast, citizens are more likely to pay taxes if they believe the state will spend the money efficiently (Cummings et al. 2009; Edlund 1999; Frey and Torgler 2007; Frey and Feld 2002; Levi 1989; Pommerehne, Hart, and Frey 1994; Scholz and Lubell 1998; Smith 1992; Smith and Stalans 1991; Torgler and Schneider 2007*b*).

4.4 The Partito Popolare Italiano, The Partito Socialista Italiano, and the Rise of Fascism

The Italian government purged the majority of the associations with Catholicism in 1898, but rising fears of Socialism made Catholics and right-wing liberals strange bedfellows. Although a Catholic political-economic movement flickered in the South, it never recovered from earlier losses. Pope Pius X began rolling back the progress of the Catholic workers' movement and effectively outlawed the Christian Democrats in 1903 (Pollard 2008). As Saunders (1998,188) writes, the political dimensions of Catholicism remained a "fragmentary, disorganized, and contradictory set of beliefs and practices" that only connected with the church hierarchy "in a sporadic and partial way". Southern Catholics reacted by having little to do with the workers' movement and organizational life. However, Italian organizational life thrived in the North during the reign of Prime Minister Giovanni Giolitti. Pollard (2008,64-65) notes that,

(Saunders 1998,188).

Lombardy was the geographical stronghold of Catholic labour, with 62.5 percent of the membership of agricultural unions and 43 percent of the agricultural ones: 55 percent of the total membership of all Catholic unions. Apart

from Lombardy, the only other region with a significant proportion of Catholic unionized labour was Venetia with 18.3 percent of total membership, and worth of Rome, support for Catholic unions was exiguous.

This is significant because it suggests that, while Putnam describes a long history of associational behavior (civic-ness) in the Catholic church dating back to the republican governments of the middle-ages, in fact the Catholic church made a conscious effort to build associations as an alternative to a Socialist workers movement. The Catholic church, thus, played an important role shaping a virtuous civic culture in Northern Italy in the years immediately preceding World War I; this did not materialize in Southern Italy. Meanwhile, the central regions of Italy, Emilia-Romagna, Marche, Umbria, and Tuscany, remained a Socialist stronghold. On the one hand, intense political competition between the Catholics and the Socialist for the support of both laborers and peasants drove Northern and Central Italian civic-ness and institutional superiority. On the other hand, the lack of any real political competition in the South inhibited the formation of efficient public institutions, and hence, a civic oriented populace. Tarrow (1967,168-169) states that clientele groups dominated Southern Italian politics at the time of unification, “but so ingrained was the clientele system that the mass of new voters, most of them rural and all of them dependent economically on the political elite, were easily integrated into the existing system.” Therefore not only was political competition lacking, but poor Southern peasants were dependent on their clientelistic relationships with local elites.

The rise of a Catholic political party, Partito Popolare Italiano (PPI), marked the beginning of Catholic mainstreaming in Italian politics. Because the South almost completely dismantled organized Catholicism, the PPI’s support came mainly from the Northern re-

gions of Italy (see Section 4.3). Pope Pius X died three weeks after the outbreak of World War I and was succeeded by Pope Benedict XV. An immediate reversal of the anti-modernization policies of his predecessor followed, and with that came an improved relationship with the Italian government and the Italian people. While anti-Italian stigma had been attached to the Catholic church since the Risorgimento, Italian-Catholic politicians and the patriotism of the Catholic clergy during the war changed the prevailing feelings about Catholicism in Europe (Pollard 2008). Furthermore, the war bitterly divided the old ruling-class paving the way for outside parties such as the PPI and the Socialist (PSI). The election of 1919 was disastrous for the ruling elite. More than half (53%) of the seats in the chamber went to the PPI and the Socialist with only 91 seats going to Giolitti's party. Only in the South did the "old government" parties win more than half the votes, which was largely the result of a practiced called *transformismo* in which ruling parties win over the opposition in return for political, and often, financial favors. The liberals, especially in the South, made use of public resources for both individual and political gain (Walston 1988,49).

The North and South were divided across party lines; 146 of 156 of the Socialist deputies came from the North and Center; 76 of the 100 PPI deputies were also from the North; and 162 of the 239 liberals and radicals (old government) were elected in the South. When elections were called in 1921, the Giolitti (Prime Minister) government's hegemony rested on shaky ground. He therefore had to make certain concessions to the Fascists, including adding them to the government's party list. The disparate governing coalition Giolitti put together was doomed from the outset, which resulted in his immedi-

ate resignation, to be followed by a string of short-lived prime ministers and the eventual rise of Benito Mussolini.

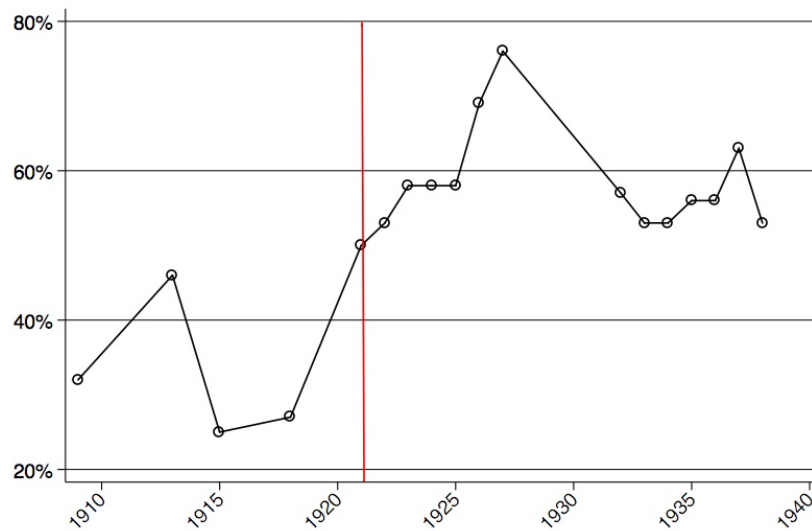
The strongest push for Fascism did not come from Northern Nationalist regions like Trieste, but rather from the landlords and leaseholders of the traditionally Socialist regions of Emilia-Romagna and Tuscany. By 1921, the *fasci* (individual groups which would later form the fascist party) had already made considerable headway as a grassroots movement in the traditional red zones of central Italy and the North. *Squadristo*, a form of political intimidation, proved to be an important tactic in the purging of local unionists and Socialists. Encouraged by the promise of jobs and land, local peasants later joined the Fascists *squadristo* in transforming the *zone rossa* from a Socialist stronghold into a Fascist mainstay (Clark 1996,216-217).

In late 1921, Mussolini turned the squadristi factions into an entire mass political movement (Partito Nazionale Fascista, PNF) with over 300,000 members by 1922 and a “respectable” base of politicians. They were no longer a ragtag group of peasants, landlords, and leaseholders; instead they encompassed a wide-range of working-class and middle-class Italians, largely in the North, especially those disappointed by the Catholics and the Socialists and a large number of students. Syndicalism became a significant facet of the Fascist movement as the Catholic and Socialist unions diminished. Considerable opposition met Mussolini’s campaign against the syndicalists in Puglia (Sabetti 2000). Clark (1996,218) notes that, “the union, or syndicate, linked the old radical aspirations to the new reactionary reality; or rather, it showed that Fascism was not merely a reaction.” Further he writes, “It was literally true, in 1920-21, the Fascists made the trains run on time, indeed

run at all.” Many people believed Mussolini’s Fascists were Italy’s savior. The combination of militant action in Rome and Milan and the pursuit of compromise with politicians boosted morale. To avert a civil war, the king invited Mussolini to form the new government on October 28, 1922, and by 1925, Mussolini had completely consolidated political power.

The Fascists offered the Vatican preferential tax treatment, support for religious education, and a rise of stipends for priests, which won the church’s support, and with it that of much of the population. Mussolini used this political capital to suppress those Catholics who opposed him, which caused a large decline in the Catholic labour movement, an ideal outcome for both the Vatican and the state (Pollard 2008). Secret negotiations between Pope Pius and Mussolini took place between 1926 and 1929 that culminated in the Lateran Treaty, which provided for the establishment of Vatican City as a sovereign, independent state. The Financial Convention compensated the Church for substantial losses, and the Concordat opened the door to new relations between the Church and state and the rebuilding of Catholicism in Italian society (Pollard 2008). Even as church-state relations ameliorated and the state drastically expanded, tax evasion remained high. It did decline, but development remained substantially in the North (see Figure 4.3 and refer back to Figure 4.2).

Figure 4.3.: Evasion of Total Inheritance Taxes, 1909-1939



Source: Gini 1962

Redline marks the beginning of the Mussolini government.

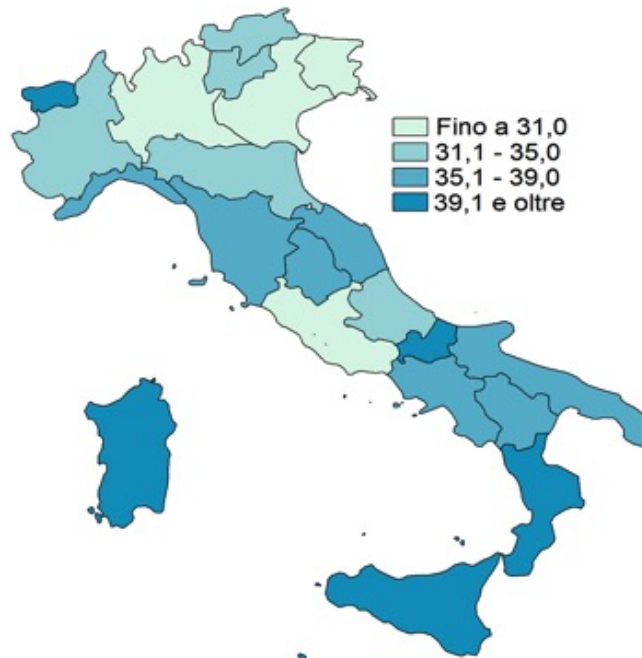
4.5 The Fascist Period

Contrary to punctuated equilibrium theory in which major shifts punctuate long periods of equilibrium, disparities between Northern and Southern Italy developed in a more continual fashion. Tax reforms introduced by Mussolini's finance minister, Alberto De Stefani, in the early Fascist period (1922-25) provided preferential tax treatment to productive industries with the misguided expectation that these industries would react gratuitously by complying with existing tax law. Mussolini reacted to this error with a shift from liberal tax policies to an authoritarian model. He declared tax evaders "the worst parasites in the nation" and increased tax enforcement between 1926 and 1929 (Manestra 2010,29). He introduced tax verification agents and criminalized tax evasion. However, increased foreign

commitments in the 1930s led him to restrain the more authoritarian aspects of the administration's tax policy. A more cooperative model between taxpayers and the government, especially with respect to businesses, began to prevail.

Other changes, such as Mussolini's industrial policy, further accentuated economic divisions between the North and the South. Economic development throughout the Fascist period was concentrated in engineering, steelmaking, chemicals, and hydro-electricity supply – all industries located in the *industrial triangle* of the North-West. Almost half of industrial workers and two-thirds of engineers worked in Lombardy, Liguria, and Piedmont, and the majority of workers from the South were farmers and artisans (Clark 1996). This means that more Southern Italians are self-employed, and consequently responsible for paying their taxes instead of having them deducted from wages. Self-employment also makes it easier to evade taxes by dealing in cash. As shown in Figure 4.4, the percent of self-employed individuals is higher in the Southern regions than the North.

Figure 4.4.: Self-Employed by Region, 2009 (percentage of total employees)



Source: ISTAT 2010

The state also increased the extent of the welfare state in the Fascist period, making Northern industrial workers eligible for generous benefits not available to Southern workers – an imbalance that continues to this day. This has supported patronage and clientelistic practices as a means of income supplementation in the South, and many Southern Italians have sold their votes for public employment and favorable tax treatment (Ferrera 1996a).

Fascism was a Northern movement, and the state generally neglected the South. Energy prices in the South were double those in the North and inflation wiped out the financial security of a significant number of Southerners. When the United States began drastically cutting back on immigration in the 1920s (from 233,000 per year 1901- 1910 to 11,500 in 1930), the North became the center of Southern migration, resulting in an extraordinary

drain of human capital in the South (Clark 1996). Mussolini made concessions to landowners and lawyers in the South funneling jobs through *parastato*, quasi-governmental agencies which dealt with health, welfare, and pensions. This then became the most important criteria for the distribution of resources (Clark 1996; Walston 1988).

Although we have no available data on overall tax compliance between Northern and Southern Italy in the Fascist period, a drop in the evasion of inheritance taxes coincided Mussolini's consolidation of power in 1926 and his tax reforms (see Figure 4.3). This suggests that administrative capacity and wherewithal can be an effective tool for tax enforcement. While the Fascist period intensified distinctions between the North and South and therefore probably increased evasion in the South, Mussolini also instituted several policies that remain in the tax code today such as progressive and deductive taxation.²

4.6 The First Republic to The Second Republic

During World War II, Italy's major political parties organized anti-fascist "partisans" or bands of rebels that organized a mass propaganda machine, encouraged strikes, and campaigned for higher wages in the North (Clark 1996,313). The Communists (PCI) led the largest resistance group, the *Garibaldi Brigade*. The other resistance groups, in order of size, were the Party of Action, the Christian Democrats (Green Flames) (DC), the Socialists, and the Liberals. By 1944, one umbrella organization known as the Committee of National Liberation for Upper Italy (CLNAI) consolidated this opposition, and this became the seeds of the provisional government Clark (1996,315).

²Deductive taxation refers to policy allowing the tax authorities to tax citizens not only on the basis of their income, but also on their standing of living.

The PCI reaped the majority of the political benefits of the resistance, which were concentrated in the North. The South was almost entirely excluded from the movement, and leftist parties in the North could not penetrate the existing regional political structures (Clark 1996,316). Northern Italians celebrated resistance and anti-fascism post-World War II, and political participation was high, but the South remained untouched (Duggan 2008). In the 1944-46 period, Sicilian farmers organized to secede from the North, which led to a June 2, 1946 popular vote pitting the Italian dynasty against the Republic. The North, led by the communists, socialists, and Christian Democrats, favored the Republic; the majority of the South voted to uphold the Dynasty (Duggan 2008; Gilmour 2011). Southern opposition continued to divide the region ideologically from the North, and in 1946 tensions between the PCI and the Christian Democrats presented another challenge to national unity. While the PCI was closely tied to the Soviets, the aid and investment of the U.S. government and U.S. firms influenced the Christian Democrats and the De Gasperi government. American aid and jobs also won support in the South.

Under pressure from the Vatican and the South, the 1947 De Gasperi coalition excluded the Communists and Socialists. The 1947 Italian Constitution, however, showed remarkable levels of compromise between the parties. Article 53, for example, states, “all shall contribute to public expenditure in accordance with their means. The system of taxation shall be based on the criteria of progression.” Article 20 states “no special legislative limitation or tax burden may be imposed on the establishment, legal capacity or activities of any association or institution on the ground of its ecclesiastical nature or its religious or worship purposes” (*La Costituzione della Repubblica Italiana* 1947). With the elections growing

closer, the Americans and the Vatican ramped up support for the Christian Democrats and threatened to excommunicate supporters of other parties. In the end, the South rallied to the Church and the Christian Democrats; the center (*zona rossa*) remained in the hands of the PCI, and the North turned to the Christian Democrats (Clark 1996).

The new Republic implemented broad tax reform (*Legge Vanoni*) on January 11, 1951 under the control of Finance Minister Enzo Vanoni. The law had four major provisions: 1) taxpayers – both employees and self-employed – had to fill out annual tax returns; 2) greater progressivity combined with lower income taxes overall; 3) a series of consumption taxes; and 4) business taxes on items such as stamps and licensing (Amrosetti 2004). Unfortunately, Vanoni lacked the administrative capacity to implement the major features of the reform, and tax compliance remained low. The new tax code was particularly susceptible to particularism, and high income earners as well as specific DC voting blocs in the South took advantage. Specific voting blocks became linked to particularistic benefits, which made it very difficult to sever ties between the patron and client.

The Christian Democrats, which ruled for the majority of the post-war era, developed an enormous political machine that furthered separated the South from Rome. The Christian Democrats implemented a land reform policy in Southern Italy from which only a select few supporters actually benefited, increasing the clientelistic network in the South. Huge public works projects, costing the state billions of lire, were funneled directly into the pockets of well-connected entrepreneurs, many of whom had extensive mafia ties (Duggan 2008; Gilmour 2011).

The 1950s marked the beginning of approximately two decades of great prosperity in northern Italy. As it became one of the most industrious regions in Europe, greatly benefiting from the European Community, the Marshall Plan loans, and an influx of cheap southern labor, the South remained impoverished. Data provided by Clark (1996,357) depicts southern Italy as similar to many underdeveloped countries, but much larger in population and territory than most. In 1951, for example, income per head was 90 lire per day (half of that in the North) and unemployment was approximately 50%. The disparities between the North and the South were so considerable the state instituted three broad infrastructure-focused state intervention plans, known as the *Cassa per il Mezzogiorno*, National Hydrocarbons Agency (ENI), and the Agrarian Reform, which agencies administered from Rome.

Established in 1950, the *Cassa's* original strategy related primarily to agricultural production, but by 1957 it had transformed to favor the relatively capital-intensive private and public firms in the steel, chemical, and petrochemicals industries. Consequently, it increased unemployment among Southerners by shifting investment from the agricultural periphery to the urban coastlands and importing high-skill workers from the North to the South (Chubb 1982). Although Amintore Fanfani, De Gasperi's successor, hoped to replace the clientele system with a new form of organized politics in the South, none of the state intervention plans disrupted firmly embedded clientelism (Tarrow 1967).

According to (Chubb 1982,32), the *Cassa* which was "concieved as a special streamlined instrument to channel state funds into carefully chosen development projects" but it "was soon transformed into a political bandwagon for the maintenance of local clienteles."

Tarrow (1967,313) disparages both Cassa and ENI, calling them both, “far from revolutionary... mainly a program of mass patronage, which could gather votes for the party from all groups and shades of opinion in the South.” In Calabria, from 1940 to 1976, all the directors of the Cassa’s main office were Christian Democrats (Warner 2009). According to Duggan, these bureaucrats considered the public sector as a tool to garner partisan political support, instead of a means to develop the South or to foster what he calls an “ethical model of citizenship” (Duggan 2008,562-63).

Mario Caciagli (2006) argues that clientelism is a cultural phenomena and a unique form of political culture, and that a specific cultural code based on reciprocity and deference defines it. The typical resilience and path dependency of institutions contributed to the tenacity of clientelism in the southern Italian political system.³ Steinmo (2010,16) argues that “any institutional arrangement is part of an adaptive process in which multiple agents operate within a dynamic context.” Applying this to clientelism in Southern Italy explains the adaption of the DC to clientelistic pressures. At the same time, a system supported by notables supported the clientelistic system (Patronage System)⁴ and a type of clientelism that directly utilized public resources in exchange for votes (Caciagli 2006). Caciagli (2006) explains, “in the conditions of the South, clientelism remained the principle factor in inhibiting a culture of social cooperation and collective action” in the south. Clientelism secures lasting political power, but fails to building a civic consciousness or an active civil society.

³See Pierson 2000; Steinmo 2008 in Chapter 2 Section 2.1

⁴See Warner 2009,129

Data from Warner (2009,130) demonstrates a telling story about clientelism in the South. In the early 1950s, the South accounted for 45% of all public employees, but only 38% of the population. This number increased to 63% of bureaucrats by 1963, overwhelmingly driven by clientelistic practices between the DC and important interest groups.⁵ The Catholic Church's "Catholic Action", which was integral to the DC's dominance, often determined who became civil servants and who occupied government ministries. Warner (2009,141) writes, "the DC's clientelist system grew not so much from staffing the public bureaucracies under its control, but from distributing the financial largesse of which the state agencies were in possession, and from bureaucratic problem-solving on behalf of individual constituents."

Clientelism is not a homogenous phenomena, rather it acclimates to a specific political and economic environment. On the one hand, in the South, where resources were extremely scarce and interest groups were not visible, the DC dealt with individual constituents by promising universal benefits and resource distribution. In the North, where interest groups, such as Catholic Action, were firmly rooted in the political ecosystem, the DC had to appeal to local leaders with specific benefits usually in the form of public works. In fact, Tarrow (1996) contends that it was the progressive politics in the North, such as the DC, PCI, and Catholic Action, which guaranteed "defense of democracy and of social development"⁶ that deliberately established civic associations, and with that, good governance. In the South, hierarchical links were more common, while in the North, the state and civil society were more involved.

⁵Data was calculated from Saraceno 1972,102, table 1.

⁶See Warner 2009,142

Patrons can represent their clients through the distribution of tax favors or by their willingness to turn a blind eye to tax evasion (Duggan 2008). According to Hopkin and Mastropaolo (2009,153),

[T]hese clientelistic networks were able to show the benevolent face of the state, which not only made few demands on citizens, but could even help resolve their private difficulties. As far as the less benevolent face – taxation, military service, bureaucratic inefficiency – was concerned, the state’s deference toward local notables allowed them to offer their clients help and protection.

I mentioned above that when the state lacks the capacity to govern and redistribute goods efficiently, citizens will often pursue other means of redistribution, including clientelism. (Bergman 2009; Fargion 1997; Hopkin and Mastropaolo 2009; Rothstein 2011). By contrast, citizens are more likely to pay taxes if they believe their tax money is being spent efficiently (Cummings et al. 2009; Edlund 1999; Frey and Torgler 2007; Frey and Feld 2002; Levi 1989; Pommerehne, Hart, and Frey 1994; Scholz and Lubell 1998; Smith 1992; Smith and Stalans 1991; Torgler and Schneider 2007b).⁷ In the South, where the government was both inefficient and taxation was relatively high, clientelism was a vehicle to sidestep the inefficiencies of the state and avoid high taxation. The DC’s clientelistic political strategy, guaranteed its national political dominance for nearly 40 years. Even in the most Northern areas – where the PCI maintained a great deal of strength – the DC’s use of clientelistic politics in the form of business regulations and lax tax enforcement, broadened the support for the DC (Hopkin and Mastropaolo 2009).

When the governing coalition incorporated the Socialists (PSI) in the 1960s, the Italian welfare system moved in an ambitious and progressive direction. Between the mid-1950s

⁷See Section 4.3

to the beginning of the 1970s welfare appears as the largest facet of central government expenditures reaching 38% by the mid-1970s (Ferrera 1986). Welfare spending became a tool by which patrons could redistribute public goods through the welfare state to a vast network of clients. Between 1951 and 1976, the portion of the labor force employed by the state doubled to 22% of the labor force, which is both a sign of Italy's bureaucratization and clientelism (Ferrera 1986,395). We can also examine the distribution of public employment by party identification to better understand the extent of clientelism in the welfare system; Table 4.3 clearly exposes the mass patronage system favored by the DC.

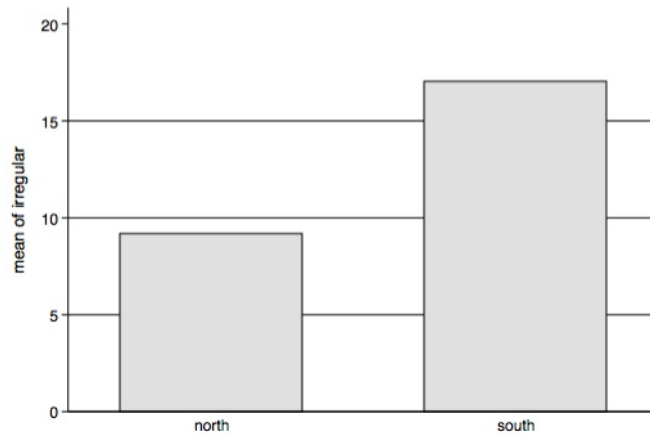
Table 4.3: The Distribution of Executive Board Positions by Party, 1945-1975

Parties	1945-47	1948-54	1955-62	1963-69	1970-75	Total
DC	25.1	31.5	35.7	38.0	38.5	26.3
PCI	8.7	5.3	4.0	4.1	4.1	4.3
PSDI	6.4	6.5	7.1	5.3	4.7	45.8
PSI	5.9	4.3	4.2	5.4	8.4	5.6
PLI	5.0	7.2	4.1	3.5	2.3	4.0
MSI	0.5	1.6	2.1	2.5	1.7	2.0
Not Identified	47.5	40.1	39.3	37.6	37.0	38.5
(N)	(219)	(2,019)	(3,822)	(4,028)	(3,453)	(13,541)

Source: Ferrera 1986,448 *Not identified refers to officials with no party affiliation or unknown party affiliation.

Italy's welfare system is a two-tiered system characterized by a highly protected class of worker – mainly public employees and industrial workers – and those in non-traditional and *grey* or *black* market jobs. Considering the large regional discrepancies in employment, the two-tiered welfare system significantly benefits northern workers more than their southern counterparts (See Figure 4.5). Southerners supplement their insufficient incomes through subverting the rules and regulations of the welfare system as well as by evading taxes, and public administrators tolerate and even encourage them (Ferrera 1996).

Figure 4.5.: Differences in Irregular Employment by Region



Source: Chiarini and Marzano (2007)

One study of Italian firms by Regonini (1984,106) revealed that 42% of the employees of more than 10,000 firms studied evaded their social security payments. The failure to enforce tax laws eroded the support of universalism by labor. Labor rightly assumed that they would bear the brunt of the financial obligations in the form of increased payroll taxes, and clientelism favored a particularistic system instead a universalistic welfare state (Lynch 2010). Unions thus proposed to make evasion of social security taxes a criminal offense (abandoned by Mussolini), but the DC defeated the measure. In the absence of such a measure, both the welfare state and the tax system in Italy are products of particularistic politics and clientelism the leading political parties pursued after WWII.

Although the relative gap between the North and the South remained as wide as ever, a massive injection of state spending and welfare (education and healthcare) significantly increased the living standards of the average southern Italian individual in the early 1960s. However, by 1967 the Italian economy was showing signs of crisis. A large migration of

unskilled southern workers successfully supplanted high-skill factory workers in the North, which led to major factory floor protests throughout Northern Italy. Subsequently, Southern factory workers took to the shop floor to demand better pensions, social security, housing, and health services. By 1976, the trade union movement became a major force in Italian politics encompassing nearly 50% of workers (Clark 1996,377). Large pay-raises, however, exponentially increased overall labor costs in Italy, causing a considerable downturn amongst Italian firms. With labor costs exceeding those Briton and German firms experienced by 39%, profits greatly tapered by the end of the decade. Both the extreme right and left responded to the crisis with political terrorism, including assassinations and kidnappings. Italy was ripe for a long-term solution to the political turmoil.

Two decades after regional governments had been enshrined into the constitution, the state introduced regional governments in the Spring of 1970. By the mid-1970s, Italian regions could provide subsidies, fund and staff welfare agencies, draw up regional development plans, and organize their own cooperatives. However, as Clark (1996,392) writes, these regional governments fed the Calabrian Mafia (*ndrangheta*) and the Neopolitan *camorra*, with local baronies supporting particularism, rather than creating more efficient, democratic institutions. “There may,” he notes, “have been little popular enthusiasm for the regions, but many of the organized interests-groups thought they were splendid”(Clark 1996,392).

After the introduction of the regional governments in 1970, important legislation was introduced to shake up the tax system. Tax reform in 1973, which the Minister of Finance, Luigi Preti, introduced, forced Italy to construct a more modern tax system to match the

demands of a developed nation. It further had to complement a burgeoning public deficit and a far more uncertain situation than the preceding decade. This included the establishment of a variety of new taxes such as the IRPEF (national progressive income tax), IRPEG (corporate income tax, replaced by IRES), ILOR (local income tax), INVIM (capital gains tax), and a VAT (Value Added Tax).

The state even attempted to revert to the more authoritarian – tough sanctions and stigmatization – measures Mussolini had used to enforce tax compliance. Provincial newspapers throughout Italy published the names of famous people who had evaded their taxes as well as 200,000 tax evaders between 1979 and 1981. Law 516/1982, the so-called *manette agli evasori* (handcuffs for evaders), designated a number of tax behaviors as revealing an attempt to evade taxes, making them serious criminal offenses with elevated penalties. Prior to *manette agli evasori*, a judge could not indict an offender before there was undeniable proof of evasion (Santoro 2010). However, behavior remained resistant to these changes. The courts found many of the provisions of, *manette agli evasori* unconstitutional, and only a small fraction of accused transgressors were convicted under the law (Santoro 2010, Kindle Locations 951-952). The less punitive Law 154/1991 and 74/2000 replaced *manette agli evasori*. Examining Table 4.4, we can observe that evasion actually increased from the time of the implementation of the tax reform through 1978, decreasing slightly 1978-1980, but never falling below 33.7% in this period.

The level of evasion during this period, coupled with continuous attempts to fix the tax system, suggests that the tax administration was defenseless in the fight against evasion. A patronage system immersed in the political culture of both northern and southern Italy

Table 4.4: IRPEF Evasion + Erosion 1975-1987

Year	Visco (1994a)	Visco (1984b)	Vitaletti (1984)	Bernardi (1989)	Visco (1992)
1975	33.7				
1976	39.0				
1977	42.0	42.0			
1978	41.8	42.0			
1979	38.9	37.7	43.2		
1980		37.0	42.5		
1981			39.7		
1982					
1983					
1984				56.6	
1985					
1986					
1987					46.7

Source: Bernardi 1989; Visco 1984*a,b*, 1992; Vitaletti 1984

ultimately produced tax evasion. But in the North, clientelism materialized as legitimate public works projects, while in the south, the provision of welfare benefits, public sector jobs, and tax favors characterized it. The South had been greatly damaged by organized crime, and youth unemployment was just barely under 50%. While Duggan (2008,575) notes, that the trappings of modern consumerism had come to the South, he credits cash transfers through the social security system and “superfluous public sector jobs” for that prosperity that existed in the region. In the North, on the other hand, the 1980s was a time of great prosperity. Commentators have called the region success “the second economic miracle”. Manufacturing and artisan production was booming, largely due to the state’s willingness to overlook tax crimes and an exceptionally corrupt political system.

The 1980s turned out to be the beginning of a series of corruption scandals that would eventually bring down Italy’s national government, leading to the so-called “Second Republic” and the prominence of Silvio Berlusconi. The largest corruption case, *Tangentopoli*

(Bribesville), exposed a number of high ranking public officials (half of parliament) for acts of bribery. Contrary to Putnam et al.'s theory of Northern (1994) civic supremacy, the most notorious corruption scandals were born in the North. Tarrow (1996), in fact, denotes this as one of *Making Democracy Work's* greatest shortcomings. How could a region that is clearly civically endowed be the center of such large-scale corruption scandals?

This flaw in Putnam et al.'s theory of tax evasion in the South leads back to the complexities this chapter has sought to address in terms of tax evasion, compliance, and morale. By constructing a historical landscape dating back to the Risorgimento through the fall of the First Republic, I have identified several influential periods which, in theory, should have resulted in punctuations to Italian taxpayer behavior. The Risorgimento clearly had significant repercussions for church-state relations, and in that, defined two different patterns of taxpayer behavior. I argued that pro-state liberals in the North would be much more inclined to contribute to the state coffers, compared to the pro-church Catholics in the South. I then turned to the advent of Fascism, especially in the North. Although institutions including the tax system experienced a major shock, the divisions between North and South only increased. After the fall of Fascism and the end of WWII, the rise of mass political parties, and with that, clientelism, altered the political and economic landscape, but exacerbated the gap between the North and South. Political competition and progressive politics had the effect of shaping functioning public institutions (albeit through clientelism) and a responsible citizenry in the North, whereas the DC's political monopoly in the South eventuated in a form of clientelism that provided public employment to unqualified workers and tax favors to local businessmen. Then, a series of tax reforms in the 1970s and

strict penalization of tax evaders did little to combat the deep rooted issues in the Italian tax system. Finally, a series of major corruption scandals originating in the North in the 1980s and 1990s shed light on some of the underlying issues; they further illuminated the fact that corruption is not unique to southern Italy and is not necessarily the product of a backwards culture. Ultimately, this chapter concludes that institutions (i.e. church, political parties, and clientelism), just as much as culture, shape tax behavior, as Chapter 3 and Chapter 4 suggest.

5. A Nation Divided?

Taxes are the price we pay for civilization. Taxes pay for our schools, our roads, our security, and our government. They also pay for goods and services for which there is not necessarily public consensus. What contributes to citizens complying with tax policy is a question that social scientists have been pondering for many years. Sandmo and Allingham were innovators in the field. They were the first to address the question of why citizens comply or evade. For them, evasion was a matter of utility maximization. If the probability of sanctions and the severity of the penalty were low enough that evasion would maximize a taxpayer's utility, then the taxpayer would be expected to evade. Although pioneering, this approach is not free of criticism. The vast majority of taxpayers are honest. Explanations outside of the economics of crime approach, which consider sociodemographic considerations and cultural variables, examine an individual's *intrinsic* motivation to pay taxes. These studies have revealed a great deal more about tax morale, tax compliance, and tax evasion. Yet, despite the vast number of studies on compliance and evasion, little research has thoroughly analyzed the institutional environment in which a taxpayer behavior is construed. Italy's regional dualism, historical complexities, and cultural variation provide researchers an ideal case from which to extrapolate why we do or do not pay taxes. Does rational choice alone explain willingness to pay taxes? Do underlying cultural dif-

ferences explain the regional variation? Or have institutions shaped economic outcomes? These are all important questions which have both empirical and practical consequences.

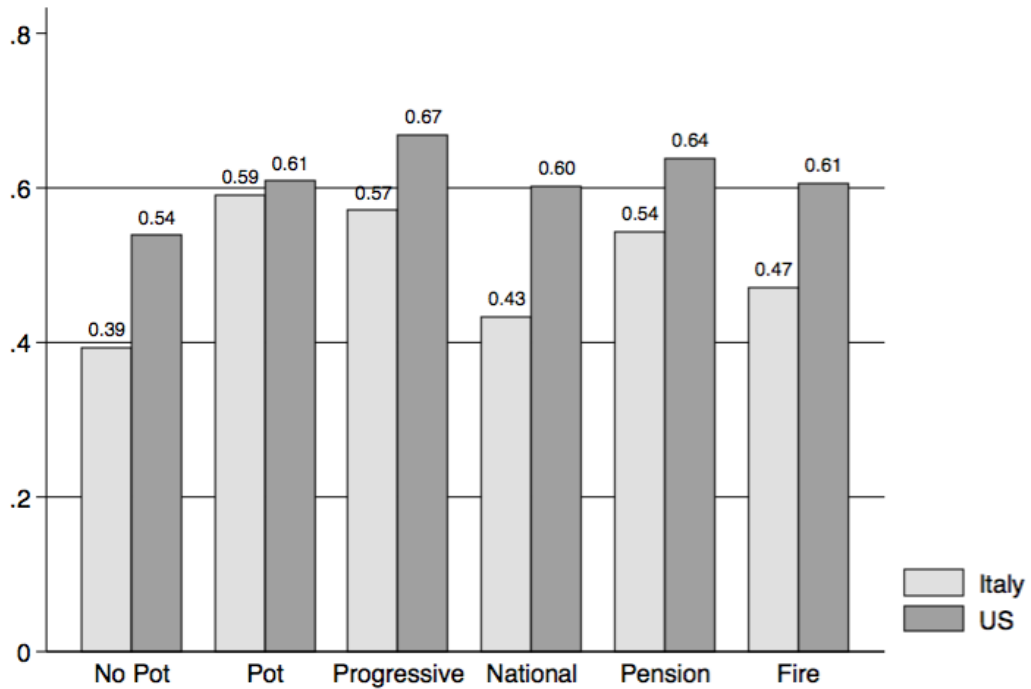
Estimates suggest that around 26% of income taxes are evaded, with considerable disparities registered among different types of workers in Italy: Self-employed individuals and entrepreneurs evade approximately 60% of their income taxes, while employees only evade approximately 10%, strongly implying there are important structural aspects of evasion. Whereas taxes are withdrawn automatically from the paychecks of employees, taxes are left to the discretion of the self-employed. By simply exchanging cash and not issuing receipts the self-employed can easily evade taxes. The self-employed make up a much larger percentage of the economy in the South than in the North which is a reasonable explanation for some of the differences. The regional variation is just as telling, but it requires a multitude of explanations. IRAP evasion (regional production tax) moves from 13%-50% in northern Italy, while in the south the lowest rate is 54%, while Calabria loses the most at 94% taxable income.

Edward Banfield and Robert Putnam have written influential books suggesting that Southern citizens' only immediate concern is to the familial unit, which in turn, has weakened governmental efficiency and economic development. Theoretically, strong inward-facing ties suffocate a sense of responsibility, reciprocity, and trust in those persons not within the immediate family or closely linked to them, greatly increasing transaction costs. This can also lead to more individualistic behaviors and an adversarial relationship with the state. According to this logic, paying taxes increases the utility of the state by decreasing the utility of the family unit. On the other hand, weak outward-facing ties, actually increase

an individual's sense of duty to others and cuts down on transaction costs through an escalated feeling of reciprocity and trust in others. A taxpayer can then increase his utility by paying taxes, because tax dollars are redistributed through the state to increase the utility of others. The culturalist would suggest that culture shapes taxpayer behaviors, explaining much of the variation between the North and the South.

Institutionalists argue that it is the institutions, both formal and informal, that guide economic outcomes and even cultural experience. They imply that the culturalists ignore the institutional setting in which behaviors are formed. What institutions were present that resulted in dishonest taxpayers in the South? Beginning with the formation of Italy, the two regions went down two divergent political and institutional paths shaping how well those governments govern, and importantly, how its citizens perceive the state. The quality of the institutions to which our tax money is paid encourages honest or dishonest taxpayers. Although the United States is not central to the present study, my most recent experimental evidence indicates that when taxpayers in Italy and the U.S. are compelled to pay into a pool that will be given to the national government, taxpayers in the U.S. comply 17% more than their Italian cohorts (See Figure 5.1). Perceptions regarding the quality of government are significant and institutions do matter.

Figure 5.1.: Average Compliance: Italy vs. U.S.



Although each of these frameworks has been promoted to explain why Northern Italy is different from the South, and more specifically, why tax compliance differs, they are typically employed as contradictory explanations rather than compatible. This study's comparative analysis – institutional and individual – of taxpayer behavior in Italy revealed complex relationships between structure, culture, and institutions. It is thus implausible to consider one framework without the other. Just as institutions shape culture, culture can have profound effects on how institutions are governed. As discussed throughout the paper, civic virtue and social capital have a positive effect on tax morale, and northern Italy is endowed with higher levels of both. I have also suggested through historical analysis that certain

institutions actively promoted the development of different forms of civic participation and engagement in North, while neglecting the South. Below is a summary of these findings, followed by a discussion of possible policy implications and avenues for further research.

The object of this research was to re-examine the long-studied question of what explains regional disparities in Italian tax morale and compliance. I proposed four main independent variables that significantly shape tax morale and compliance. I first exploited the culturalist argument using civic culture and social capital to explain regional variance in taxpayer behavior. Briefly, I also examined the effects of being self-employed on tax morale. In contrast to most conventional assumptions, I generated a final hypothesis that considers the historical legacy of institutions in shaping taxpayer behavior. My analysis of the structures of evasion in Italy demonstrated that the reasons for evasion cannot be limited to a small number of quantitative variables, but instead, taxpayer behavior has to be analyzed as the result of a myriad of simultaneous and interacting variables.

Chapter two reconsidered the theoretical frameworks and debates often induced to frame an understanding of tax morale. Until the 1990s, tax compliance literature was more concerned with why people evade taxes, rather than voluntarily pay. The most significant debate was between those who believed that tax evasion was simply a result of rational choice and those who believed that cultural and societal variables also constituted behavior. The discourse has increasingly shifted to focus more on the latter; however, focusing on culture and individual agency has come at the expense of institutional explanations. The review demonstrated a deep division between the two schools of thought, presenting a significant challenge to tax research.

Chapter three explored the culturalist argument exploiting survey data provided by the Bank of Italy and experimental data provided by Steinmo et al. (2015) and funded by European Research Council. I formed three main hypotheses regarding regional differences in civic culture, social capital, and tax morale. As had been firmly established in the literature elsewhere, individuals from North demonstrate higher tax morale than the citizens from the South, although the discussion of why this may be the case has received little attention. Differences in economic performance and government efficiency have been duly documented, but the tax morale literature merely mentions it in passing; it is often just taken at face-value. My results from the survey indicated that there is a difference in social capital and civic culture between the North and the South, and they significantly increase tax morale.

To validate these results, I conducted a series of tax compliance experiments, followed by a Social Value Orientation (SVO) task that tests others-regarding preferences. Others-regarding preferences are used instead of civic participation and social capital because it gauges the extent to which an individual is individualistic or altruistic. As many observers have noted, Southerners are more individualistic and their sense of civic duty only relates to their immediate family, whereas citizens from the North are more prosocial and connected to those outside their immediate family. SVO is tool of extracting bridging vs. bonding social capital. The benefit of a laboratory setting is that we can control the environment allowing us to more easily parse out cultural effects. The main critique of laboratory experiments concerns the extensive use of students; however, Alm, Jackson, and McKee (1992) argue

experimental results can contribute significantly to policy debates, as long as some conditions are met: the payoffs, and the experimental setting must capture the essential properties of the naturally occurring setting that is the object of investigations.

They further state, “there is also no reason to believe that cognitive processes of students are different from those of ‘real’ people.” Contrary to our preconceived notions about the South, SVO in the North was not different than the South, and tax compliance was nearly the same. I, therefore, concluded that although tax compliance and tax morale differ between the North and the South, when placed in a similar environment, participants from the North and the South behave nearly identically. This then led me to ask the question: Which institutions, then, have led to such disparate taxpayer behavior?

Chapter four historically examined the two most powerful institutions in Italy – the state and the Catholic church. My analysis began with the *Risorgimento* and the state supporters in the North vs. the anti-state Catholics, located mainly within the Vatican and Southern Italy. In the end, unification pitted the North against the church and the South. Unification resulted in a large decrease in economic performance in the South, furthering the deep-seated resentments held against the North, and in that, the state. I suggested that Southern Italians would opt to finance their local priest, instead of the state. However, the clergy’s participation in World War I improved the early stigmatization of belonging to the Catholic church held in the North. As church-state relations improved in the North, the situation in the South continued to deteriorate. With the rise of Mussolini and Fascism (a center-north movement) the divisions between North and South only increased requiring Southerners to become increasingly dependent on *patron-client* relationships. Moreover, I argue that post-

World War II created a situation that fostered political competition and progressive politics in the North, but the DC's monopoly exaggerated clientelistic politics in the South. This had the effect of shaping functioning public institutions (albeit through clientelism) and a responsible citizenry in the North, and rather, a new form of clientelism that provided public employment to unqualified workers and tax favors to local businessmen in the South. In the 1970s a series of tax reforms and strict penalization of tax evaders did little to combat the deep rooted issues in the Italian tax system. This was followed by a series of major corruption scandals originating in the North in the 1980s and 1990s. The findings of this chapter point to the complicated relationship between institutions and individual agency. There is little doubt of a causal relationship between the aforementioned institutions and taxpayer behavior, but this does not excuse individual action from evasive (dishonest) behavior.

This dissertation considered the broad question: "What shapes regional disparities in Italian tax morale?" Simply put, the answer lies in both culture and institutions. Of course, culture varies between Northern and Southern Italy, just as culture differs between Northern and Southern Europe, more generally; however, I demonstrated that the context in which a culture is formed is more important when analyzing taxpayer behavior, than culture alone. Culture by itself cannot account for differences in evasion between Calabria and Lombardy, or even, Italy and Sweden. Testing the Bank of Italy survey against my tax compliance experiments exemplifies the contextual relationship between taxpayer behavior and culture.

Increasingly, policy makers have relied upon *carrot and stick* approaches to fight tax evasion, rather than fixing the underlying problem: unresponsive institutions. Augmenting

penalties and fines, while at the same time promoting responsible taxpayers will increase compliance to an extent, but insignificantly; Italy is a perfect example of this. Since Mussolini, Italy has increased fines and verification, but tax evasion has remained consistently high, especially in the South. As shown in Figure 4.1 Figure 4.2, the quality of government in Italy and Southern Italy, to a greater extent, is one of the lowest in Europe, supporting the narrative that quality of institutions is an important component of taxpayer behavior.

Through the process of writing this dissertation, I have become increasingly convinced that countries (regions in this case) with a large percentage of self-employed individuals will inevitably have higher rates of evasion. Looking at Figure 4.4 in Chapter 4, we can see that at least 35% of the workforce is self-employed in the South. Table 5.1 demonstrates that only Greece has more self-employed individuals than Italy, just as only Greece has more evasion.

Table 5.1: Percentage of Self-Employed in Total Employment: 16 Western European Countries

Country	Year				3-year Average
	2000	2010	2011	2012	
Norway	7.4	7.7	7.0	6.9	7.2
Denmark	9.1	9.1	9.1	9.1	9.1
France	9.3	9.3	9.5	-	9.4
Sweden	10.3	11.0	10.4	10.5	10.6
Switzerland	13.2	10.6	10.7	10.7	10.6
Germany	11.0	11.6	11.7	11.6	11.7
Finland	13.7	13.5	13.4	13.6	13.5
Austria	13.1	13.8	13.8	13.3	13.6
United Kingdom	12.8	13.9	14.0	14.6	14.1
Belgium	15.8	14.4	14.3	14.3	14.3
Netherlands	11.2	15.0	15.0	15.3	15.1
Ireland	18.8	17.1	16.6	16.7	16.8
Spain	20.2	16.9	16.6	17.6	17.0
Portugal	26.0	22.9	21.3	21.9	22.0
Italy	28.5	25.5	25.2	25.1	25.3
Greece	42.0	35.5	36.3	36.8	36.2

Source: OECD Factbook 2014

The ability to deal exclusively in cash drastically increases the temptation to evade and decreases the probability of being caught evading. Further research will more thoroughly address the structural aspects of the economy on tax evasion and also the normative effect this has on compliance. For example, is evasion more acceptable, and even contagious, in societies that have a large number of self-employed and small businesses? Paradoxically, enforcement and punishment could have adverse effects on the self-employed and small businesses, which in turn, could be problematic for an economy that is dependent on self-employed individuals.

5.1 What's next?

There is an old Neapolitan tradition known as *caffè sospeso* (suspended coffee). The customer instead of purchasing one coffee pays for two. One for herself and another *suspended coffee* for an unknown patron who cannot afford one. The suspended coffee has become an entire movement representing a sense of duty to others. Although Neapolitans are generous with coffee, their taxpaying behavior would suggest something entirely different about their culture. Edward Banfield and Robert Putnam, have both written influential books suggesting that Southern Italian citizens' are inherently less civic than Northern Italians, which in turn, has led to less efficient government. This dissertation, has suggested that it is not that the North intrinsically has more civic consciousness than the South, rather Southerners are less willing to pay taxes because of the institutional arrangement that they have been dealt.

One of the more contentious aspects of *Making Democracy Work* was its pessimism. Culture's path dependent nature translates into very few policy formulas. Unfortunately, I am also left more pessimistic about the chances of reform than optimistic. Tax compliance requires good governance both for enforcement and for citizens' perception of the state. Governments can implement large scale public awareness campaigns and make whistleblowing easier, for example. However, these policies are typically superficial, campaign tools and have little meaningful effects on the extent of evasion. Until governments can build transparent, efficient institutions, focused tax compliance policy is superfluous.

Tax evasion is a global endemic of which Italy falls behind only Greece in the level of tax evasion as a percentage of GDP per capita. But this is not a problem that is unique to Italy and Greece alone; in fact, the Southern European countries, all of which have been impacted by debt crises, have relatively high levels of evasion. They also share similar institutional characteristics such as fragmented welfare states, a large number of self-employed individuals, and a history of clientelism. Exploiting Italy as a case study allows me to better understand how taxpayer behavior is shaped in countries with similar characteristics. As these states continue to decrease the size of their welfare states through mandatory cutbacks and austerity, now more than ever, Southern European nations need to address the underlying problems of poor governmental accountability and the bankrupt state of their institutions. This should be the first meaningful step in fostering tax compliance.

Appendices

A. Appendix

A.1 Construction of Dependent Variable

Bank of Italy Survey of Household Wealth and Income

DV: Tax Morale: Index of questions regarding citizens' opinions concerning public spirit and taxation. The gauge citizen attitudes about the Italian tax system. They were requested to identify the extent to which they agree to the following statements:

1. Here is a set of statements that some interviewees before you made about Italy's tax system. To what extent do you agree with each of them: not at all, very little, so-so, quite a lot, very much?
 - (a) The more someone earns, the more (in percentage) he/she should contribute to Government spending
 - (b) Paying taxes is one of the basic duties of citizenship
 - (c) Not paying taxes is one of the worst crimes a person can commit because it harms the whole community
 - (d) Even if someone thinks a tax is unfair, he/she should pay it first and then complain if necessary
 - (e) It is right to pay tax because it helps the weak

(f) If everyone paid taxes, in the end we would all pay a little less

1= not at all; 2= very little; 3= so-so; 4 = quite a lot; 5 = very much.

2. Generally speaking, among the problems facing the Government, that of tax evasion is:

(a) Very serious

(b) Serious

(c) The same as any other

(d) Marginal

(e) Non-existent

Before creating the index I will reverse the direction of this variable so that it moves in the same direction as tax morale (i.e., very serious represents high tax morale).

A.2 Construction of Independent Variables

Political Culture and Social Capital

1. Interest in politics: Coded from 1 to 4

(a) 1 being not at all,

(b) being not very,

(c) being fairly interested,

(d) being very interested.

2. Number of associations: Based on the question: “In the last year, have you taken an active part in gatherings of any of the following groups or associations: associations/groups involved in social, environmental, union policy, religious, cultural, sports or recreational, professional, or voluntary activities?”

(a) (no),

(b) (yes, with only one group/association)

(c) (yes, with more than one group/association)

3. Government responsibility to provide public services: Based on the question: Considering the Government’s need to guarantee public services, please say which statement is closest to your own opinion:

(a) The Government’s duty is to provide all citizens with as many public services as possible (e.g. school, healthcare, pensions, transport, etc.) even if it means heavy taxes;

(b) The Government has some unavoidable expenses for social welfare, which should be covered by taxes and duties, increasing these as and when necessary;

(c) Taxation is too high, so if there is not enough money, expenses should be reduced by cutting back services; and

(d) The Government should raise the bare minimum in taxes and duties to cover absolutely essential public services (e.g. defense, justice, the police, etc.) and

leave the rest to private initiative. The coding has also been reversed to better reflect the direction of tax morale.

4. Perception of Evasion: Based on the question: What percentage of the total amount of tax due from the population does the Government lose as a result of tax evasion?
 - (a) Less than 10%;
 - (b) Between 10% and 20%;
 - (c) Between 20% and 30%;
 - (d) Between 30% and 50%;
 - (e) More than 50%.

5. Amnesty is an index of the following two questions: What is your opinion of the practice of granting amnesties?
 - (a) Amnesties are a good system and should be granted as often as possible to recover some of the lost revenue;
 - (b) Amnesties are a good system, but should be used sparingly so as not to encourage tax evaders;
 - (c) Amnesties are an unfair but necessary method of balancing the national accounts; and
 - (d) Amnesties are a very unfair system because they discourage honest citizens.

6. What do you think is the main outcome of a tax amnesty?

- (a) Tax evasion diminishes because previously undeclared income is uncovered;
- (b) Tax evasion increases because the amnesty rewards tax evaders and discourages honest taxpayers;
- (c) Tax evasion doesn't change because once tax evaders have regularized their past position, they begin to evade tax again until the next amnesty.

7. Tax inspection: Based on the question: Do you think it would be a good thing if tax inspections were made more often, or not?

- (a) Yes, I would like them to be done much more often because it's the only way to stop tax evasion;
- (b) Yes, I would like them to be done more often, but within limits, to stop the Government interfering too much in people's lives;
- (c) I think things are all right as they are;
- (d) No, I wish they were done less often because the present level of control is already too great;
- (e) No, absolutely not; I think they should be done less often.

8. Honesty

- (a) Not paying for public transportation:
- (b) Keeping money found by accident: Measure citizens honesty and are based on a series of scenarios in which the respondents are asked to judge the extent of

which the activity is justified on a scale from 1-10 (1 = never justifiable; 10 = always justifiable). I will reverse the coding so it better reflects tax morale.

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