TAX REVENUE AND MORALE: A CASE STUDY OF THE CZECH REPUBLIC

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Abstract: *Tax revenues constitute a very important aspect of the functioning of every state. However, apart from economic factors, they seem to be influenced by the cultural characteristics as well as the tax morale of the particular nation. The present study attempts to evaluate the role of shared cultural values and their links to taxation and tax morale. We use the example of the Czech Republic and compare our findings with those found for other countries. To our knowledge, no previous studies linking tax morale and cultural values have been done in this specific country.*

Our results suggest that in the case of the Czech Republic, the feeling of belonging to the nation, regular church attendance as well as strong religious beliefs have significant positive effect on tax morale, while the confidence in government and belief in government seem to have no effect at all. These findings are quite interesting due to the fact that the Czech Republic is currently one of the most atheistic countries in Europe, while the national pride has always been a special matter. Our findings might be useful for current policies aiming at influencing cultural values or taking culture into account when designing optimal economic policies and taxation.

Keywords: culture, taxation, tax morale, state, cultural values, religion, Czech Republic

JEL Classification: H7, H21, P48

1. INTRODUCTION

The question about which role should be played by the state in economic life is one of the most important questions economic science attempted to answer during the last century and at the beginning of the current century. Liberal economists represented by the Nobel Prize winner (1976) Milton Friedman (Friedman and Friedman, 1980) claim that the role of the state should be minimized and that most of the economic processes should be given a chance for self-regulation. According to this idea, the level of taxation, being one of the most important sources of income of the state, should

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be minimized as well. On the other hand, proponents of Welfare state theory support the idea of the state as a provider (Wilensky, 1975). In order to provide goods and services for its citizens, the state should collect considerable tax revenue. What is frequently forgotten in this kind of discussions, is that the role of the state may be to a large extend determined by the culture of the country in question and it may be not possible to find one universal solution for the optimal amount of taxation and optimal size of state due to culture differences.

The levels of taxation in different countries vary considerably. For example despite very close GDP per capita in Norway and the USA, or in Germany, Denmark and Sweden and United Kingdom, there is a big difference in tax revenues as percentage to GDP (Table 1).

Table 1
Tax Revenues (% GDP, 2010) and GDP per capita in Selected Countries

	GDP per capita 2005 constant international $, PPP	Tax revenues (% GDP, 2010)
Denmark	32,608	34,6
Germany	33,499	12,0
Norway	46,926	25,6
Sweden	33,686	21,7
United Kingdom	32,187	26,0
USA	42,642	9,0

Source: International Monetary Fund database and Word Bank statistics (2010).

The aim of this paper is to analyze the links between the level of culture, taxation (and tax revenues of the government measured as a percentage of GDP) as well as the role and the place of the tax morale (and the issue of cheating) in this process.

This paper is organized as follows: part 2 describes empirical effects of culture on economics. Part 3 elaborates on the tax morale and the civic duty to pay taxes. Part 4 introduces the tax morale empirical econometric model for the Czech Republic that explains the links between various cultural dimensions and the tax morale. Part 5 concludes the paper with comments on the main results and their implications.

2. CULTURE AND ECONOMICS: LITERATURE REVIEW

In economic science, the sub-field that was dealing with cultural values and their empirical effects experienced a boost at the end of the 20th century and the beginning of the current century (Gogas and Pragidis, 2013). Among many authors who attempted to systematically describe systems of cultural values four most relevant ones deserve mentioning: Inglehart, Basanez and Moreno (1998), Schwartz (1994a, 1994b), Hofstede (2001), Hofstede and Hofstede (2005) and Trompenaars (1993). All of these scholars succeeded both in providing a systematic concept of human values applicable in

different countries and in computing indicators which allow comparing cultural values. To the knowledge of the authors of this paper, most economists nowadays rely on the indicators computed by Geert Hofstede (Kirkman *et al.* 2006), who was the first to introduce the concept of dimensions of national cultures and compute usable quantification of such. The most important question to answer is whether Hofstede's concept of cultural dimensions including its quantification should be used in scientific research in 21 century given the fact that most of the indices were computed in the 1960s and the 1970s. In general, Kirkman *et al.* agree with Smith and Bond's (1999, 56) that other authors who studied concepts similar to Hofstede's (including Chinese Culture Connection, 1987; Schwartz, 1992, 1994; Trompenaars, 1993; Smith et al, 1996 as examples) supported Hofstede's conclusion rather than contradicted them. Further on, the review of Kirkman *et al.* (2006) showed that researches, using indices of Geert Hofstede, successfully managed to differentiate countries according to the cultural values and thus to increase variance. In addition Kirkman *et al.* (2006) claimed that most of the most of the country differences predicted by Geert Hofstede were supported.

The literature on the effect of cultural values on economic, social and psychological processes grows exponentially. More recent studies based on Hofstede's cultural indices can be divided to two categories. The first category continues to look for the effects on cultural values on economic, social, psychological and other processes either through simple correlations or via more complicated procedures partially described above. The second category of papers discusses the whole concept of cultural dimensions and correctness and relevance of Hofstede's estimates.

This study does not attempt to present overall review of literature published after the year 2002 (this would be the task for a separate paper), but some examples are mentioned below.

For instance, Scholtens, Bert and Lammertjan Dam (2007) studied the influence of cultural values on the international differences in business ethics. The authors analyzed ethical policies of almost 2,700 firms in 24 countries and related them to the Hofstede's cultural indices. These ethical policies include human rights policy, policy against bribery and corruption, and the overall comprehensiveness, implementation and communication of firm's codes of ethics. The authors found that there is a positive relation of individualism and uncertainty avoidance dimension to the ethical policies and negative relation of masculinity and power distance.

Moreover, Chui and Kwok (2007) studied the way national cultures influence consumption of life insurance on a simple of 41 countries (data collected from 1976 till 2001). The findings suggest that power distance and masculinity/femininity dimension are negatively related to the life insurance consumption, whereas individualism as a positive impact.

Furthermore, Nadler and Zemanek (2006) recomputed the effects of culture on economic development in 31 countries in order to update similar types or research

published in the 1980s and 1990s. The authors studied the effect of cultural values on per capita gross domestic product, literacy rates, the negative of the population growth rate, and life expectancy development. Their study also partially supports Hofstede's findings.

In addition, Singh (2006) studied the relationship between national culture and adoption of new products, ideas, or behavior in order to suggest a framework for distinguishing between innovative and imitative behavior. His results suggest that cultures were power distance is small, uncertainty avoidance is weak, and cultural values suggest masculinity are more prone to innovative behavior in their consumption patterns. The other result suggests that consumers coming from a large power distance, strong uncertainty avoidance and/or feminine culture are more susceptible towards normative influences, while those from collectivist countries tend to relay on interpersonal communication.

There is a discussion in the literature about whether the dimensions of Geert Hofstede are still usable, given the fact, that most of the original data were collected in the 1960s and the 1970s (some countries, especially but not only the countries of transition, were added later).

Drogendijk and Slangem (2006) studied the effects of five cultural distance measures (two based on Geert Hofstede (1980) another two on Schwartz (1994a, 1994b) and the fifth one based on managerial perceptions) on the choice of multinational enterprises between expanding abroad through greenfield or acquisition. The results suggest that high scores on all cultural distance measures significantly increase the likelihood that multinational enterprises choose greenfields and that the explanatory power of Hofstede's measures is comparable to explanatory power of Schwartz measures while the explanatory power of managerial perceptions is somewhat lower. The authors conclude that it is too early to consider Hofstede's dimensions to be outdated and Schwartz framework to be superior.

Soares, Farhangmehr and Shoham (2007) examined different approaches as for conceptualization of cultural values for marketing research. The paper compares five dimensional model of culture designed by Hofstede (1980, 1991, 2001) with eight other models which attempt to operationalize cultural values and presents arguments for Hofstede's approach. Most importantly the authors argue that Hofstede approach is "simple, practical and usable shortcut to the integration of culture into studies" (Soares, Farhangmehrand Shoham, 2007, p. 283).

Cultural indices represent a valid tool for international differentiation of countries according to the relevant cultural values. Even though some indices were computed in the end of the last century, the explanatory power of them seems to be comparable to the explanatory power of other similar tools computed more recently, while the simplicity and practical applicability exceeds the alternatives. Using cultural indices in economic research bring new meaningful insights into economic processes.

3. TAX MORALE AND WILLINGNESS TO PAY TAXES

According to Torgler (2003), who analyzed the main determinants of tax morale in Canada and employed game theoretic literature which analyses tax evasion in all the types cooperative and non-cooperative games, in real world people pay more taxes than traditional economic approaches would predict, and therefore it is necessary to analyze other than economic determinants of the willingness to pay or evade taxes (Torgler, 2003). The author presents a set of four macroeconomic models which differ by control variables and are based on the data of World Value Study for Canada.

Further, Torgler and Schneider (2007) studied the attitudes towards paying taxing in multicultural European countries represented by Belgium, Switzerland and Span and found that direct democracy, citizens' involvement and religiosity contribute to raising the tax morale. Additionally, Schneider (2008) finds that the willingness to pay taxes is also predetermined by the size of the shadow economy, which according to his estimations, makes from 20 to 28 per cent for the countries of Central and Eastern Europe.

According to Hanousek and Palda (2004), tax evasion is one of the central problems facing the government of transition countries. Quite often, the system of taxation in those countries targets narrow groups of wealthy people that are capable of endowing the state budget which leads to inefficient system of taxation and low tax morale. Transition economies often lack quality government services that can be found in their Western counterparts. Moreover, massive spread of international travel that became possible after the fall of the Iron Curtain and the possibility to compare the level of public services at home and abroad, further reduce tax morale in transition countries. With regard to this, Feld and Tyran (2002) find the link between willingness-to-pay taxes and the quality of government services in transition countries.

Surely, the level of tax morale and the perception of the civic duty that result in the willingness-to-pay taxes or engage in corruption, differ from country to country. Cabelkova and Hanousek (2004) find on the example of data from Ukraine that the level of corruption and trust in the rule of law and the state might be considerably lower in some transition economies than the others. Further, Hanousek and Palda (2006, 2009) analyze the tax morale and level of tax evasion in the Czech Republic and come to a conclusion that there exists an evasional Kuznets curve (meaning that the tax morale rises with the growing wealth of the citizens), and that the tax revenues are likely to increase with the increasing quality of public services.

However, most of the studies quoted above, concentrated on the tax evasion and the willingness-to-pay taxes and very little research was done on estimating the tax morale of the citizens. This paper attempts to fill in this gap introducing below the empirical model of estimating tax morale.

4.   EMPIRICAL MODEL FOR ESTIMATING TAX MORALE

Similarly to Torgler (2003), this paper analyzes the determinants of tax morale using World Value Study (2008) data, but contrary to Torgler (2003) it employs the data for the Czech Republic only and uses more than one indicator of tax morale in order to test for the robustness of our finding with respect to the chosen indicator. Namely, we work not only with subjective attitude towards cheating on tax in general but also with the subjective opinion on paying cash to avoid taxes and claiming state benefits when not eligible.

We chose the case of the Czech Republic due to the specific situation with regard to the political and economic situation amongst all post-Communist countries of Central and Eastern Europe (similar to other countries sharing the same past, e.g. Poland – see Cieslik (2013)). Although the Czech Republic is probably the most successful case of economic transformation and (alongside with Poland) revealed the highest economic growth (prior to the economic and financial crisis of the 2008), the trust in the government and the state are quite low. In 2011, prestigious British journal "The Economist" called Czech political system a "rotting partitocracy". According to the journal, political parties in the country hijacked the democratic process and their leaders became arrogant and corrupt (The Economist, 2011). This situation might be described as the "state capture"—an excessive exploitation of public resources by the ruling elite (Grzymala-Busse, 2004; or Cieslik, 2013). An independent study conducted by the researchers from the Charles University in Prague introduced the so-called "zIndex" of public procurement. The index shows that 67% of the €13.7billion spent in the Czech Republic between 2006 and 2010 is not tracked in the government's official procurement database. About 14 % of all tenders during that period (worth some €2 billion) only had one bidder, and none meet the criteria of the OECD and the Regional Development Ministry (Chvalkovská, Janský and Skuhrovec, 2011).

In order to identify the determinants of the tax morale in the Czech Republic, we constructed three ordered Logit models. All of the models include same sets of independent variables and differ by the estimates of the tax morale variable. We used three estimates for tax morale all coming from the WVS survey (2008). In formal terms, our empirical model takes the following form:

$$P(Y = 1 | x) = \frac{e^{\beta_0 + \beta_1 x_1 + \ldots + \beta_k x_k}}{1 + e^{\beta_0 + \beta_1 x_1 + \ldots + \beta_k x_k}} \qquad (1)$$

where β are coefficients to be estimated. The right hand side of the equation is in form of logistic cumulative distribution function. The dependent variable Y in probability model is binary and indicates whether the subject would be cheating on taxes if she or he had the chance, whether she or he would be paying cash to avoid taxes, and finally, whether the respondent would claim government benefits to which she or he were not entitled.

The original coding was on ten-point scale with 1 standing for never justifiable and 10 - always justifiable. The dependent variables (Cheating on Tax and Claiming State Benefits) were developed by recoding the ten point scale to three point scale. The value one is an aggregation of first three points, the value two is the aggregation of second three points and the value three is the aggregation of the last four points. The dependent variable Paying Cash to Avoid Taxes was developed by recoding of the original ten point scale to five point scale where the value one is an aggregation of first two points, value two is an aggregation of the second two points, value three is an aggregation of the third two points, value four is an aggregation of the forth two points, and value five as an aggregation of the last two points.

Besides necessary control socio-demographic variables such as age, sex, occupation, income, and marital status, we include variables, which are to indicate the level of identification with the country as the group of people (national pride variable) for according to for example Tyler (2001) pride to be a group member encourages cooperative behavior within a group. The question remains, whether paying taxes might be viewed as cooperation in all the cultural environments. For example, in the case, when citizens do not view the government to be reliable agent as for the reasonable use of the taxes collected, it might be view by the population that not paying taxes represents cooperative behavior. For this reason we include two variables, which indicate confidence in the government and subjective attitude towards the government, namely whether the government is viewed to be "good" or "bad".

One of the very often mentioned in the literature variable with respect to any type of morale is religiosity (see for example Margolis, 1997). One might have certain doubts about what religiosity is and how to measure it. Similarly as there are lots of definitions of religiosity, there might be several indicators for it. The most straightforward might be whether a respondent believes in God. On the other hand one can claim that belief in God might not as important for a person as to influence his behavior. For this reason we include both the variable indicating the belief and the variable indicating how important God is in one's life. Another critic of these indicators might be the idea, that what is important in religiosity is not only in what one believes but what one does. For this reason we also included the variable mapping how often one visits religious services. This variable is important also for one may mention that morality of the respondent is influenced to a large extent by the community one belongs to and might be reinforced by the information one gets from the priest. The comprehensive list of constructed variables is presented in Annex A at the end of this paper.

The results of all three model's estimations are presented in Table 2. In all three models, similarly to Torgler (2003), older respondents have higher tax morale than younger people; males report lower tax morale than females.

The Logit model that is employed in this paper, mostly the signs of the estimated coefficients are important but the magnitude also reveals some information. Here, positive signs signal that, *ceteris paribus*, the odds of remittance occurrence are rising

Table 2
Determinants of tax morale in the Czech Republic, ordered Logit estimates

Dependent variable	Cheating on tax 1 - Never justifiable, 3 – Always justifiable				Paying cash to avoid taxes 1 - Never justifiable, 5 – Always justifiable				Claiming State benefits when not eligible 1 - Never justifiable, 3 – Always justifiable			
	Coefficient		Std. Error	Sig.	Coefficient		Std. Error	Sig.	Coefficient		Std. Error	Sig.
(a) Demographic factors												
Age	-0,021	***	,008	,007	-,015	**	,006	,018	-,020	**	,008	,012
Education	-,073		,139	,599	-,038		,113	,736	-,172		,150	,253
Male	,678	***	,189	,000	,518	***	,157	,001	,413	**	,194	,034
(b) Marital status												
Married or registered partnership	,073		,246	,767	-,025		,211	,906	-,129		,246	,601
Widowed	,608		,423	,150	,497		,342	,145	,206		,432	,634
Divorced or separated	,649	**	,297	,029	,776	***	,251	,002	,105		,304	,729
(c) Employment and occupation												
Employed	,205		,223	,357	,306		,187	,101	,438	*	,229	,056
Higher controllers	-1,421	**	,583	,015	-1,064	**	,456	,020	-1,946	***	,738	,008
Lower controllers	-,947	**	,447	,034	-,999	***	,380	,009	-,948	**	,468	,043
Routine non-manual	-,577		,460	,209	-,796	**	,393	,043	-,173		,464	,709
Lower sales service	-,571		,471	,226	-,766	*	,403	,057	-,553		,486	,255
Self employed	-,206		,491	,676	-,597		,436	,171	-,814		,543	,134
Manual supervisors	-1,252	*	,678	,065	-1,104	**	,539	,041	-1,365	*	,740	,065
Skilled worker	-,651		,426	,126	-,779	**	,368	,034	-,318		,435	,464
Unskilled worker	-,493		,412	,232	-,682	*	,356	,056	-,398		,424	,348
Income	,282	***	,094	,003	,288	***	,081	,000	,125		,098	,200
(d) Further variables												
Confidence in government	-,121		,113	,285	-,140		,096	,145	-,068		,116	,560
Attitude toward government	,000		,045	,997	-,018		,038	,627	,006		,046	,905
Pride	,238	**	,116	,040	,252	**	,099	,011	,349	***	,118	,003
Believe in God	,286		,277	,302	,294		,240	,220	,497	*	,287	,083
The importance of God	,133		,092	,146	,051		,079	,520	,012		,096	,899
Church attendance	,201	***	,072	,005	,142	**	,059	,017	,160	**	,074	,031
Model fitting information (significance levels)	,000				,000				,000			
Valid observations	955				955				956			

Notes: Significance levels: (*) 0,05 < P < 0,10; (**) 0,01 < P < 0,05; (***) P < 0,01. In the reference group female, never married or registered partnership, farm labor, do not believe in god, not employed.
Source: own calculations

with increase in the explanatory variable. If one is interested in the magnitude, taking the value of *exp* of the estimate yields the *odds ratio*, since coefficient actually are log odds ratios.

In accordance to Toddler (2003), in our models, education seems to have no significant effect on tax morale. Looking at the marital status, in two out of three models, only divorced or separated, out of three possible categories, have lower tax morale than never married. This difference goes in opposite direction than in Torger (2003), who found, that in Canada separated people have higher tax morale than singles. Similarly to Toddler (2003) higher income has significant negative effect on tax morale.

Looking at employment and occupation, employment status does not seem to have significant effect on tax morale whilst out of eight occupational statuses only higher and lower controllers together with manual supervisors have significantly higher tax morale comparing to farm labor.

Probably the most interesting effects on tax morale give the variables of attitude to government and national pride. Contrary to Toddler (2003) confidence in government and attitude toward government seem to have no significant effect on tax morale (in Toddler, 2003 trust in government had highly significant positive effect on tax morale), whilst national pride (how proud you are to be a country citizen), has significant positive effect on tax morale (in Toddler, 2003 the effect was also highly significant and positive). Internationally this finding is interesting from the perspective of how tax morale can be influenced by government interventions.

In the case of Canada according to Toddler (2003) higher national pride and trust in government have positive effect on tax morale therefore government actions might have an effect on tax morale. Similarly, as we found, in the Czech Republic the effect in the national pride variable on tax morale is positive[1], however nonexistent it is in the case of government trust (according to our model and data).

Religious beliefs are another issue which is frequently associated with morality in general and tax morale in particular. According to Toddler (2003), religiosity has a positive effect on tax morale in Canada. Church attendance in his model of tax morality had highly significant and *positive* effect on tax morale, whilst the particular religious confession of the respondent was not statistically important.

Thus, the authors concluded that religious confession does not influence tax morale, but religiosity as itself, represented in his model by church attendance variable, imposes those behavioral constraints increasing tax morale. Opposite to his, our findings suggest that in the Czech Republic neither belief in God nor the importance of God in one's life has statistically significant effect on tax morale. On the other hand church attendance has highly significant and positive effect to tax morale in all the three models.

6. SUMMARY AND CONCLUDING REMARKS

In this paper we analyzed links between cultural values and taxation in order to find factors which influence tax morale in the Czech Republic. Using the data from the

World Value Study (2008), we compared the factors identified for the Czech Republic with those reported in similar research in other countries.

Strong evidence was found that similarly as elsewhere (in particular, in Canada) pride to be a country's citizen and church attendance have significant positive effect on tax morale. On the other hand, confidence in government and attitude toward government was not statistically important, which may under certain conditions imply, that actions of government do not have an effect on tax morale. These findings are robust with respect to indicator of tax morale and persist even after controlling for age, gender, education, income, marital status, employment status and occupation.

These results are especially interesting due to the fact that the Czech Republic is one of the most atheistic countries in Europe which was caused by its turn to the Protestantism in the 16th century, Hussite Wars and facing the Crusaders' armies from all over Europe, and finally the restoration of the Catholicism by the Habsburgs after the defeat of the Czech Protestant forces at Bila Hora in 1620. As a result, the Czechs remain on of the most religion-neutral nations in the world (with the exceptions of catholic strongholds in southern Moravia). In the same time, the issue of national pride and "belonging" to the country remains to be very strong in the country (which is typical for all small nations) and is typically getting stronger during football and ice hokey matches that involve the national team. However, when it comes to the attitude towards government or the belief in government, the Czech case reveals the typical example of how political elites in the post-transformation countries of Central and Eastern Europe can get stuck in the spiral of corruption, lack of credibility and stagnation. Overall, it becomes clear that the political and economic development in the Czech Republic reveals its hidden side and yields some alarming trends that do not have a favourable impact on strengthening the believes of citizens in their state and on improving their tax morale. Czech taxpayers seem to be motivated not by their politicians but by their beliefs and public awareness.

Religiosity is another issue which is often mentioned in connection with morale in general and with tax morale in particular. In our case, similarly to Torgler (2003), church attendance proved to have highly significant positive effect to tax morale. This effect is robust with respect to the indicator of tax morale and persists even after controlling for age, gender, education, income, marital status, employment status and occupation. On the other hand, neither proclaimed belief in God nor the subjective importance of God in once life showed to be statistically significant explanatory variable for tax morale. Thus, similarly as Torgler (2003), we can conclude that, according to our model and data, it is not that important what are one's proclaimed beliefs, but what one does.

Note

1. The national pride variable (how proud you are to be a country citizen) is coded inversely, so that 1 represents "very proud" answer and 4 represents "not at all proud" answer. Given the fact that tax morale variables were also coded inversely, we interpret positive

coefficient at a relation of the type the more frequently a person visits religious service the better tax morale he has.

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