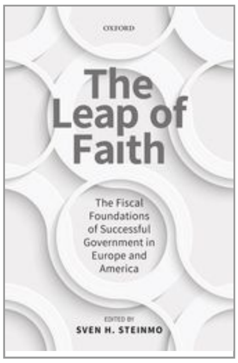

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Sven H. Steinmo

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Explaining Italian Tax Compliance

A Historical Analysis

John D'Attoma

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Abstract and Keywords

It is well known that tax compliance is low in Italy. Many scholars have examined Italian taxpayer behavior, mainly using experiments and surveys. However, little attention has been given to the historical circumstances that have shaped divergent taxpayer behavior in Italy. This chapter uses historical data from Italian unification through the Second Republic to assess the effects of Italy's major formal institutions (the Church, state, and political parties) and informal institutions (clientelism) on Italian tax behavior. It argues that nineteenth-century unification and Fascism had significant repercussions for the Italian state and how Italians perceive the state. Because of this, Italians lack trust in their government and their fellow citizens, which inhibits a willingness to pay taxes. The implication then is a low-trust/low-compliance equilibrium that becomes increasingly difficult to reverse.

Keywords: tax compliance, Italy, trust, political parties, taxes

Ex-Prime Minister Silvio Berlusconi once famously claimed that the "evasion of high taxes was a God-given right" (Bhatti et al. 2012). Reports from Istat, Corte dei Conti, and l'Agenzia delle Entrate estimate that tax evasion in Italy costs the state €120 billion per year in lost revenue (Santoro 2010). Using data from the Istituto nazionale di statistica (Istat), Alessandro Santoro demonstrates that evasion of value added tax (VAT) averages about 34 percent across regions

(Santoro 2010). Figure 5.1 shows evasion rates for the regional tax on production.[1]

One explanation for relatively sluggish and asymmetric development in Italy argues that Southern Italy is driving most of these ills. This line of inquiry depicts Southern Italians as less endowed with civic virtue and social capital, which is reflected in their lower levels of economic development and, as shown in Table 5.1, government performance (Banfield 1967; Bigoni et al. 2016; Cartocci 2006; Putnam, Leonardi, and Nanetti 1994; Sabatini 2005a; 2005b). Here civic virtue is defined as high civic awareness and a shared consensus regarding the legitimacy of political institutions and public policy, together with political competence and trust (Almond and Verba 1963). Social capital refers to features of social life, such as networks and trust, that facilitate civic participation (Putnam, Leonardi, and Nanetti 1994).

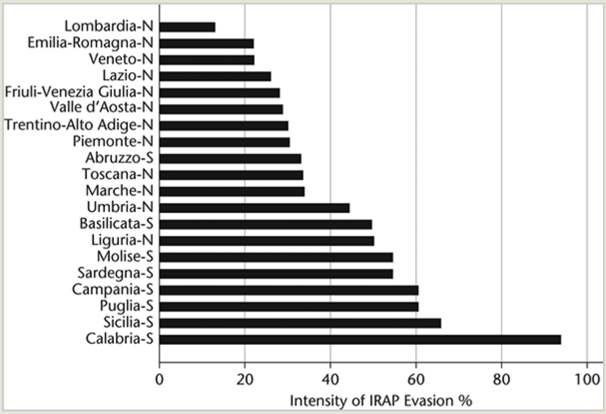

Figure 5.1. Rates of evasion of IRAP by region 1998–2002

Source: Istat in Santoro (2010).

Table 5.1. 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

***Source*: Nationally representative public opinion surveys were conducted by The Quality of Government Institute about perceptions of local education, health, and law enforcement institutions. Researchers asked participants to rate each of the three institutions on quality, impartiality, and corruption. For more information, see Teorell et al. 2011.**

This line of research typically associates development to the cultural underpinnings of society. Edward Banfield followed by Robert Putnam and his colleagues suggest that Southern Italy is a region characterized by *amoral familism*. Societies tied by amoral familism (bonding social capital) "emphasize family relations to the exclusion of all others" (Fukuyama 1995). **(p.107)** A centuries-old debate about the Italian character would have us believe the Italian "character is faulty, and that this faultiness even explains much of the social and political problems of their country today" (Patriarca 2010: 5). Indeed, Europeans perceive Italians as the least trustworthy of Western European nations (Mackie 2001).[2] In this framework, ethical behavior is thus **(p.108)** confined to the immediate family and closest friends. By *siphoning* money from the breadwinner, paying taxes, which benefits society at large, can be perceived as hurting the familial unit by imposing a cost coming out of their earnings that will indirectly benefit someone outside the familial unit, rather than directly benefiting themselves.

Nevertheless, the amoral familism argument has been met by a litany of critics, who argue that the social capital literature often confounds explanations with outcomes, which implies that public institutions and the elites that govern those institutions are somehow responsible for fostering a civic citizenry. For example, Levi suggests that a government's ability to protect property rights and a merit-based society (one opposed to the clientelism or nepotism found in Southern Italy) instill a generalized trust in society (Levi 1996). Even Putnam mentions in *Making Democracy Work* that the regimes prior to unification intensified distrust and vertical ties in the South, but he barely mentions how unification reduced the South to "semi-colonial status" and "its fragile commercial sector brutally merged with the North's more flourishing economy, a uniform tax system and customs union imposed on its vulnerable industries, and brigandage rooted out by a full-scale military campaign" (Tarrow 1996: 394). Filippo Sabetti contends that the growth of institutions and ecclesial infrastructure since the eighteenth century better explain the Italian political economy than the amoral familism stressed by Putnam.

Like these critics, I contend that the moralist argument fails to account for the institutional environment (such as a period of progressive politics, political competition, or strife between the Church and the state) from which behavior may manifest. While the vast majority of these scholars analyze economic and social development, I am concerned with why tax compliance is so low across Italy. Simply put, tax behavior reflects the quality of and perceptions about the government institutions to which a taxpayer is contributing. I argue that Italian tax compliance has evolved within a low-efficiency/ low-trust equilibrium environment or what Bergman (2009) calls a low-compliance environment. There is ample evidence in the literature suggesting that individuals are more likely to pay taxes if they believe that their government is honest and efficient (Cummings et al. 2009; Edlund 1999; Frey and Feld 2002; Frey and Torgler

2007; Levi 1989; Levi, Sacks, and Tyler 2009; Pommerehne, Hart, and Frey 1994; Scholz and Lubell 1998; Smith 1992; Smith and Stalans 1991; Torgler and Schneider 2007). Taxation mobilizes citizens to demand accountability from their government, but on the other hand, a lack of government accountability can actually have the opposite effect, motivating individuals to evade their responsibilities (Huntington 2012; Paler 2013). According to Ross (2004: 234), "[b]oth the size of the tax burden, and the **(p.109)** quality and quantity of government spending matter; citizens ultimately care about the 'price' they pay for the government services they receive."

It is no wonder that tax evasion is so rampant in Italy; Italy consistently ranks near the bottom on the Quality of Government index compared to other European nations (see Table 5.2). However, Italy's 44 percent tax burden (the ratio of tax revenue to gross domestic product (GDP)) is one of the highest in the European Union; only Denmark, Belgium, France, and Sweden have a higher tax burden (European Commission and Eurostat 2012). It is possible then that Italians live in an institutional environment that legitimizes tax evasion. If Europeans have come to think of Italians as dishonest and Italians themselves have come to agree, this may be a byproduct of this low-efficiency/ low-trust equilibrium. Because confidence in public institutions is a direct reflection of the quality of those institutions, clearly Italians should have far less trust in their public institutions than Swedes (see Jenny Jansson, Chapter 3 in this volume). I suggest that, consequently, Italians are more likely to cheat on their taxes and avoid funding public institutions.

Table 5.2. 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

Region	Quality	Region score	Rank
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

***Source*: Nationally representative public opinion surveys were conducted by The Quality of Government Institute about perceptions of local education, health, and law enforcement institutions. Researchers asked participants to rate each of the three institutions on quality, impartiality, and corruption. For more information, see Teorell et al. 2011. Southern regions are in bold.**

The particular tax compliance environment from which tax behavior is derived is one of government instability, bureaucratic complexity, and administrative inertia. Italian unification pitted the state against the Catholic **(p.110)** Church and the North against the South. After a relatively short period of asymmetric state-building, Italians found themselves fighting in World War I for a country that was still greatly divided. Citizens' disaffection with the political system and a sharp economic downturn led to the rise of Benito Mussolini, Italian Fascism, and another world war. Since World War II, Italy has sustained a relatively high level of prosperity, despite major political turmoil such as right- and left-wing political terrorism in the 1970s; a large corruption scandal in which half of parliament was charged with corruption in the 1980s; and sixty-three governments since the "First Republic." The political and institutional instability in Italy has led to a profound distrust of government, and alongside that, an unwillingness to contribute to the state through taxation.

In the following sections, I examine these issues, focusing on the ways in which specific timing and institutions have shaped this low-efficiency/ low-trust equilibrium. I trace the ways in which unification pitted the North against the South, providing a different experience with the state in the two regions and hence different preferences regarding taxation. Furthermore, I argue that post-unification (1900–22) political instability fostered a deep distrust amongst Italians toward their political institutions, shaping a general political ideology that saw excessive taxes as an infringement of individual rights. This overarching political ideology curtailed the ability of successive administrations to create efficient and effective tax regimes.

This was then followed by a series of short-lived prime ministers, which led to the rise of Fascism (1929), followed by World War II, furthering Italian political discontent. Following World War II, a deep distrust of government shaped the new constitution, making tax collection an arduous task for the administration. Although the 1960s and 1970s can be characterized by unprecedented economic growth in Italy, much of it was fueled by clientelism and corruption, which in many ways contributed to tax evasion. Moreover, many in a series of major tax reforms implemented in 1972 to support the modern state were undermined by an overburdened judicial system, followed by a reliance on tax amnesties. Finally, the 1990s tax reforms attempted to address Italy's extremely large small-business and self-employed sector—one of the largest drivers of evasion. But those reforms were also watered down by the immense power of that sector weakening the administration's ability to collect taxes. In sum, I argue that unstable political institutions, such as a weak parliament unable to garner confidence and a constitution that protects the taxpayer at the expense of efficient administrative capabilities, beginning with unification, fostered a profound distrust of the state, which hindered the state's ability to collect taxes.

(p.111) The Risorgimento and Italian Politics

In this section, I argue that the Risorgimento resulted in deep divides between the North and the South, which greatly affected citizens' willingness to pay taxes. Elites extracted a disproportionate amount of tax from the South to fund the development of the North, engraining a deep-seated distrust of the newly formed nation state in the South. The dominant ideology shaping the fiscal apparatus of the state reflected a great distrust in state power and intrusion. Tax collection thus was perceived to be a form of encroachment on individual rights, dampening the ability of the administration to collect taxes. By the end of the nineteenth century, interplay between the major political parties further shaped the tax environment. The Catholic Church and right-wing liberals joined forces in the North, where there was a strong industrial labor base, to organize mass political engagement in direct competition to the socialists. Catholic, right-wing, and socialist organizations made conscious efforts to build effective and efficient public institutions in order to garner support for their political movements; these institutions promoted a high-compliance environment in the North. On the other hand, the South, populated by mainly peasants, lacked any kind of industrial base and became disengaged with civic and associational life, leading to a low-compliance environment.

The Risorgimento (Resurgence) refers to a period of political consolidation in Italy from 1815 to 1871, ultimately culminating in Italian unification. Although the Risorgimento led to formally ratified political unification, it left the country divided between North and South, economically and politically. As Clark notes, the state imposed an unprecedented tax burden in the South at the time of unification, which funded the development of the North. The South made up only 27 percent of GDP, but 32 percent of the tax base, while the North generated 48 percent of national wealth and paid only 40 percent of the nation's taxes (Mack Smith 1997: 81).[3] Due to a much larger agricultural base in the South, higher taxes on grain disproportionately affected the South, while the North benefited the most from public spending. Since bread was a staple of the Southern Italian diet, increased taxes on grain also hit Southern peasants the hardest (Carter 2010: 211). The North's political dominance meant that it controlled decisions on taxation and public spending, which favored citizens in the North and extracted important resources through taxation from the South, exacerbating the North–South economic divide. For example, between 1862 and 1897, 455 million lire was spent on landfills in Northern and Central Italy, while only 3 million lire was spent on such resources in the South. The majority of school and railway **(p.112)** spending was also concentrated in the North. Development in the South certainly suffered after unification, and, as a result, so did the Southerners' relationship to the newly formed state. Figure 5.2 illustrates the rapid decline in Southern (Mezzogiorno) per capita income as a percentage of Northern per capita income after the Risorgimento. These differences in economic development, investment, and taxation led to a sense of unfairness and distrust in the South, and hence to less willingness to pay taxes.

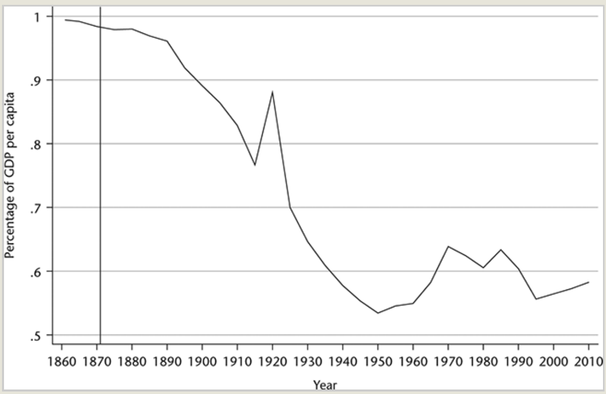

Figure 5.2. GDP per capita in the Mezzogiorno as a percentage of Northern GDP per capita

Source: Bianchi et al. (2011). Note: the vertical line represents unification.

As the South was becoming further separated from the North economically, there was an important debate taking place regarding the fiscal state. Italy's history with foreign occupation instilled a sense of distrust of state power, which shaped the structure of fiscal institutions. It was thought that the government should never collect more than 5 percent to 10 percent of gross national product in taxes; the fiscal system would be based upon private rights, not public, and a system of laws, not authority; furthermore, the tax system would first and foremost respect the fundamental right of property. This last idea severely hampered the administration's ability to put together a land registry and has had long-lasting effects on the capacity of revenue officials to collect taxes, especially from the self-employed and entrepreneurs (Manestra 2010).

However, claims that the tax burden was too high were not solely the result of a liberal environment, but also an excessive tax burden. The early **(p.113)** foundations of the Italian state exerted a massive tax burden on a population that was cautious of the state and citizens of neighboring regions. According to Manestra (2010), the tax burden was approximately 10 percent higher than in Great Britain as a result of a series of wars that did not have wide consensus among Italy's diverse population.

Toward the end of the nineteenth century, the Giolitti government set out to reform the tax system, but in the end the administration was unsuccessful, leaving federal, regional, and local taxes relatively unchanged. This was a problem not only at the legislative level; problems existed at the administrative level as well, largely related to difficulties in implementing the new national cadaster (compare this to the situation described by Marina Nistotskaya and Michelle D'Arcy in Sweden, Chapter 2 in this volume). Furthermore, local administrations were reluctant to update their lists of taxpayers, given that their organizations were made up of taxpayers themselves (Manestra 2010). Tax authorities also found it difficult to sanction taxpayers, as tax commissions were often biased in favor of the taxpayer, largely as a result of the excessive tax burden, exceeding 50 percent. In addition, the tax administration had difficulty proving the incomes of the self-employed and other professionals (Manestra 2010). Taken together, this three-dimensional relationship between administration (tax burden), the state (structure), and ideas such as distrust and caution amongst the populace, fostered tax non-compliance very early on. Corrado Gini (1962) echoes this when he claims that poor economic conditions, an inherent lack of respect for the state, low administrative salaries, inconsistencies in tax law, and an interpretation of private law were all drivers of low tax compliance.

In addition to administrative difficulties, I suggest that the dynamics between political parties also had an important impact on taxpayer behavior. By the turn of the twentieth century, rising fears of socialism and a large labor movement in the North made Catholics and right-wing liberals strange bedfellows. The Catholic Church and right-wing liberals, after the turn of the century, made a conscious effort to build civic associations as an alternative to a socialist workers' movement. This played an important role in driving civic consciousness and institutional development in Northern and Central Italy in the years immediately after World War I. By contrast, the lack of any significant industrial labor force in the South hampered political competition and inhibited the formation of efficient public institutions or a civic-oriented populace. Tarrow (1967: 168–9) argues that at the time of unification, "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.” In other words, rather than having a political choice, poor Southern peasants became dependent on their clientelistic relationships with local elites. The provision of individualized goods from **(p.114)** patrons to clients inhibited the foundation of a civic-oriented populace. Here we begin to see the beginnings of two separate equilibria. I characterize the North as moving toward a high-trust/high-efficiency equilibrium shaped by political competition and a strong industrial base, while the South’s low-trust/low-efficiency equilibrium was formed by the state’s neglect of the South and consequential clientelistic relationships.

The rise of a Catholic political party (the Italian People’s Party, Partito Popolare Italiano) after 1914 marked the beginning of Catholic mainstreaming in Italian politics and challenged the dominance of the ruling party in the North. Because the state had almost completely dismantled organized Catholicism in the South in the early twentieth century, support for the Italian People’s Party came mainly from the Northern regions of Italy. Pope Benedict XV, Pope Pius’ successor, immediately reversed his predecessor’s anti-modernization policies, such as banning Catholic trade unionism, while improving the Church’s 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 Italy, bitterly dividing the old ruling class and paving the way for outside parties such as the People’s Party and the Socialist Party (Partito Socialista Italiano). These two parties took a combined total of more than half of the legislative seats in the election of 1919. Only in the South did the “old government” parties (Liberal Democrats, Partito Liberale Democratico) win more than half the votes. This was largely the result of the practice of *trasformismo*, in which ruling parties won over the opposition party in return for political and, often, financial favors. The old-guard liberals, especially in the South, made use of public resources for both individual and political gain.

Political strife in Italy only further divided the North and South along party lines. As a result of the 1919 election, 146 of the 156 Socialist deputies came from the North and central regions; 76 of the 100 People’s Party deputies were also from the North; and 162 of the 239 deputies from the Liberal Party and the Radical Party (Partito Radicale), who had previously dominated parliament, were elected in the South. Although this election resulted in the first “Radical” government, led by Francesco Nitti, political turmoil between the Radicals, Socialists, and Fascists led to Nitti’s resignation and the return of the Liberal Democrat Giolitti as prime minister in 1920. When elections were called again in 1921, the Giolitti government’s hegemony was tenuous. To solidify his control, he made 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 **(p.115)** immediate resignation, to be followed by a string of short-lived prime ministers and the eventual rise of Fascist leader Benito Mussolini.

In sum, the early twentieth century in Italy was marked by deep divisions between the North and South. These divisions were economic as well as political. The government extracted high taxes from the South to address its debts from the Risorgimento and develop the North. Political parties competed for the burgeoning industrial labor movement in the North by providing and building effective public services. The South, on the other hand, was ruled by the old ruling partly (liberals), who enjoyed a large political monopoly. By providing public jobs and financial favors to the landed elite through *trasformismo*, the ruling party maintained its hegemony in the South, marginalizing Southern citizens from the political process.

The Fascist Period

Here, I argue that the rise of Fascism reversed the Northern progress toward a high-efficiency/high-trust equilibrium, and even furthered Southern resentment toward the state. The Fascist period can be characterized by two main approaches to building effective administrative capabilities and public services across Italy: an attempt to modernize the tax system with a series of uniform tax reforms and a series of public investments that had the unintended effect of increasing the North–South economic divide. To dampen some of the more negative consequences of the administration's policies, the government funneled money through quasi-state organizations, strengthening clientelism in the South. Whereas in the North, the high-compliance environment began to unravel due to an authoritarian state and a second world war, clientelism hardened the low-compliance environment in the South.

Tax reform during the Fascist period involved three separate methods. The first, liberal tax reform in the early Fascist period (1922–5), provided preferential tax treatment to productive industries with the misguided expectation that these industries would then comply with existing tax law. After this reform failed, Mussolini shifted from liberal tax policies to an authoritarian model, where he would stigmatize and penalize evaders. He declared tax evaders "the worst parasites in the nation" and increased tax enforcement between 1926 and 1929 (Manestra 2010: 29). However, the corporatist economic model and increased foreign commitments, such as the Italian–Ethiopian War in the 1930s, which diverted administrative resources, led him to restrain the more authoritarian aspects of the administration's tax policy, which demanded a large amount of administrative oversight. This **(p.116)** led the administration back to the more liberal, cooperative model of the 1922–5 period, especially with respect to businesses. Mussolini's industrial policy further accentuated economic divisions.

Although tax and administration reform are important aspects of any successful attempt to increase tax compliance, Mussolini's complete disregard for the South exacerbated the economic divisions between the North and South and therefore the differences in their tax compliance environments. Economic asymmetries and disproportional public investment generated a feeling of unfairness and distrust in the economic system, both of which reinforced the low compliance. Mussolini's industrial policy accentuated economic divisions between the North and the South by concentrating economic development in engineering, steelworks, chemicals, and hydro-electricity supply—all industries located in the industrial triangle of the Northwest. Almost half of industrial workers and two-thirds of engineers worked in Lombardy, Liguria, and Piedmont, while the majority of workers from the South were farmers and artisans (Clark 1996). 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. Because of the North's large industrial base, unionized workers were able to lobby for and win larger pensions than the average Southern Italian peasant. This contributed to patronage and clientelistic practices as a means of income supplementation in the South. Clients would directly exchange their votes for public employment and favorable tax treatment (Ferrera 1996).

Moreover, Mussolini's push to project Italy as an international power had adverse consequences for the Southern economy. Mussolini implemented a revaluation of the lira in 1926 to project Italy's position, which reduced wages and sharply increased unemployment, largely in the agricultural South (Neville 2014). In the late 1920s through the early 1930s, Mussolini increased tariffs on wheat, which amounted to a large concession to landowners, who gained the most from the government policies, whereas Southern peasants were hit the hardest. To lessen the damage in the South, the administration funneled jobs through *parastati*, quasi-governmental agencies that dealt with health, welfare, and pensions. Distribution through quasi-governmental agencies then became the most important criterion for resource distribution (Walston 1988).

Fascism only enlarged the economic and social disparity in Italy, and especially in Southern Italy. Moreover, Fascism's antidemocratic foundation and its overwhelming reliance on the state as the center of individual life reversed the virtuous circle in the North, while increasing discontent in the South due to the state's general neglect of that region. This had the effect of generating low trust and low compliance across the peninsula.

(p.117) The First Republic

The period after World War II brought great, but asymmetric, prosperity to Italy. Just as during the previous period, political competition among the Christian Democrats, the Socialists, and the Communists (Partito Communista Italiano) led to major public works and investment in Northern Italy, while the Christian

Democrat political monopoly in the South intensified clientelistic networks. Although the central government invested heavily in the South beginning in 1950 with a Fund for the South (*Cassa per il mezzogiorno*), the implementation of the fund was greatly affected by clientelism. In 1970, regional governments were established, further exacerbating the underlying issues in the South. Regional governments were granted more autonomy and discretion in the distribution of resources, especially financial resources, which they could then funnel to private interests. While clientelism became stronger in the South as a result, one of the largest corruption scandals in Italian history unfolded in the North. Widespread distrust in the governing parties brought down the government and led to the Second Republic.

After World War II, Italian citizens were polarized both economically and ideologically. In the period 1944–6, Sicilian farmers formed a movement aimed at secession from the North, which led to a June 2, 1946 popular vote pitting the Italian dynasty (the monarchy ruled by Humbert II of Savoy) 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 (Gilmour 2011; Pollard 1998). In 1946, tensions between the Communists and the Christian Democrats presented another challenge to national unity: while the Communist Party was closely tied to the Soviets, aid and investment from the US government and US firms influenced the Christian Democrats and the Alcide De Gasperi government.

The 1947 Italian Constitution, however, showed remarkable levels of compromise between the parties, reflecting also a deep distrust in the state. The Italian Constitution, first and foremost, protects the individual from the state, which has unintentionally hindered the ability of the tax administration to collect taxes. Article 53 states: “all shall contribute to public expenditure in accordance with their means.” Consequently, assessing an individual’s means accurately is an arduous process. The intended effect, however, was to associate taxes with an individual’s moral sensibilities. Referring to the tax reforms, Vanoni elegantly stated in the House of Deputies (Resoconti parlamentari 1948: 3744):

> In our country there is often the feeling that tax evasion has become a way of life … the individual almost considers it a legitimate form of defense against an imposition he considers detrimental to their sphere of individual action … tax **(p.118)** evasion takes on the characteristics of real and substantial anarchy, a negation of the first requirements of social life and is precisely why it seems irrepressible to get to a system in which there is neither justification, nor moral, nor techniques for evasion, and that leads to more open condemnation, moral rather than legal, for the evader.

Vanoni thus sees tax evasion within this context-specific equilibrium. The legitimate fear that the state will infringe on individual rights reflects the historical circumstances specific to the Italian taxpayer.

Between the new Finance Minister Enzio Vanoni and his colleagues there was wide consensus that administrative reform was the most pressing issue regarding taxation. Cesare Cosciani (1950) argued that the history of the tax system was plagued by irrationality perpetuated by a legislature that created an overabundance of laws that only specialists could understand. With past failures in administration in mind, Vanoni implemented broad, but incremental, tax reform, emphasizing taxation as a democratic responsibility. On January 11, 1951 under Finance Minister Vanoni the Republic passed the largest tax reform since the Fascist period, known as the *Legge Vanoni* (Vanoni Law). The law had four main features: (1) taxpayers—both employees and the 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 (Ambrosetti 2004).

Vanoni’s measures, especially those addressing mutual trust between taxpayer and administration, did not outlive his term, however. Audits actually became more inefficient and tax investigators were increasingly underpaid compared to private tax accountants (Manestra 2010). In 1959, the administration began raising rates on everything from capital gains to self-employed income. As a result, taxpayers increasingly came to disrespect the administrators or tax collectors. Therefore, highly paid tax accountants, who are paid to keep taxes low for their clients, were in direct conflict with an underpaid and under-appreciated tax administration. Administrators were at a clear disadvantage.

Though the 1950s marked the beginning of approximately two decades of great prosperity, data provided by Clark (1996: 357) depicts Southern Italy as similar to many underdeveloped countries, but much larger in population and territory than most. The disparities between the North and the South were so considerable and evident that the state instituted the Fund for the South, a rural spending agency providing roads, housing, and water to rural areas. Although the “Italian Economic Miracle” led to a convergence of incomes, with Southern income reaching approximately 70 percent of the national average, the Fund also established large fiscal transfers from North to South and significant migration flows from South to North. This fueled cultural stereotypes and out-group resentments.

(p.119) The “economic miracle” and a massive injection of state spending on welfare (education and healthcare) significantly increased the living standards of the average 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 highly skilled 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 had become a major force in Italian politics encompassing nearly 50 percent 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 by 39 percent those experienced by British and German firms, profits tapered off significantly by the end of the decade. Both the extreme right and left responded to the crisis with political terrorism, including assassinations and kidnappings.

Weak public institutions, such as an unstable parliament and a constitution that severely hampered administration, the resilience of strong informal institutions, such as clientelism, and economic downturn reinforced this low-trust/low-efficiency equilibrium. From unification to Fascism, followed by the First Republic through the end of the economic miracle, we can observe several recurring themes in which the administration attempts to address low tax compliance by reorganizing tax administration, but without addressing the underlying defects of the tax system. New laws were stacked upon old laws, and new taxes were introduced to pay for wars and social programs. The tax system became increasingly more complicated and incomprehensible to the vast majority of taxpayers, further decreasing trust in a severely underfunded administration. Not only was there a lack of trust between taxpayers and the administration, but strong regional resentment stemming from long-standing cultural stereotypes lingered, and even proliferated, as a result of migration patterns, economic insecurities, and fiscal transfers. And once again, Italians were concerned about political crises and, consequently, political terrorism. These institutional and political dynamics structured the way in which Italians viewed their state and fellow citizens, consolidating the low-compliance environment.

From the Tax Reform of 1972 to the Present

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 **(p.120)** agencies, draw up regional development plans, and organize their own cooperatives. However, as Clark writes, these regional governments fed the Calabrian Mafia (*ndrangheta*) and the Neapolitan *camorra*, with local barons 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” (1996: 392). Further unsuccessful attempts to curb tax evasion led to tougher sanctions on taxpayers and large tax reforms. However, a large aspect of these reforms concerned tax amnesty programs and a new Sector Studies program, both of which only furthered the low-compliance environment. Finally, in the early 1990s large-scale corruption was uncovered, bringing down the government and ushering in the era of Silvio Berlusconi—a renowned tax evader himself.

After the introduction of regional governments in 1970, important legislation was introduced to reform the tax system. Tax reform introduced in 1973 by the Minister of Finance, Luigi Preti, 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. The basic foundation of these reforms rested on the same principles as previous tax reforms: administrative changes, especially reducing a bloated bureaucracy and the numerous superfluous laws; and improving how the administration calculated taxable income. 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 VAT.

The state even attempted to revert to a more authoritarian regime—tough sanctions and stigmatization—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 increased penalties. Prior to *manette agli evasori*, a judge could not indict an offender before there was undeniable proof of evasion (Santoro 2010), which, as I noted above, was an arduous process since the burden of proof was the responsibility of the investigators. *Manette agli evasori* resulted in an overburdened judicial system and a series of amnesty programs. As Manestra (2010: 42) states, "handcuffs for all, became handcuffs for no one." 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 location 951–2).

Additionally, tax amnesties and the inability to punish decreased compliance by influencing the compliance environment and social norms (Alm, McKee, **(p.121)** and Beck 1990). Nonetheless, the Italian tax administration has relied heavily on amnesties since unification. According to Manestra (2010), there were eighty-three separate amnesties between 1900 and 2002, and between the 1970 tax reform and 2002 a form of tax amnesty was used every year. One of the major defects of repeated amnesty is it decreases the amount of risk associated with evasion. If potential evaders foresee an amnesty in the future, they will likely underreport their income. The use of amnesty was so common that tax evasion became a safe way to increase one's income, as illustrated by the responses from the 2004 Bank of Italy Survey of Household Wealth. When asked about their opinion on tax amnesties, 50 percent of respondents said they were unfair, compared to 36 percent who said they were a good policy. In another question participants were asked what they believed the outcome of amnesty to be; 32 percent responded, “tax evasion increases because the amnesty rewards tax evaders and discourages honest taxpayers” and 30 percent said, “tax evasion doesn’t change because once tax evaders have regularized their past position, they begin to evade tax again until the next amnesty.”[4]

Following the 1973 reform, there were three main approaches that shaped the 1990s tax reform bill, according to Manestra (2010). The most important aspect of these procedural changes was reforming the way in which small businesses fulfilled their accounting obligations. Structural changes attempted to fix the major sources of tax revenue, mainly VAT and direct taxes. Finally, quantitative reform set out to address the number of taxes, especially on sources of income. The less punitive Law 154/1991 and Law 74/2000 replaced *manette agli evasori*. As was common throughout the neoliberal era, tax reform in this period reduced tax rates while broadening the taxable base. However, income tax evasion actually increased after implementation of the tax reform through 1978, decreasing slightly in 1978–80, but never falling below 33.7 percent in this period.[5]

The most important feature of the 1990s tax reform was the adoption of *Studi di Settore* (Sector Studies) in 1998. Due to the large size of the self-employed and small-business sectors, focusing on this particular aspect of the economy was an important step forward for the administration. While most countries collect various data on individuals and companies, then place them into homogeneous populations based on those characteristics with minimum expected incomes, Italy is rare in that it actually makes this data available to the taxpayer before they file their taxes. Moreover, published minimum expected incomes are first negotiated between the tax administration and taxpayer representatives, such as the Consiglio Nazionale dell’Economia e del Lavoro (CNEL). Sector Studies came out of the recognition that the main driver of tax evasion in Italy was its particular economic structure, but the small-business sector’s clout with government officials was so great that Sector Studies actually resulted in a more favorable situation for most taxpayers.

(p.122) It is easy to predict the outcome of a policy that informs taxpayers of their expected minimum income level. As Bergman (2009: 10) elegantly argued, “People maximize utilities inasmuch as they pay as little taxes as they can. But the environment in which people operate fundamentally shapes how they frame the maximization benefits.” Hence, those who make above the expected minimum will reduce their income to match the mandatory minimum, while those who earn below the minimum will either risk being audited, which is very likely, and bear those costs, or they will increase their income to avoid the legal costs of an audit. The societal effect of this is also significant. If it is known that small businesses and the self-employed can easily avoid taxes, the ripple effects will weigh heavily on the Italian tax system.

The continual unsuccessful attempts to fix the tax system, coupled with a series of corruption scandals that would eventually bring down Italy's national government, only exasperated the low-trust equilibrium. The largest corruption case, *Tangentopoli* (Bribesville), exposed a number of high-ranking public officials (half of parliament) for acts of bribery and led to the so-called "Second Republic" and the prominence of Silvio Berlusconi—a billionaire businessman who came in as a political outsider profiting from the lack of trust and promising to reduce taxes. He also was later convicted of tax evasion. The vicious circle that Steinmo discusses in the Introduction to this volume is evident throughout Italian history. An inefficient, corrupt, or a perceived-to-be-illegitimate state shapes a climate of distrust, rendering tax collection troublesome. Thus, the efficient provision of public goods becomes increasingly more difficult, reinforcing this low-trust/low-efficiency environment, and, in that, low tax compliance.

Discussion and Conclusions

Walk into any bar in Italy and you will likely hear someone lamenting their high taxes, poor public services, and corrupt politicians. The compliance environment is a direct reflection of this. Indeed, taxes are often a major topic of national conversation. The fight against tax evasion in Italy goes back long before Italy was a unified nation. In fact, aspects of Italian life that we often take for granted are often the result of some clever way of circumventing tax laws. For example, a salt tax in twelfth-century Pisa persuaded Florentines to stop using salt when baking bread—an unfortunate trend that continues to this day. It has also been suggested that the beautiful Triulli buildings in Puglia were built with dry walls and without mortar to allow settlers to easily dismantle them when the "taxman" came. Furthermore, tax evasion has historically been so rampant that Mussolini famously claimed that tax evaders are the worst parasites on earth. Similarly, former Prime **(p.123)** Minister Mario Monti asked his fellow citizens to stop referring to tax evaders as *furbi*, meaning clever. Unfortunately, these references tend to lend weight to the amoral familial approach.

However, the flaw in the amoral familialist argument leads us back to the complexities this study 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 periods and institutions that have influenced the relationship between state and citizen.

The Risorgimento clearly had significant repercussions for Northern and Southern institutions and, in that, defined two different patterns of taxpayer behavior. I have argued that Southern Italians perceived the North as a distinct entity apart from themselves, and even as colonizers, while the North embraced calls from liberals for a unified nation state. Because the North was politically dominant, the South was expected to contribute a disproportionate amount of revenue to fund public works projects largely going to the North.

The rise of socialism and a socialist workers' movement in the North forced Catholics and right-wing liberals to join forces in direct competition to the socialists for the growing working class. While the South was left neglected by the political class, clientelism became deeply ingrained into the Southern way of life. In the North, political competition helped shape functioning public institutions and a thriving labor movement. This put the North on track to form a high-trust/high-efficiency equilibrium, while a low-trust/low-efficiency environment was established in the South.

The advent of Fascism altered the North's course, however. Unification, two world wars and Fascism shaped the compliance environment in both the North and South. After the fall of Fascism and the end of World War II, a deep distrust in the state was further reflected in the new Republic's constitution. An underlying fear that the government would infringe personal freedom and rights made tax collection increasingly difficult. This led to several tax reforms, most of which had very little effect on the compliance environment. Moreover, many of the more intrusive policies that would have resulted in increased controls were deemed unconstitutional. The administration thus felt handcuffed by certain institutional arrangements, rendering their only option a number of amnesty programs.

These amnesty programs merely deepened the low-compliance environment, making it increasingly difficult to enforce existing tax laws. The administration, realizing that the main source of evasion was the self-employed and small-business sectors, implemented a series of reforms called *Studi dei Settore* in the late 1990s. However, due to the political power of this particularly large sector of the economy, the reform ended up benefiting the taxpayer instead of **(p.124)** the administration. Since then, the administration has attempted to fix some of the underlying problems with the tax system through pre-populated tax returns and a push to settle tax disputes out of court. Figures suggest that revenue as a result of these measures has increased.

Social norms and equilibria are sticky. Apart from major punctuations in the environment, change is usually incremental. Therefore, Italian policymakers must address the underlying features of the low-trust/low-efficiency compliance environment. What is it that is driving this contagious behavior? How can policymakers address the metaphorical elephant in the room (the self-employed and small businesses) while at the same time fixing underlying economic issues? Vanoni had impeccable foresight when he said that administration reform must be implemented in a way that considers tax compliance as part of a holistic approach, accounting for not only the administration, but also the institutional (both formal and informal) environment. Benchmarking and learning from other European countries such as Sweden regarding these issues could be a step forward in creating a new taxpayer equilibrium.

(p.125) References

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Notes:

(1.) In the Northern regions from Lombardy to Lazio, evasion of the regional tax on production (Imposta Regionale sulle Attivita Produttive, IRAP) ranges from about 13 percent to 54 percent; in the South (the Mezzogiorno), covering Molise to Sicily, it ranges from about 55 percent to 94 percent (see Figure 5.1). It is worth noting that both Liguria and Abruzzo do not conform to the expected North–South pattern. Abruzzo performs just slightly worse on The Quality of

Government index (see Table 5.1) than Liguria, but the percentage of self-employed in Liguria is approximately one percent higher according to Istat (see http://noi-italia.istat.it/). The combination of lower-than-average quality of government and a high rate of self-employed individuals in Liguria could explain this unexpected result. In addition, Tuscany, Umbria, and Marche all have higher rates of self-employed individuals than Abruzzo.

(2.) Italians' perception of one another varies across regions. See Putnam, Leonardi, and Nanetti (1994); Tabellini (2010).

(3.) The center made up the remaining 28 percent of GDP.

(4.) www.bancaditalia.it/statistiche/tematiche/indagini-famiglie-imprese/bilanci-famiglie/documentazione/index.html.

(5.) The figures are cumulative figures of evasion and avoidance rates for employees, agricultural workers, manufacturing, and the self-employed, calculated by Bernardi (1989); Visco (1984a; 1984b; 1992); and Vitaletti (1984) using data on taxable incomes provided by Istat. A more detailed table, aggregated by type of employment, can be found in Manestra (2010).