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## TAX MORALE IN SERBIA: STYLIZED FACTS AND POLICY CONSIDERATIONS

Poreski moral u Srbiji – stilizovane činjenice i politike

### Abstract

Tax morale is a set of intrinsic, non-monetary factors that shape people's willingness to pay taxes even in the absence of coercion. Empirical studies show that close to a third of the variation in the shadow economy and tax evasion between countries can be explained by factors related to tax morale. This paper outlines stylized facts about tax morale in Serbia, measured using internationally comparable data from the seventh wave of the European Values Survey (EVS) 2017-2022. According to these results, about 78 percent of people in Serbia report a high level of tax morale – 9 percentage points below the EU average and 4.5 percentage points lower than the rest of Central and Eastern Europe (CEE), which ranks Serbia 25<sup>th</sup> among 31 European countries. The level of tax morale depends on formal and informal institutions – the most important being trust in the government and satisfaction with the quality of public goods and services. EVS data indicate that the degree of citizens' trust in the government and the public sector in Serbia is close to the European median, and slightly below the EU and the CEE average. On the other hand, the World Bank data on the quality of governance show that the index of government effectiveness (which indicates the quality of public goods and services) in Serbia, which rose until 2017, is still significantly below the EU and CEE average – Serbia is ranked 30<sup>th</sup> among 36 European countries. For a more significant step forward in improving tax morale in Serbia in the long run, it is necessary to take systematic and comprehensive action in the direction of improving the quality and availability of public goods and services, enhancing the trust in the government through strengthening institutions and the rule of law, improving the fairness of the public finance system, increasing investment in fundamental public services such as education and health care, eliminating tax amnesties, and upholding a value system based on honesty.

**Keywords:** *investments, savings, economic growth, economic policy, tax morale, shadow economy, public finance*

### Sažetak

Poreski moral predstavlja skup unutrašnjih, nemonetarnih faktora koji oblikuju spremnost ljudi da plaćaju porez čak i kada ne bi postojala prinuda od strane države. Empirijska istraživanja pokazuju da se gotovo trećina varijacije u sivoj ekonomiji i utaji poreza između zemalja može objasniti faktorima povezanim sa poreskim moralom. U ovom radu predstavljene su i analizirane stilizovane činjenice o poreskom moralu u Srbiji, merenom na bazi međunarodno uporedivih podataka sedmog talasa Evropske ankete o vrednosnim stavovima (EAVS) 2017-2022. Prema tim rezultatima oko 78 odsto ljudi u Srbiji iskazuje visok stepen poreskog morala, što je za 9 procentnih poena ispod proseka EU i za 4,5 procentnih poena niže od proseka Centralne i Istočne Evrope (CIE), čime se Srbija svrstava na 25. mesto među 31 evropskom zemljom. Nivo poreskog morala zavisi od neformalnih, kao i formalnih institucija – od čega posebno značajan uticaj imaju poverenje u državu i zadovoljstvo kvalitetom javnih dobara i usluga. Podaci iz EAVS ukazuju da je stepen poverenja građana u državu, odnosno javni sektor u Srbiji približan evropskoj medijani, a tek nešto ispod proseka EU i CIE. S druge strane, podaci Svetske banke o kvalitetu upravljanja ukazuju da je indeks zadovoljstva ispitanika efektivnošću javnog sektora (kojim se meri kvalitet javnih dobara i usluga) u Srbiji, koji je rastao do 2017. godine, i dalje znatno ispod proseka EU i CIE, tako da je po vrednosti ovog indikatora Srbija rangirana na 30. mestu, među 36 evropskih zemalja. Za osetniji iskorak u unapređenju poreskog morala u Srbiji u dugom roku, neophodno je sistemsko i sveobuhvatno delovanje u pravcu unapređenja kvaliteta i dostupnosti javnih dobara i usluga, jačanje poverenja u državu kroz osnaživanje institucija i afirmaciju vladavine prava, unapređenje pravičnosti sistema javnih finansija, te povećanje ulaganja u fundamentalne javne usluge poput obrazovanja i zdravstvene zaštite, prestanak prakse sprovođenja poreskih amnestija i afirmaciju sistema vrednosti zasnovanog na poštenju.

**Ključne reči:** *investicije, štednja, ekonomski rast, ekonomska politika, poreski moral, siva ekonomija, javne finansije*

## Introduction

The efficient collection of tax revenues, which minimizes the shadow economy and tax evasion, is of fundamental importance for the sustainability of public finances and economic growth. According to the neoclassical economic model, tax evasion (and the shadow economy, which is mostly motivated by tax-savings reasons) is regarded as a matter of rational choice under uncertainty, with people balancing the benefits of evasion (tax savings, which are proportionate to the level of tax burden) and expected costs of evasion (fines a taxpayer would face if detected, which depends on the probability of detection and statutory fines). Therefore, according to this approach, the shadow economy and tax evasion depend on the level of tax burden, the efficiency of tax enforcement (probability of detection) and statutory fines, with individual's risk aversion also playing an important role. However, empirical studies have shown that the estimated level of tax evasion and the shadow economy based on these factors would be significantly lower than the actual level, which means that other factors, beyond those encompassed by the rational choice model matter too. In that respect, behavioural economics offers significant insights, suggesting that, to some extent, people are willing to pay their taxes regardless of enforcement, which refers to tax morale. Tax morale is an intrinsic, non-monetary set of motives that drive people to pay taxes, i.e. their willingness to pay taxes even if there was no enforcement mechanism. Empirical literature indicates that between 20% and 30% of the variation in the level of the shadow economy and tax evasion across countries may be attributed to the differences in the level of tax morale in those countries, suggesting that it is a relevant phenomenon and an important determinant of tax evasion decision and the shadow economy [25].

The shadow economy in Serbia was on decline since the mid-2010s, due to some policy reforms (digitalization and strengthening of Tax Administration, improvement in coordination across audit agencies, reform of the penalty policy, mild cut in the labour tax wedge, flexibilization of labour market institutions, etc.) and some secular trends (decrease in unemployment, cashless transition, change in the structure of the retail sector, etc.). In spite of a

considerable decrease, the shadow economy in Serbia is still relatively pronounced, with estimates ranging from 21.1% to 23.6% of GDP [13]. To make further progress in reducing the shadow economy, it is of fundamental importance to continue reforming and strengthening the Tax Administration and other rule-of-law institutions [12]. However, in addition to that, a policy action in terms of reinforcing tax morale in that respect may also play a significant role. In that sense, the aim of this paper is to provide empirical stylized facts and policy analysis with respect to strengthening tax morale in Serbia. The topic of reducing the shadow economy gained an additional importance in the aftermath of the COVID-19 pandemic, when countries widened their deficits considerably, with substantial impact on their debt levels [19].

The level of tax morale and its determinants are usually evaluated by means of laboratory experiments or social surveys. In this study, tax morale in Serbia is evaluated using data from the seventh wave of the World Values Survey (WVS)/European Values Survey (EVS), 2017-2022, conducted on a representative sample of more than 2.5 thousand 18+ individuals. The results suggest that around 78% of people in Serbia declare a substantial degree of tax morale, arguing that it is unjustifiable to cheat on taxes, which is 9 percentage points below the EU-27 average and 4.5 percentage points lower than the Central and Eastern Europe (CEE) average. Serbia ranks 25th in Europe according to the declared level of tax morale, among 31 European countries for which the comparable WVS/EVS data are available. After a sharp decline in the late 2000s, the reported level of tax morale in Serbia rebounded in the latest wave of the WVS/EVS, but only to the levels reported in the early 2000s. This means that over the last 25 years there was no substantial improvement in the overall level of tax morale in Serbia. Mapping the tax morale data from WVS/EVS suggests that declared level of tax morale in Serbia is higher among elderly people than among younger generations, also being higher among women than among men. Reported tax morale is also higher among retired people and those who are fully employed than among the unemployed or those working part-time. In terms of the sector of occupation, the tax morale indicator is higher among civil servants

than among those working in the private or NGO sectors. Finally, the declared level of tax morale tends to decline as education and income levels rise.

Out of the three sets of determinants of tax morale (formal and informal institutions, and socioeconomic characteristics), only formal institutions are under the government's direct influence in the short and mid-run. According to the WVS/EVS data on trust in government (in broader terms – encompassing many segments of the public sector), Serbia is close to the European median in terms of the overall trust in government, lagging only slightly behind the EU-27 and CEE averages. The second relevant driver of tax morale – satisfaction of people with public goods and services is measured using the World Governance Indicator on government effectiveness. The results show that the value of this indicator for Serbia in 2023 was considerably below the EU-27 and the CEE average, thus Serbia being ranked 30th in Europe, with only six countries having weaker performance in that respect. The data also show that government effectiveness, as measured by this indicator, was rising in Serbia until 2017 but has stagnated since then, thus indicating a modest satisfaction of people with the availability and quality of public goods and services. For a pronounced step forward in the development of tax morale in Serbia, a systemic and comprehensive policy action is needed, focusing on strengthening both formal and informal institutions, with the particular focus on improving the quality and availability of public goods and services and the rule of law.

The rest of this paper is organized as follows. Section 2 provides theoretical and conceptual considerations with respect to tax morale and the shadow economy. In Section 3, the determinants of tax morale are evaluated through a review of the respective empirical literature. Section 4 outlines the methodology and data used in this paper for the evaluation of tax morale in Serbia, while Section 5 provides the statistical results and discussion of the size, dynamics, and drivers of tax morale in Serbia. Section 6 concludes and provides a menu of policy options that can be used for a systemic improvement in tax morale in Serbia.

## Tax Morale and the Shadow Economy

Government intervention in an economy is justified when it can result in an increase in overall social welfare, which is the case with the provision of public goods, regulation of externalities, or correction of market imperfections (e.g. information asymmetry and negative selection; moral hazard). Considering the social, technological and economic changes the world has faced in the last century, the functions of government have been expanding beyond the rule of law, defence and provision of basic infrastructure, to include the government intervention in education, social security (pension, health and unemployment insurance), industrial policies, etc. Consequently, the size of government and the volume of government spending in Europe increased substantially, from below 10% of GDP at the beginning of the 20th century to 40-50% of GDP at the end of the 20th century, which is the volume of spending in most European governments nowadays as well. The rise in government spending required a proportionate increase in tax revenues to ensure the sustainability of public finance. This is why tax systems expanded by adding new types of taxes – personal income tax and general consumption tax being added in most countries in the first half of the 20th century, while tax rates were substantially increased.

An increase in the number of taxes and a rise in the level of tax burden may be associated with the reluctance of taxpayers to pay taxes duly, especially if there is no effective system of tax enforcement. In that respect, under the neoclassical approach, tax evasion decision is modelled within the framework of rational choice under uncertainty. This means that the tax evasion decision is a matter of rational choice made by individuals, considering the benefits of evasion (savings in taxes, which directly depend on tax rates) and the costs of evasion (fine/penalty they would be facing if detected, which depends on the probability of detection and legal penalty scheme). Therefore, under the neoclassical approach [1], the volume of tax evasion depends on the level of taxes (the higher the tax rates, the higher the evasion will be), the statutory penalties (the higher the fines and penalties, the lower the tax evasion) and the probability of detection, which reflects the efficiency of tax administration (the higher the probability, the lower the tax evasion). In addition, the propensity to evade may

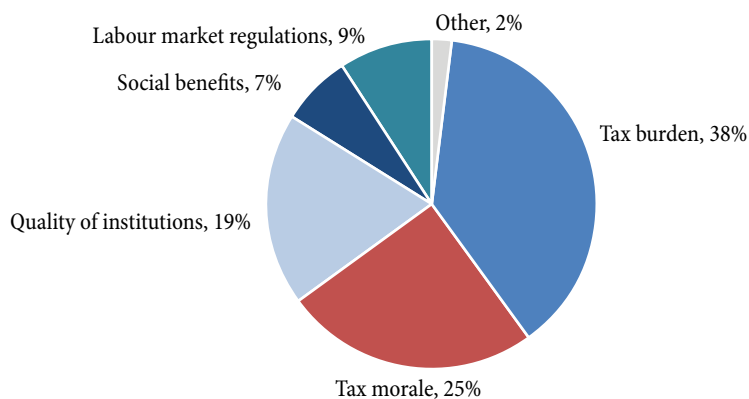
depend on the level of a taxpayer’s income, with the sign of the impact of income on tax evasion being dependent on the individual’s risk aversion.

Although the neoclassical approach (Allingham-Sandmo model) provides a coherent framework for the analysis of tax evasion decisions, empirical studies have shown that the volume of tax evasion in developed countries, when estimated based on actual rational choice parameters (tax burden, probability of detection, fines, risk aversion), would be substantially below the actual volume of tax evasion, which means that a significant fraction of tax evasion decision can be attributed to the other factors beyond those encompassed by the neoclassical model. Building on this, the behavioural approach to tax evasion analysis emerged, with the two sets of models: i) models not based on expected utility, and ii) models based on social effects. Under the first set of models (not based on expected utility), tax evasion decisions also depend on ambiguity in terms of the probability of detection. On the other hand, in the later set of models (based on social effects), tax evasion decision is not regarded as an individual’s mere utility maximization under uncertainty, thus pointing out the importance of social and cultural factors in shaping tax evasion/compliance decision. Under this model, an individual’s tax evasion decision is considered as a trade-off between private interests (tax costs) and both private and public interests (provision of public goods). Therefore, models based on social effects imply that tax evasion decision is also influenced by a taxpayer’s intrinsic views and motives with respect to tax compliance [21], thus laying the groundwork for the

identification of tax morale. In that respect, tax morale is defined as the set of intrinsic, non-monetary motives that drive people to comply and pay taxes, beyond the factors encompassed by the neoclassical approach [15]. In other words, tax morale reflects the willingness of people to pay taxes voluntarily.

The shadow economy refers to legal economic activities that are done informally, outside official records, with savings in tax costs and other regulatory costs being the main motives to do transaction informally. Therefore, it is regarded that the factors shaping the tax evasion decision also fundamentally drive the size of the shadow economy. The relevance of tax morale as a determinant of tax evasion and the shadow economy is confirmed by many empirical studies. In the paper by Torgler and Schneider, it has been shown that the correlation between tax morale and the shadow economy in Europe is significant, with considerable negative elasticity between the two phenomena [24]. Similarly, [10] has shown that an increase in tax morale by 0.05 percentage points is associated with a decrease in the shadow economy by around 2.8 percent of GDP. According to many empirical studies, the shadow economy in Europe ranges from around 10% of GDP in Western and Northern Europe to more than 30% of GDP in Central and Eastern Europe [13]. If the shadow economy and tax evasion decision was only a matter of maximizing expected utility, the variation in the shadow economy across European countries could be explained by differences in tax burden, probability of detections, fines policy, and risk aversion across those countries. However, the differences between European countries in

**Figure 1: Determinants of variation in the shadow economy**



Source: [23], author’s calculations

terms of these parameters are not large enough to explain such a substantial variation in the shadow economy and tax evasion, which means that other factors matter too. According to [25], 20-30% of the variation in the shadow economy and tax evasion between countries may be attributed to differences in tax morale, which points to the relevance and policy importance of this concept. In their study [24], Torgler and Schneider summarized the results of 12 studies on the shadow economy across the countries, with tax morale being the second largest driver, explaining around 25% of the variation in the shadow economy across the countries (Figure 1).

### Determinants of Tax Morale: A Literature Review

As it is empirically confirmed that tax morale can substantially influence tax evasion decisions, the next question refers to the transmission mechanism through which tax morale impacts the shadow economy and tax evasion, which is an important precondition for identifying the direct determinants of tax morale. In this regard, sociological, economic and political studies have identified three sets of mechanisms through which tax morale may shape the shadow economy and tax evasion decision [15]: i) Intrinsic motivation – altruism, pride, self-respect and other positive feelings associated with honest behaviour and compliance, ii) Reciprocity – treating tax payment as part of the social contract, which implies that taxpayers pay their taxes and receive in exchange a set of goods and services from the government sector; iii) Social norms – the willingness of people to pay taxes influenced by the prevailing social norm, meaning that if it is unacceptable to cheat the government by underpaying taxes, non-compliance imposes psychological costs, reinforcing tax morale and encouraging tax payment.

Further to the theoretical and empirical literature, tax morale is a multidimensional issue shaped by many factors, which can be grouped based on different criteria. As the aim of this study is to evaluate tax morale in Serbia and outline policy recommendations aimed at strengthening tax morale, the direct determinants of tax morale will be classified into three categories: formal institutions, informal institutions, and socioeconomic characteristics

of the society. While formal institutions can be largely influenced by government policies, the impact of policies on informal institutions is weaker, with some effects being attainable, though only in the long run. Finally, in most empirical studies, socioeconomic characteristics are treated as a vector of control variables.

### Formal Institutions and Tax Morale

Formal institutions encompass the established laws, regulations, and procedures that structure political, economic, and social interactions within a society. Considering the above-mentioned reciprocity principle, in line with the social contract, citizens perceive taxes as their payments to the government for the provision of a wide range of public goods and services. In this regard, people's willingness to fulfil their obligations under this social contract will fundamentally depend on:

*a) Trust in government* – According to many empirical studies, trust in government in a broader sense (in the cabinet of ministers, presidency, parliament, judiciary, police, public officials, tax administration, political parties, etc.) is one of the key drivers of tax morale (see: [11]). With an increase in their trust in government, citizens become more convinced that the government's obligations under the social contract will be met, which raises their willingness to pay taxes.

*b) Government effectiveness and quality of public goods and services* – A large body of empirical research suggests that tax morale depends on the perceived fairness and effectiveness of the government [3]. Higher effectiveness of government spending implies enhanced availability and quality of public goods and services provided by the government. Therefore, higher effectiveness of government spending is associated with greater satisfaction of citizens with the availability and quality of public goods and services, which may encourage them to deliver on their part of the social contract – i.e. to pay taxes. In addition, government transparency provides an additional assurance to taxpayers regarding the effectiveness of government spending, which is also expected to have an incentivizing impact on tax compliance.

c) *Perception of fairness of the public finance system* – The willingness of people to pay for public goods and services also largely depends on their perception of the fairness of the public finance system, including horizontal and vertical equity in the distribution of tax burden, fairness in the allocation of government spending, and fairness and transparency in tax enforcement (see: [11]). Linked to that, it is also evident that the overall willingness of people to pay taxes is negatively affected by the degree of economic inequality in a society [26], which means that the design of tax and benefits policies that effectively reduce economic inequality may yield a dividend in terms of an increase in tax morale. Empirical studies on Serbian businesses suggest that negative evaluation of the tax authorities by businesses is associated with lower tax morale, which means that an improvement in taxpayers' perception of the tax authorities' activities could result in an increase in tax morale and tax compliance ([17]).

d) *Strength of the relationship between government and citizens* – As the financing and production of public goods is a matter of collective decision-making with substantial redistributive effects, the willingness of people to pay taxes is expected to rise if public decisions are made by the authorities closer to the citizens (e.g. local governments), as well as if citizens have a stronger feeling that they actively participate in the decision-making process. In this regard, there is a set of empirical studies suggesting that tax morale is positively linked with the degree of decentralization in the country as well as with the frequency of referenda [23]. For example, according to [16], *ceteris paribus*, in the Swiss cantons with more frequent referenda, tax evasion is lower by around 30% in comparison to the cantons in which referenda are held less frequently.

### Informal Institutions and Tax Morale

Informal institutions refer to the socially shared unwritten norms, values and beliefs. As individuals act and live as part of social groups, many economic and social decisions are made by taking into account the prevailing norms, values and beliefs in society, because violating social norms may result in internal sanctions (such as shame,

guilt, etc.) or external penalties (such as social stigma). In that respect, empirical literature suggests that informal institutions may shape tax morale, in several manners:

a) *Culture* – Culture is seen as a broad set of social norms that are rather persistent over time [15], which may shape the behaviour of people in different aspects, including tax evasion decision. For example, study by [6] points to the different level of tax morale in the East and West Germany, attributing that to cultural differences. Similarly, [14] found that the tax morale of first-generation immigrants to Europe, exhibited in the host country, is strongly linked to the tax morale in their country of origin.

b) *Patriotism* – A sense of belonging, national pride and (profound) patriotism increase the psychological costs of tax evasion, with a positive impact on tax morale and tax compliance in general [20]. Although the link between patriotism and tax morale is stable, it is non-linear, with a significant rise in tax morale in the episodes of collective threats (such as wars, natural disasters, etc.).

c) *Religion* – There is compelling empirical evidence that the degree of religiosity in society is closely (positively) linked to the level of tax morale [22], although there is no evidence of variation of the degree of tax morale across mainstream religions (see: [11]).

d) *Sense of community* – A stronger feeling of belonging to the community, social responsibility and civic participation also increase the psychological costs of evasion, which is why they are positively related to the level of tax morale in society [4].

e) *Peer behaviour and societal trust* – The attitude of individuals towards (non)compliance is also shaped by the prevailing behaviour of their peers. If there is a strong level of trust in society (i.e. there are social norms which imply that untrustworthy behaviour is stigmatized), it will also have a positive impact on the overall level of tax morale [4], [11].

### Socioeconomic Characteristics and Tax Morale

In addition to the factors that directly shape people's stance towards tax evasion, compliance decision may also be shaped by socioeconomic and demographic characteristics of the population. In that respect, empirical studies (summarized

in: [11]) suggest that there is a significant variation in tax morale across age (elderly people reporting higher levels of tax morale), gender (women exhibiting higher tax morale than men), marital status (married people reporting stronger tax morale than single), income (tax morale being positively linked to economic status and life satisfaction), employment status (full-time employees and pensioners showing a higher degree of tax morale than self-employed or unemployed individuals). The impact of education on tax morale can be ambivalent – while education raises awareness of the importance of paying taxes for the provision of public goods, it also develops critical thinking skills, making more educated people more likely to spot government spending inefficiencies [2]. Nevertheless, the results of several econometric studies suggest that the positive impact of education on tax morale prevails. Apart from basic socioeconomic and demographic characteristics, tax morale is also positively associated with the degree of personal moral integrity and the degree of support for democracy, while higher aversion to ethnic diversity is linked to lower tax morale.

### Measurement of Tax Morale: Methodology and Data

Being an intangible phenomenon, tax morale cannot be measured directly but can rather be indirectly estimated. In the economic literature, there are two approaches to estimating tax morale: i) laboratory experiments, or ii) surveys.

The willingness of people to pay taxes or to evade them is fundamentally linked to the well-known “free rider” problem, which is a concept describing the propensity of people to maximize their own utility by paying less for public goods than the value these goods provide to them, expecting that other people will pay for public goods and services. The results of laboratory experiments [5] show that, on average, people would voluntarily contribute about 50% of the full amount for the provision of public goods, which means that free rider problem is pronounced, but also suggests that people show a considerable degree of tax morale. The experimental results also suggest that tax morale decreases with an increase in the total

number of taxpayers, while the possibility for taxpayers to communicate with each other before starting the game encourages cooperation. It is also shown that tax morale declines when the opportunity cost of giving increases.

Considering the limitations of experiments, tax morale is more often evaluated by means of representative surveys. In this respect, most empirical studies use data from the World Values Survey (WVS), European Values Survey (EVS) or other surveys (Life in Transition Survey; European Social Survey, etc.). The WVS is a global survey on people’s values and beliefs across different countries, which started in 1981 and has since become one of the most widely used cross-national and time-series surveys, covering more than 60 countries. Thus far, there have been seven waves of WVS, with the most recent one covering the period 2017-2022. The WVS and EVS measure tax morale through a question asking people whether cheating on taxes is justifiable – respondents provide their answer by selecting an option on the Likert scale from 1 to 10 (1 – never justifiable; 10 – always justifiable). This means that a lower mean value of the indicator implies a higher degree of tax morale. Although surveys provide useful insights into people’s values and beliefs, the results should be interpreted with caution, considering the general limitations of surveys, primarily related to the issues connected with honesty of survey participants when providing answers to sensitive questions.

In this study, tax morale in Serbia is measured using data from the 7th wave of the WVS/EVS (2017-2022). The survey was conducted on a representative (full probability) sample of the population aged 18 years and older, with 2,566 individuals providing answers to the questions on tax morale. The survey was done by means of face-to-face interviews.

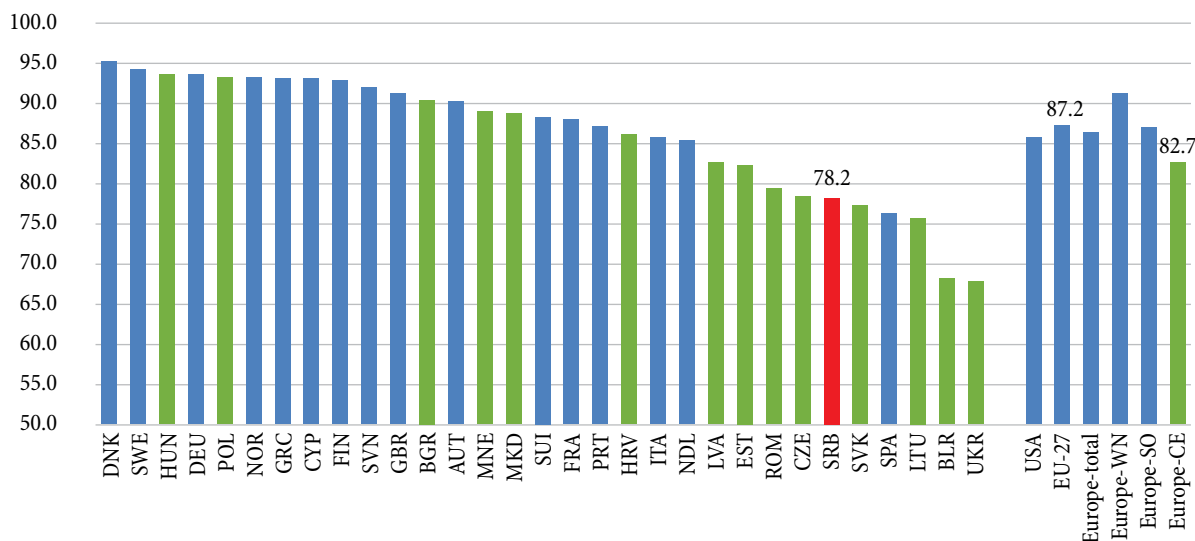
### Tax Morale in Serbia

#### Stylized facts

##### *a) Level of tax morale*

According to the WVS/EVS data, close to 64% of people in Serbia indicated that cheating on taxes is never justifiable, while the share of those who reported that cheating on

Figure 2: Tax morale 1a – Share of the population who believe that cheating on taxes is mostly not justifiable (%)



Source: Author's calculations using the WVS/EVS data

taxes is either never justifiable or mostly unjustifiable stood at around 78% of respondents, with the mean answer being 2.56 (Table 1).<sup>1</sup>

Table 1: Tax morale in Serbia – Is cheating on taxes justifiable?

	Total (%)	Cumulative (%)
1 - Never justifiable	63.9	63.9
2	6.8	70.7
3	4.2	74.9
4	3.3	78.2
5	4	82.2
6	2	84.2
7	2.1	86.3
8	1.6	87.9
9	0.8	88.7
10 - Always justifiable	7.7	96.4
Don't know	1.9	98.3
No answer	1.7	100.0
Mean	2.56	
Std Dev.	2.81	
(N)	2566	

Source: WVS/EVS Database and author's calculations

When compared to other European countries (Figure 2), Serbia ranks 25<sup>th</sup> among 31 European countries in terms of the reported level of tax morale. The share of respondents who reported a substantial degree of tax morale in Serbia (78.2%) is 9 percentage points lower than

the EU-27 average and 4.5 percentage points lower than the Central and Eastern Europe (Europe-CE) average.<sup>2</sup>

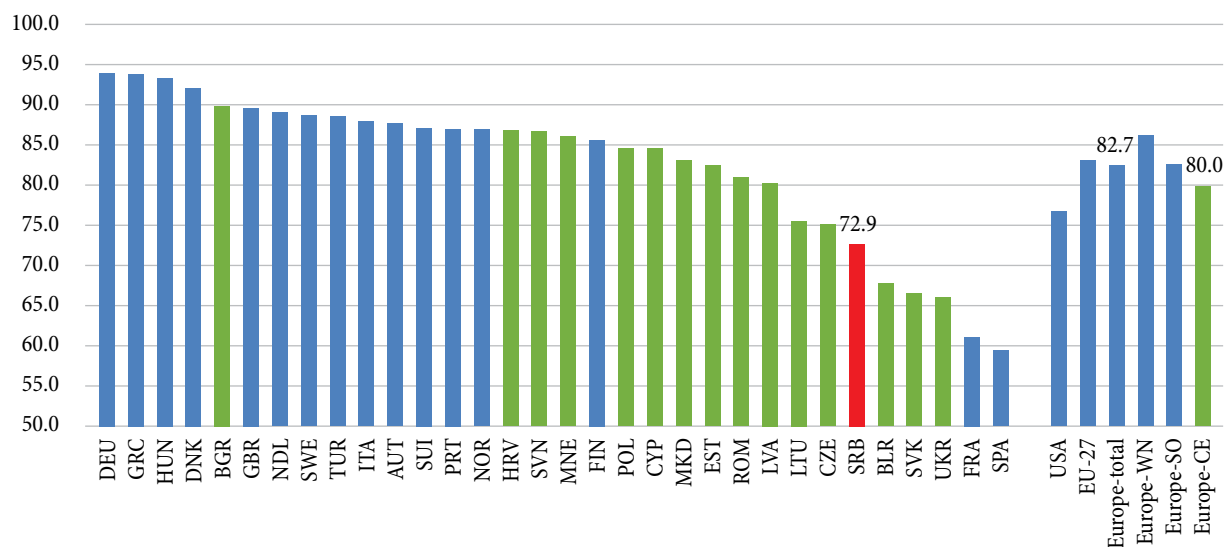
In a broader context, WVS/EVS data suggest that reported level of tax morale is higher in developed European countries (Europe-WN), somewhat lower in Southern Europe, and the lowest in the CEE. This is in line with findings from other empirical studies, which suggest that tax morale is lower in Eastern Europe compared to Western Europe, which is explained by the institutional crisis experienced by ex-communist economies [9].

As questions on taxes are regarded as sensitive, it is useful to conduct a robustness check of the results using an alternative (control) question. Since social benefits provided by the government can be treated as negative taxes, the control question on tax morale is based on the people's attitude toward claiming government benefits. The results (Figure 3) indicate that 72.9% of survey participants in Serbia reported that claiming government benefits to which they are not entitled is not justified, which ranks Serbia 25<sup>th</sup> among the 31 European countries. The reported degree of tax morale in Serbia, based on the alternative indicator, is lower than the Europe average by 9.8 percentage points, while being lower than the CEE average by 7.1 percentage points.

1 For the purpose of this analysis, tax morale, in due course, will be measured by the share of the population who reported that cheating on taxes is never justifiable or mostly unjustifiable (i.e. those who opted for options 1-4 on the Likert scale).

2 For the purpose of this analysis, all 31 European countries are grouped into three cohorts: Western and Northern Europe (Europe-WN), Southern Europe (Europe-SO) and Central and Eastern Europe (Europe-CE).

**Figure 3: Tax morale 1b – Share of the population who believe that claiming government benefits to which you are not entitled is mostly not justifiable (%)**



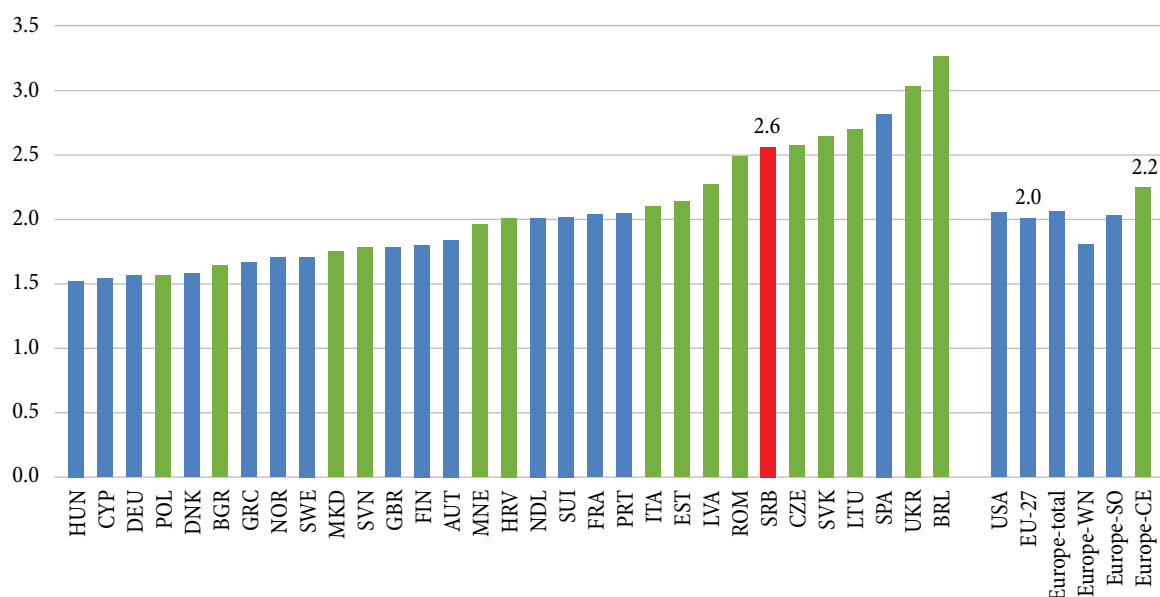
Source: Author's calculations using the WVVS/EVS data

An additional way to measure the degree of tax morale in Serbia, in comparative terms, is to calculate the mean answer on the Likert scale, with a lower mean value implying a higher degree of tax morale. According to the results, for the question on cheating on taxes (Figure 4), the mean value for Serbia stood at 2.56, which is 0.6 percentage points higher than the EU-27 average and 0.4 percentage points higher than the CEE average. Only six European countries reported a higher mean value of

this indicator, thus indicating a lower level of tax morale than in Serbia.

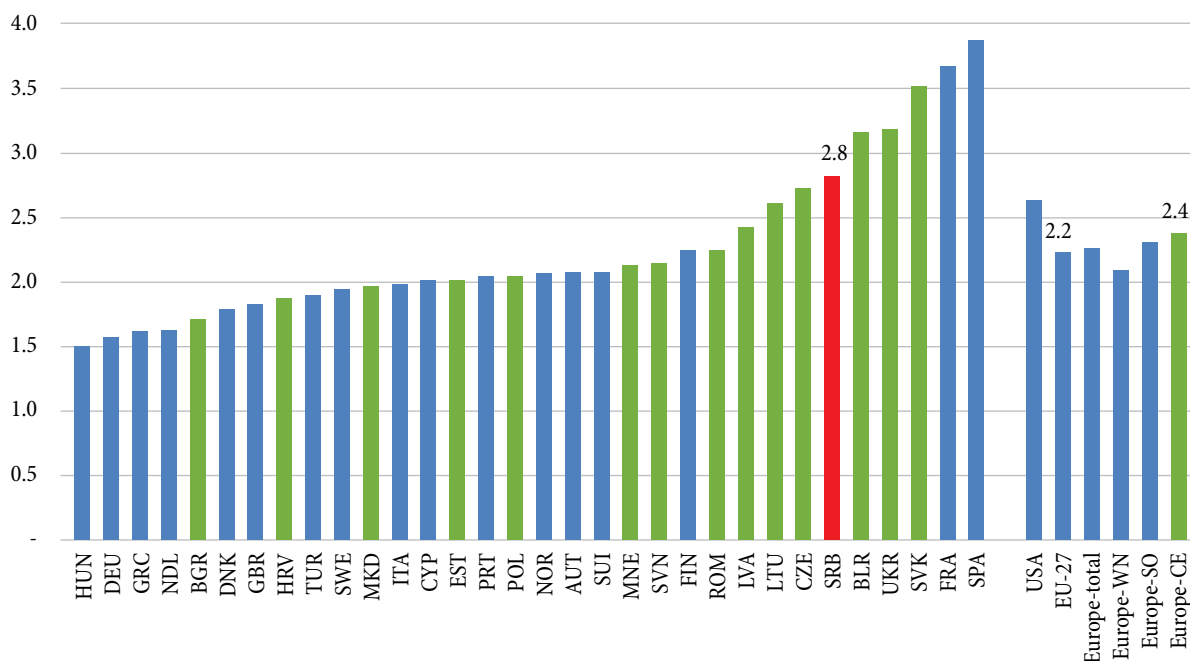
Relatively similar results are obtained based on the mean value of the answer to the question on claiming government benefits without meeting the eligibility criteria. The mean value for Serbia on this indicator stood at 2.8, which is 0.6 percentage points higher than the EU-27 average and 0.4 percentage points above the CEE average (Figure 5).

**Figure 4: Tax morale 2a – To what extent is it justifiable to cheat on taxes? 1 - never justified; 10 - always justified (mean value)**



Source: Author's calculations using the WVVS/EVS data

Figure 5: Tax morale 2b – To what extent is it justifiable to claim government benefits to which you are not entitled? 1 - never justified; 10 - always justified (mean value)



Source: Author's calculations using the WVS/EVS data

*b) Trends in tax morale*

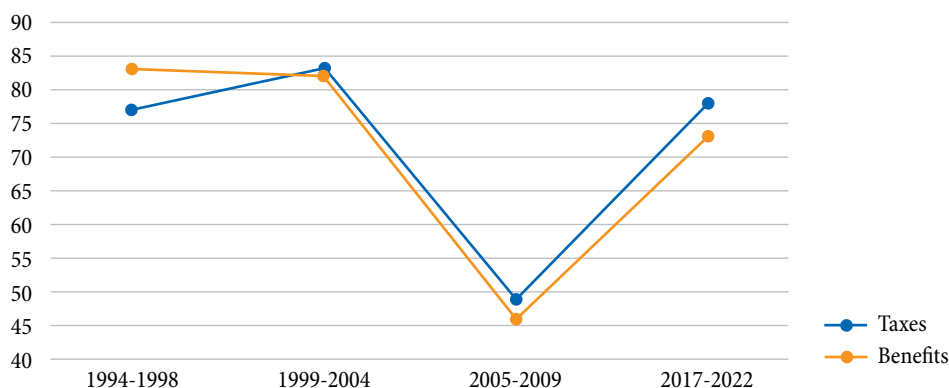
Since Serbia participated in four waves of WVS/EVS, the data on tax morale are available for four periods, which allows for the evaluation of trends in the reported tax morale. Building on the available data (Figure 6), the reported level of tax morale showed a slight increase or stagnation (depending on the indicator) in the early 2000s, followed by a substantial decline at the end of that decade. Finally, the reported level of tax morale in the fourth wave (2017-2022) rose substantially, thus getting closer to the levels reported in the early 2000s. The presented data indicate that over the last quarter-century, there was

no improvement in the reported degree of tax morale in Serbia, as both indicators in the fourth wave fall short of their respective values in the first wave.

*c) Mapping tax morale*

Calculating the reported degree of tax morale by socio-economic and demographic cohorts can provide valuable insights for understanding tax morale and for tailoring the policies aimed at strengthening it. Pursuant to the results (Table 2 and Table 3), elderly people in Serbia report a higher degree of tax morale, which may be explained by their risk aversion as well as by the fact that many of them

Figure 6: Tax morale trends in Serbia – Share of the population who believe that cheating on taxes or benefits is not justifiable (%)



Source: Author's calculations using the WVS/EVS data

are direct beneficiaries of government services (healthcare, the pension system, etc.). This finding, which is rather robust for both indicators of tax morale (tax-based and benefits-based), is also in line with findings in empirical studies on other countries.

With respect to gender, women in Serbia report a somewhat higher level of tax morale, rather than men, which may be explained by women's higher degree of risk aversion, linked to the fact that they are more often supported family members. In terms of the marital status, married individuals in Serbia show a higher degree of tax morale compared to singles, which could be explained by the fact that married people often feel more bound by the social norms (as they share the responsibility for their family).

In terms of the labour market status, the results indicate that retired people, as well as those who are full-time employed, declare a higher degree of tax morale in comparison to the unemployed or part-time employed

**Table 2: Tax morale 1a – Share of the population in Serbia who believe that cheating on taxes is never justifiable or mostly unjustifiable – by socio-economic and demographic characteristics**

		Never justifiable (%)	Mostly unjustifiable (%)	Mean
Age	16-29	48.2	65.8	3.5
	30-49	61.6	76.5	2.8
	50+	72.8	85.0	2.0
Sex	Female	65.7	80.3	2.4
	Male	62.0	76.1	2.7
Marital status	Married	65.7	80.4	2.4
	Single	54.9	71.1	3.1
Labor market status	Full-time employed	63.1	77.0	2.7
	Part-time employed	30.4	64.2	3.9
	Self-employed	65.3	71.8	3.0
	Unemployed	59.4	78.7	2.5
	Retired	76.2	87.6	1.9
Sector of employment	Government	63.7	79.5	2.6
	Private	64.2	77.7	2.7
	NGO	64.8	81.7	2.5
Education	Lower	71	85.1	2.1
	Middle	62.8	76.1	2.6
	Higher	55.7	72.4	3.2
Income level	Lower	72.8	84.4	2.1
	Middle	57.8	72.5	3.0
	Higher	68.6	82.8	2.3
Urban-rural	Urban	63.5	77.8	2.7
	Rural	65.0	79.4	2.3

Source: Author's calculations using the WVS/EVS data

individuals. It should be noted that, according to the tax-based indicator, self-employed individuals report higher tax morale than those who are full-time employed, which is in contradiction to findings for other countries. On the other hand, according to the benefits-based indicator, the reported degree of tax morale of self-employed persons in Serbia is somewhat lower than that of full-time employed individuals. At the same time, people employed in the government sector report a higher level of tax morale than those who work in private and NGO sectors, which can be explained by the fact that civil servants are aware that their salaries depend on overall tax compliance. In addition, those working in private and NGO sectors often have more flexible arrangements (working part-time or freelancing), which may also shape their stance towards tax morale.

Regarding the role of education and income, the results indicate that individuals with higher levels of

**Table 3: Tax morale 1a – Share of the population in Serbia who believe that it is never justifiable or mostly unjustifiable to claim government benefits to which you are not entitled – by socio-economic characteristics**

		Never justifiable (%)	Mostly unjustifiable (%)	Mean
Age	16-29	44.2	62.7	3.5
	30-49	54.3	72.8	2.9
	50+	62.1	77.4	2.4
Sex	Female	55.9	73	2.8
	Male	55.9	73	2.8
Marital status	Married	56.8	74.3	2.7
	Single	51.7	69.1	3.0
Labor market status	Full-time employed	55.5	71.2	3.0
	Part-time employed	40	71.6	3.9
	Self-employed	52.4	74.4	3.0
	Unemployed	54.4	73.5	2.7
	Retired	61.9	78.4	2.4
Sector of employment	Government	54.9	71.4	3.0
	Private	55.2	72.8	2.9
	NGO	53.8	76.3	2.9
Education	Lower	64	80.9	2.2
	Middle	54	70.9	3.0
	Higher	47.4	65.1	3.5
Income level	Lower	62.5	81.6	2.3
	Middle	48.1	65.9	3.3
	Higher	65.6	79.3	2.4
Urban-rural	Urban	56.6	73.9	2.9
	Rural	54.3	70.6	2.7

Source: Author's calculations using the WVS/EVS data

education and higher incomes in Serbia report lower tax morale on average than those with lower education and income. A potential explanation for this could be that more educated people are more likely to identify inefficiencies in government spending and services, which may discourage them from tax compliance. Finally, individuals in rural areas report somewhat higher tax morale than those in urban areas, although the difference is relatively small.

Results presented in Table 2 and 3 show only the descriptive statistics (averages) by socioeconomic and demographic cohorts. To claim the causality between socioeconomic and demographic characteristics, econometric modelling would be required. However, even these results may provide tentative guidelines for government actions aimed at boosting the tax morale in Serbia. In this regard, the findings suggest that measures and policies to promote tax morale in Serbia should be more intensively targeted at younger cohorts, men and single people, as well as the unemployed, and those with higher education and higher incomes.

### Determinants of Tax Morale in Serbia

As discussed in Section 2, tax morale is shaped by formal and informal institutions as well as by socioeconomic

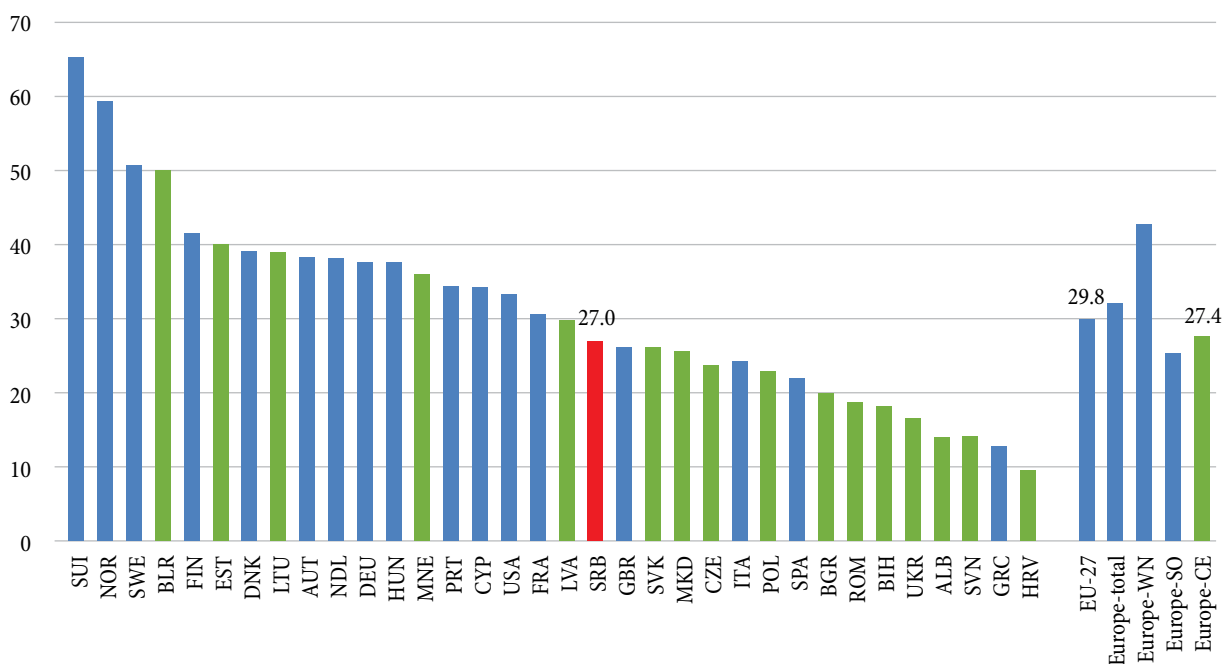
characteristics of the population. Since only formal institutions are under a direct influence of government, the analysis of the key determinants of tax morale in Serbia will be focused on factors linked to formal institutions. According to many empirical studies presented in Section 2, the trust in government and government effectiveness (i.e. people’s satisfaction with public goods and services) are two main institutional factors that shape the degree of tax morale. Therefore, this study will particularly focus on these two sets of factors.

#### a) Trust in government

Further to the results presented in Figure 7, around 27% of the population in Serbia declared having trust in the government in a broader sense, which is somewhat below the EU-27 average and close to the CEE average. This places Serbia near the European median in terms of citizens’ trust in government. Since Serbia’s performance in terms of tax morale is substantially lower than its trust in government, this may hint at the pronounced importance of other factors.

However, the analysis of citizens’ trust in particular branches of government in Serbia conveys a different message. According to the WWS data, the solid overall trust in government is mainly driven by high trust in the

Figure 7: Share of the population who fully or mostly trust in government, in Europe (%)



Source: Author’s calculations using the WWS/EVS data

army, universities and police (between 45% and 60%), while trust in the judiciary, cabinet of ministers and parliament is significantly lower (below 30%). Since the cabinet of ministers and parliament have a crucial role in shaping government spending policy, low confidence in those branches of government tends to discourage tax morale in Serbia.

### b) Government effectiveness

It is well established that higher government effectiveness, which results in the greater availability and quality of public goods and services, motivates people to pay taxes, thus boosting tax morale [3], [11]. One way to measure government effectiveness is to use the World Governance Indicator (WGI) on government effectiveness, which captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The WGI government effectiveness indicator may range from -2 to 2, with higher values indicating a higher degree of government effectiveness.

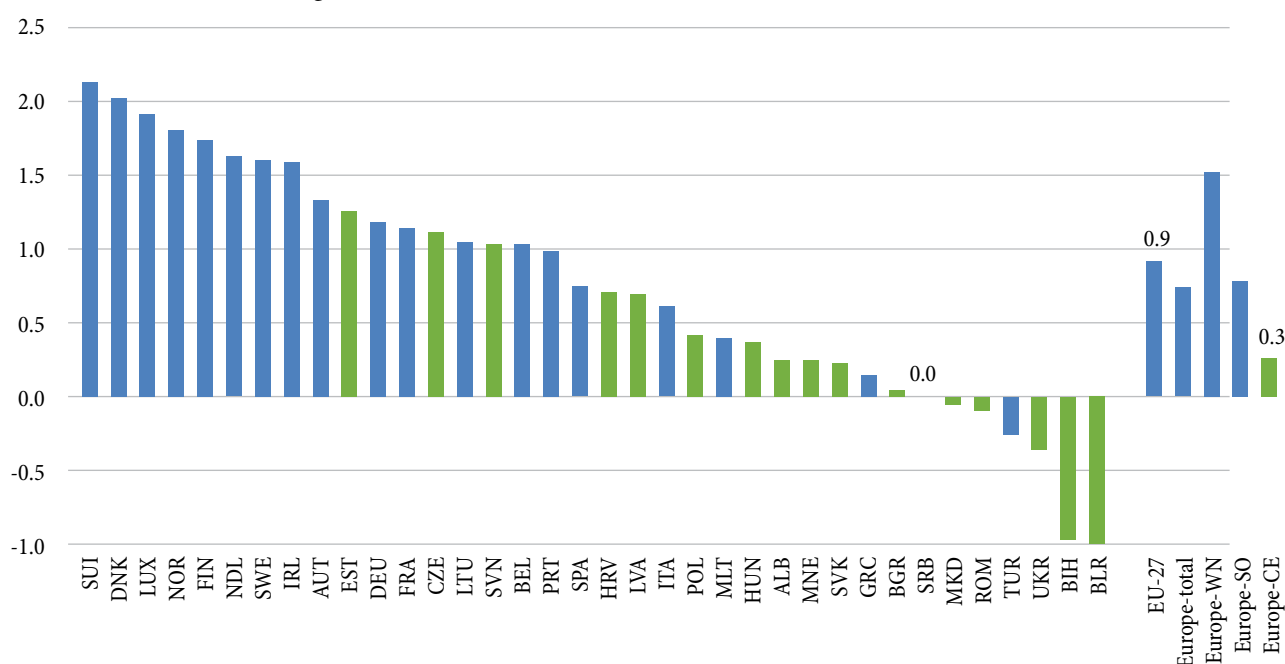
According to the results (Figure 8), in 2023, the value of the WGI government effectiveness indicator for

Serbia stood at 0, which is substantially below the EU-27 average (0.9) and the CEE average (0.3). With this score, Serbia ranked 30<sup>th</sup> in Europe, with only six countries having weaker performance in this regard. The data also show that government effectiveness, as measured by this indicator, was on the rise in Serbia until 2017, but has stagnated since then (Figure 9).

The results regarding government effectiveness align with Serbia's overall performance in terms of the declared level of tax morale, suggesting that a low level of satisfaction with the availability and quality of public goods and services is one of the key drivers of the modest level of tax morale in Serbia.

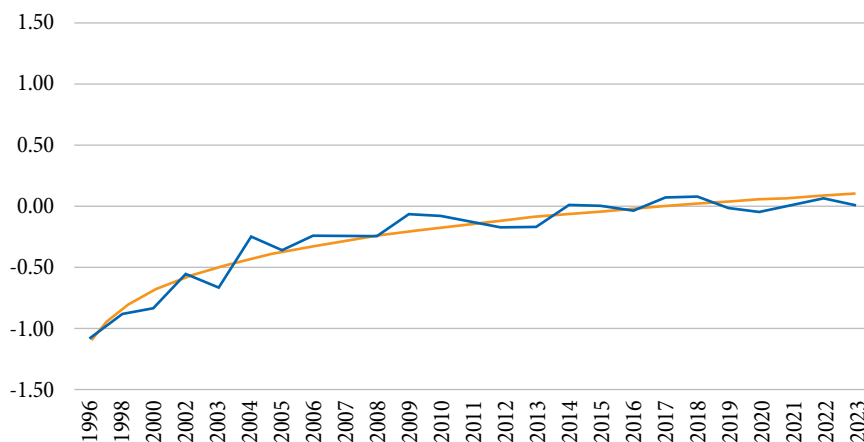
The EBRD's Life in Transition Survey database provides data on the willingness of people to pay more taxes for financing particular government functions, offering useful information on the citizens' perception of government priorities. This can yield important insights, as directing more funds to the government functions that are seen as priorities by citizens, may also promote their tax morale, i.e. stimulating them to pay more taxes. The results (Figure 10) show that taxpayers in Serbia see healthcare, the pension system, education and (means-tested) social benefits as priorities, which is why 55-65% of them are willing to pay more taxes for these services.

Figure 8: WGI – Government effectiveness index in 2023 (mean)



Source: Author's calculations using the World Governance Indicators Database (the World Bank)

Figure 9: Government effectiveness in Serbia, 1996-2023 (mean)



Source: Author's calculations using the World Governance Indicators Database (the World Bank)

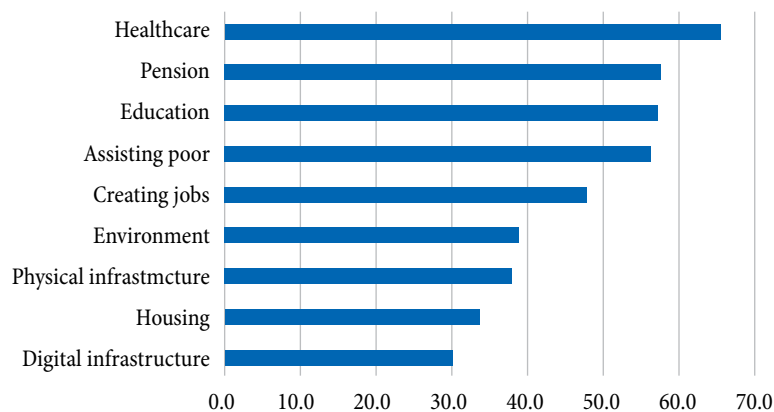
On the other hand, the propensity to pay more taxes for government spending aimed at creating new jobs, protecting the environment, developing physical and digital infrastructure and housing services is significantly lower.

### Concluding Remarks and Policy Considerations

According to recent empirical studies, the shadow economy in Serbia is estimated to be around 21-23% of GDP, depending on the estimation methods [18]. Although it has been declining over the last decade, the shadow economy in Serbia is still relatively pronounced compared to other EU countries, which has significant consequences for public finance and growth, considering that a sustainable budget balance is a prerequisite for the implementation and effectiveness of many other policy instruments [8]. Since (illegal) savings in tax costs are

the main motivation behind the shadow economy, policy measures aimed at reducing the shadow economy should focus on addressing the main drivers of tax evasion. In this respect, further improvement in the government's capacities for efficient tax enforcement is of fundamental importance. Empirical studies ([24] and [25]) suggest that tax morale is also a significant factor of the level of the shadow economy. The results presented in this study indicate that there is a considerable gap in the level of tax morale in Serbia in comparison to the EU and CEE averages. Therefore, it is concluded that coherent policy actions aimed at systematically strengthening tax morale could yield a significant impact on the reduction of the shadow economy and tax evasion in Serbia. Considering the multidimensional character of tax morale, the policy mix in that respect should also be multi-layered and long-term oriented, with a strong focus on the considerations discussed in due course.

Figure 10: Share of the population in Serbia who are willing to pay more taxes for government functions (%)



Source: Author's calculations using Life in Transition 2022-2023 data

*Strengthening the trust in government* – Enhancing the overall level of trust in the public sector, particularly in those branches of government which play a crucial role in designing, implementing and enforcing public policies (executive institutions, parliament, judiciary), is one of the crucial instruments for improving tax morale, as higher trust in government would provide assurance to taxpayers that tax revenues are to be spent efficiently and effectively. In this regard, each of these goals – strengthening the rule of law, improving the transparency of government institutions, tackling corruption, promoting democracy, and developing inclusive institutions – is considered a *condition sine qua non* for the effective enhancement of tax morale.

*Improving the availability and quality of public goods and services* – As citizens perceive taxes as the price they pay for a set of goods and services provided by the government, the improvement in the availability and quality of public goods and services is one of the crucial ways to encourage people to pay their taxes. Considering the findings presented in this study (Figure 10), strengthening government spending on healthcare, education, the pension system and assistance to the poor would be particularly appreciated by Serbian taxpayers. In addition to an increase in spending on these functions, the improvement in the efficiency of spending (allocation criteria, monitoring of implementation, etc.) is also important. Although investment in infrastructure is not perceived as one of the taxpayers' priorities, it is very important for economic growth. Therefore, to strengthen the growth perspective and encourage tax morale, it would be beneficial to keep public investments high, but with considerable improvement in terms of the system for selecting, contracting and implementing infrastructure projects. Only under these assumptions would higher government spending on infrastructure result in welfare-improving outcomes, with a positive impact on tax morale.

*Improving the transparency of government budget* – Informing citizens on the ways tax revenues are spent, in an effective and easy-to-understand manner, can considerably motivate taxpayers to pay their taxes. In that sense, publishing “the citizens' budget” (with illustrative and easily understandable data on the use of the government

budget) and sending it annually to all taxpayers could raise awareness among the public about the importance of paying taxes duly. In addition to the information on the purpose for which tax revenues are spent, this report could also provide information on Serbia's tax levels (relative to other European countries), in order to tackle the widespread view that taxes in Serbia are rather high, from the comparative perspective.

*Increasing fairness and equity of the tax-benefit system* – Empirical studies for other countries and survey results for Serbia suggest that the perception of fairness in the public finance system plays an important role in shaping citizens' stance towards tax compliance. In this regard, reforming the tax system to moderately enhance its vertical equity and redistributive effects, as well as strengthening means-tested social benefit programs targeted at the poor (rather than providing unconditional benefits to wider cohorts of population), may help promote tax morale among Serbian taxpayers.

*Slashing the practice of “tax amnesties”* – Tax amnesties refer to limited-time opportunities offered by governments to taxpayers with unpaid taxes, allowing them to settle their liabilities with reduced or no penalties. These amnesties aim to help governments recover unpaid taxes and encourage compliance, while providing taxpayers with a way to resolve their debts without harsh repercussions. In spite of that motive, the studies on this topic (see: [2]) suggest that tax amnesties typically do not yield significant positive effects on tax revenues but may rather have the opposite effect in the mid and long run, as offering tax amnesties sends a negative signal to taxpayers who have timely and duly settled their tax liabilities. In that respect, the government should occasionally reaffirm the message that tax amnesties will not be offered in the future.

*Improving public perception of the operations of law enforcement institutions* – Improving the perception of fairness and non-selective approach in the operations of law enforcement institutions may also play a significant role in promoting pro-compliance behaviour of people. In that respect, ensuring transparency in their activities and maintaining open communication with the public is very important.

*Strengthening pro-compliance social norms by means of informational tax nudges* – As outlined in this study, social norms substantially shape individuals' stance on tax compliance. Changing social norms is a complex task, for which a longer time perspective is needed. However, enhancing the perception of pro-compliance social norms could be achieved even in a shorter time frame. Taking into account insights from behavioural economics, one way to raise the awareness of the pro-compliance social norms is to use informational tax nudges, by sending an annual brief to all taxpayers stating, for example, that eight out of ten people in Serbia pay their taxes duly (with actual figures calculated using Tax Administration data).

*Developing horizontal and vertical trust in the society* – Many studies have pointed out that tax morale is higher in societies with greater societal trust. In order to raise the trust within the society, a comprehensive, persistent and long-run oriented approach is needed, with the focus on: promoting accountability and transparency in decision-making processes, involving citizens in the decision-making process through public consultations and participatory governance, encouraging ethical behaviour and integrity among leaders, maintaining open lines of communication between institutions and the public. In addition, penalizing untrustworthy behaviour (by means of legal instruments and stigma) is also important.

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