

## 8 Towards Greater Trust and Tax Compliance

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Coercive states may be successful in getting some things done (and clearly even the Russian government functions well enough so that it is not in danger of collapsing in the near future). However, the Polish–Russian–Ukrainian comparison suggests that a state that seeks to build up and to maintain trust with its citizens will be more effective than one that treats its citizens in a more coercive manner. And studying the origins of tax compliance in these countries shows that political parties, the relative strength of society versus the state, religious culture, legacies of corruption or the presence of a federalist structure do not exclusively explain why some transitional states are more capable of administering policy than others. Rather, it is the construction of a bureaucratic rational state oriented towards society, the use of constructive historical legacies when available and a focus on mutually cooperative citizen–state interactions that enable trust to build up between citizen and state so that state activity will be accomplished more successfully.

To alter fundamentally a legacy of poor state–society relations, a break from the past, afforded by a dramatic transition such as the 1989 and 1991 revolutions in Eastern Europe, provides a fresh opportunity for the state to construct a newer, healthier relationship built on mutual trust between state and citizen. States such as Russia in the 1990s that did not fully take advantage of such a unique opportunity may find that coercive measures suffice in the short term, but a fundamental overhaul of state–society relations may be necessary so that the state will function effectively for years to come. Authoritarian rule ended up not working out well for Russia in 1917 and in 1991. A return to more coercive measures today will not work out for Russia in the long run either.

In reaching such conclusions, this book has been about both *testing* existing theories on state capacity, drawn largely from the comparative politics literature, and *building* a new theory on state capacity, specific to post-communist states on both theoretical and empirical grounds. It also serves as a call for political scientists to engage in the study of

economic activities within states, specifically those that seek to evaluate how economic policies are implemented.

This project, thus, not only contributes to theoretical debates regarding the origins of capable states, but also discerns where, given limited resources, transitional states should focus their efforts in re-creating themselves in order to implement their own policies successfully.

Moreover, as Poland and Russia symbolize two contrasting routes of post-communist development and as Ukraine lies in the crossroads between the two (figuratively as well as geographically), this book takes up cases that are not just theoretically justified but also critically important for the global study of governance and development.

When governments are perceived as treating citizens unfairly and unequally, citizens' faith in the state is undermined. State and society need to be wedded to each other. Broader, mutually cooperative relationships between state and society lead to the accomplishment of state goals. In short, by focusing on taxation, this book seeks to make sophisticated analytical connections between the levels of civil society and the type of post-communist state that has emerged.

The aims of the research presented in this book have been threefold: At the meta-level, this study has sought to discern how a state transitions from a coercive state to a legal, legitimate tax state; at the macro-level, it has sought to determine how the Polish, Russian and Ukrainian states implement policies to ensure tax compliance; and at the micro-level, it has sought to establish what exactly is going on inside these countries that affects tax collection and, more broadly, governance.

In evaluating tax compliance, the project has employed qualitative process-tracing research methods – such as extensive documentary research and interviews with key informants to assess institutional design, organizational history and reform paths of bureaucracies – as well as unprecedented quantitative survey methods – through eight Taxpayer Compliance Attitudinal Surveys in Poland, Russia and Ukraine and the Public Officials Survey in Russia. While governments of all stripes can be very reluctant to provide data to independent researchers, the process of analyzing how institutions function on the ground can be particularly difficult in countries such as today's Russia, where bureaucracies are not especially transparent regarding what they do or how and why they do it. Nevertheless, this project has succeeded in obtaining data in such environments.

Comparing the origins of tax administration capacity for post-communist Poland, Russia and Ukraine clarifies the importance of building and maintaining a mutually trusting relationship between the state and its citizens. To be deemed trustworthy, the state must be viewed by

its citizens as being capable of fulfilling its obligations through the provision of goods and services and of treating citizens in a fair manner. Further, for citizens to be deemed trustworthy by their state, they not only must recognize what the duties of being a good citizen are, such as complying with tax laws, but also must individually be willing to carry such tasks out. Trust in the governed on the part of the government can build up as citizens respond to the state constructively when they deem the state to be trustworthy (and vice versa.) Further, such mutual trust will provide successful policy implementation to the benefit of all. Good governance requires both good citizens and a trustworthy state.

### **Testing the Three Theories on State Capacity**

In comparing the collection of taxes, three main theories on state capacity, drawn largely from the comparative politics literature – state capacity as a function of either political institutions such as parties, state–society relations or state structures – have been tested with respect to post-communist Poland, Russia and Ukraine. The first, regarding political parties, was shown not to be relevant. State–society relations and the structure of the state were found to be important for building state capacity in these three countries, but not precisely in the ways predicted by the second and third theories.

#### *State Capacity as a Function of Political Parties*

Chapter 3 showed, somewhat surprisingly, that political parties – how well they direct attention to the post-communist state organizations and civil service – need not play a substantial role in the construction of the capacity of state bureaucracies. With respect to examining the relevance of political parties to shaping the agenda and impacting the administrative structures significantly so that policy can be administered, Poland's relatively greater state capacity has not been due to a competitive political party system. While no governing party was re-elected in Poland from the first post-communist election in 1991 up until 2011, the party battles back and forth over civil service reform were not overly productive even as the tax service took shape.

Further, as described in Chapter 5, in interviews with several Polish personnel within six tax offices, three tax chambers, three tax audit offices and the finance ministry, bureaucrats continuously stated, 'We are civil service. We are not allied to parties.' Hence, the differences in governance levels in the three post-communist states are not due to the presence of stable, competitive political parties in Poland and the lack

of them in Russia and Ukraine. Strong political party influence is not necessary for constructing an effective bureaucratic rational state.

*State Capacity as a Function of State–Society Relations*

Among the core intuitions of the standard state–society literature is that governance depends on whether the society can be subordinated to the state or society is strong enough to resist or co-opt the state. Yet, despite the efforts at increased state control at the expense of society in Russia under President Vladimir Putin, governance is not stronger there than in Poland, where there are less of a divide between citizens and their government and less coercion.

In addition, certain cultural aspects also have been commonly viewed as important in distinguishing Russia’s state–society relationship from Poland’s. Yet, with respect to tax collection, the success of the Tax Administration Modernization Project in Nizhny Novgorod and Volgograd oblasts, as discussed in Chapter 5, indicated that once a part of the Russian tax service is given permission from Moscow to reform, renounces targets and introduces an audit-free tax collection system that requires greater trust of citizens, tax arrears can decline dramatically. Hence, utilizing less coercion works in Russia, too!

Moreover, as shown in Chapter 7, at least with respect to the case of Ukraine, religion, self-identified nationality and language had very little impact on tax compliance, suggesting that getting the right ‘software’ rather than possessing the right ‘culture’ is what matters.

Therefore, mutually constructive state–society relations are necessary for good governance – just not in a manner in which a society is pitted against the state. Indeed, the post-communist transition began with a large disconnect between state and society in all the East European and Eurasian countries that simply had to be overcome. In fact, in spite of an ongoing and, perhaps, increasing dislike for corruption scandals, party politics and politicians, Poles, as shown in Chapter 6, after the transition, have maintained general support for the new system and for those more directly responsible with governing. Thus, trust in the state by society is the foundation for a constructive and non-zero-sum state–society relationship.

*State Capacity as a Function of the Structure of the State*

While the third theory on state capacity plays down the relevance of state–society interactions, the state structural argument does hold well for explaining, in part, the dynamics that accounts for effective governance. As shown in Chapter 5, the design of *administrative*

*structures*, the *human and technological resources* afforded to bureaucracies and the *work philosophy* among bureaucrats are necessary to provide for effective policy outcomes.

However, the existing theory that links state capacity to the structure of the state fails to account for two important provisions for better governance. First, *historical reference* points, such as the use of previous institutional structures, should be utilized, whenever possible, to link back to healthier state–society interactions. History matters, but it matters in terms of how it is used and applied in the present as a model for current, constructive state–society relations. Previous paths towards creating cooperative state–society interactions that were laid down by earlier state–society efforts should be continued. Second, the *state structures*, *human and technological resources* and *work philosophy* must be directed towards society so that trust in their state is built up among citizens.

The research presented here provides some evidence to refute the notion that the structure of the Russian state, particularly federalism, accounts principally for the relatively poor implementation of policy. The Nizhny Novgorod and Volgograd tax modernization programs, mentioned above, show that once Moscow allows a target-based approach to tax collection to be eased, regions can perform in a manner more similar to that in, say, Poland. In addition, under Putin, the Russian Federation has become much more like a unitary state than it was under President Boris Yeltsin and is governed as such. Putin's expressed desire for a strict 'power vertical' is not compatible with notions of federalism. There also has been a lack of clear provision for the rights of the regions in the federal structure, and sovereignty has not been shared at different levels of government in Russia. Thus, state structure matters, as do state–society relations, but an exclusive focus on either one or the other misses out on the important links between the two theoretical approaches.

### **A New Model of State Capacity for the Post-communist States**

Analyzing the Polish, Russian and Ukrainian cases makes possible proposing revisions to the second and third theories in order to build a new theoretical model for state capacity that better explains how post-communist governments govern. In Chapter 2, I constructed a new model for state capacity, which focuses on the extent to which the state is organized in a Weberian sense and focuses on the manner in which society is ready to be a willing partner in state activity. The role of citizens' trust in the state and the state's trust in citizens to comply with the state without overuse of coercion is also emphasized.

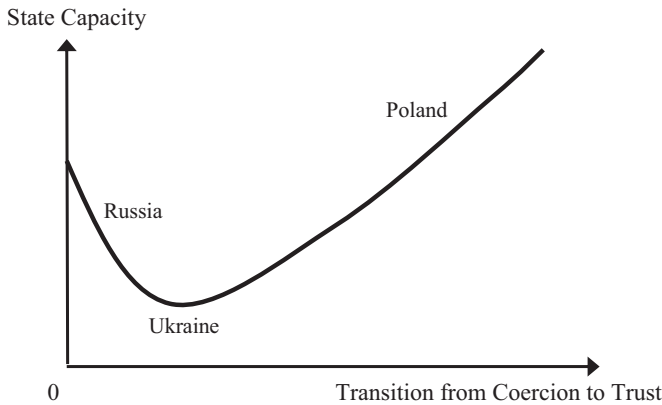


Figure 8.1 State capacity in transition from coercion to trust

This study distinctively has underlined the construction and accumulation of *trust* as state and society engage with one another as the primary instrument for transitioning from a coercive tax state to a modern, legal and legitimate one. Trust is inherent in the revenue collection process.

In essence, the new model suggests that where a state is bureaucratically rational – embodied with well-organized *structural designs, human and technological resources* and a *work philosophy* all oriented towards involving society – and a society is able and willing to be compliant, trust will develop as the two interact so that state goals can be realized more successfully.

This book has provided an evaluation of this new model by viewing more closely how state and society interact to ensure tax compliance in Poland, Russia and Ukraine. Good tax compliance was shown to be a product of a bureaucratic rational state, necessary for building up societal trust on taxes, and a society of individuals, shown to be willing to partner with the state more because of their *trust* in the state (rather than because of their *fear* of the state.)

An effective tax state is one that provokes some fear as a higher authority – all states need to rouse some fear in order to get people to comply with paying taxes – but does not employ the extreme coercion that limits state effectiveness in the long run. Russia is at that sub-optimal level, with a state often evoking more fear than trust, while Ukraine is at the bottom of the trough, trying to transition, if you will, from Russia to Poland. (See Figure 8.1.) Meanwhile, of the three, Poland is the case that has transitioned successfully from coercion to trust and, as a result, enjoys the highest state capacity.

For the state to be trustworthy before its citizens in order to receive cooperation and compliance so that state policy can be administered effectively, how street-level bureaucrats treat citizens – whether they treat them more like clients – matters with regard to whether or not the state can build up its trust to function properly. This was shown most clearly in Chapters 6 and 7 with the Taxpayer Compliance Attitudinal Surveys. To strengthen the state's legitimacy, then, improving the quality of street-level bureaucracies is vital. The provision of poor 'customer service' by bureaucrats has a negative effect on society, which may decline to fulfil its obligations to obey the state, whereas good 'customer service' can mitigate the impact of bad 'outcomes' that can emerge from interactions with the tax authorities.

To make such dramatic increases in citizens' trust in the state generally and in street-level bureaucracies in particular, states need to update, if not overhaul, their administrative structures so that they are directed at society. Transitioning from communism allows the state to re-create such citizen–state trust radically not only because the 1989 and 1991 revolutions were dramatic events but also because the communist legacy of socio-economic equality makes it easier for the state to focus on building trust in society generally rather than focusing exclusively on one sector of society at the detriment of others. The fact that the legitimacy of the transition itself was less certain in the minds of Russians than in those of Poles or even Ukrainians, however, has posed a greater hurdle for the post-Soviet Russian state.

To aid in the re-construction of a healthy state–society relationship, past legacies have been shown through the evidence presented in Chapter 3 to be very beneficial. Which historical reference points post-communist states choose to utilize to transform partly into a version of their former selves, modelled on a time when the state is perceived to have been quite capable, can give a substantial boost to society's perception of the legitimacy of the state. Hence, the book contributes to the study of comparative bureaucracy by introducing the argument that reforming bureaucracies – especially those caught up in regime change – will be shaped by historical models from decades past via 'model transference'.

Moreover, as evidence from the Taxpayer Compliance Attitudinal Surveys confirms, trusting the state to provide goods and to treat others fairly is not related to citizens' trust in one another. State–societal trust requires a unique and special relationship, irrespective of levels of social capital within society itself. A powerful interplay directly between citizens and their government will enable both state and society to mutually reinforce each other's capacities so that policies can be implemented successfully.

For Poland, as time elapses from the start of the transition and as politics takes a more nationalist turn, the question remains whether and how such mutually reinforcing trust between citizen and state – created in great part during a post-1989 period of extraordinary politics – will be maintained. For Russia, with few signs of economic recovery appearing in the near future due to the decline in global oil prices, economic sanctions imposed by the West after the Crimean invasion and a downturn in investment, among other things, the question becomes whether Russia will be even more coercive in the future to achieve state tasks. And, for Ukraine, the question, of course, remains whether it will gain enough trust from the public to transition to a stable rule-of-law democracy.

### **State Capacity Puzzle Posed by Ukraine**

One of the questions at the core of this project has been whether the changes that Ukraine has undergone have increased the propensity of citizens to trust their state. The past couple of years alone have witnessed significant change in Ukraine: the ‘EuroMaidan’ uprising, the departure of Viktor Yanukovich from power, the extraordinary presidential and parliamentary elections in 2014, the catastrophic loss of control over territory in Crimea and the Donbas, a seemingly intractable low-grade war with Russia, the conclusion of a deep and comprehensive Free Trade Agreement with the European Union, and a spiral of economic destruction. The question is whether these changes will be truly transformational. Earlier episodes of heightened political contestation in Ukraine – from ‘Kuchmagate’ to the Orange Revolution – failed fundamentally to alter the nature of the relationship between Ukrainian citizens and their state: citizens retreated into angry disaffection, and leaders took corruption to new heights, as evidenced not only by a gilded presidential palace but also by the glittering and golden spa rooms, salt therapy room, cryonic saunas and special interrogation facilities hidden deep inside the tax administration’s main Kyiv headquarters on *L'vivs'ka Ploshcha* (Lviv Square). More recent issues – such as the release of the Panama papers in the spring of 2016 and the ensuing allegations that President Petro Poroshenko had sought the restructuring of his assets abroad with the intention of decreasing taxes paid in Ukraine (a *Kyiv Post* editorial cartoon depicted Poroshenko telling others, ‘Pay your own taxes or get your own offshore company!’<sup>1</sup>), the July 2016 protest in the occupied Donetsk city of Horlivka against the Donbas separatist militants’ methods of collecting taxes, which required everything to be inventoried, in

<sup>1</sup> Published in *Kyiv Post*, 8 April 2016, p. 5.



preference for Ukraine's simplified tax system for small entrepreneurs<sup>2</sup>; and the persistent possibility that southeast Ukraine might support pro-Russian political parties – all highlight the challenges of building trust in the state.

The EuroMaidan – a revolution staged by a public that had had enough of a corrupt leader who had used public revenue (and taxes) for private gain – was meant to put an end to that cycle, by so radically altering the incentives of politicians that they would have no choice but to work for the trust of the people. If the changes in Ukraine are to be truly transformational, they will have to lead to new levels of trust – a willingness on the part of citizens to move from ad hoc, individualized strategies towards engagement with formal institutions and rule-based mechanisms.

No more than 7 per cent of Ukrainians in November 2015 felt that their state fulfils obligations to its citizens and provides them with goods and services, that their state can be trusted to do what is right and that their state treats individual citizens fairly – much lower than in Poland and Russia. This finding represented a significant decline from pre-EuroMaidan levels and found trust at its lowest level since the Ukraine Taxpayer Compliance Attitudinal Surveys began in 2005.

The research findings, however, highlight important opportunities for the Ukrainian government to rebuild its relationship with its citizens through key reforms to taxation. Overcoming distrust of the state is a difficult, but common task for any society, especially Ukraine. 'In sum, it makes far readier sense to distrust government than to trust it', writes Russell Hardin. 'The kinds of understanding necessary for trusting government are almost logically ruled out for typical citizens, while the kinds necessary for distrusting it are commonplace and resonant with ordinary life experience.'<sup>3</sup>

Ukraine does not adhere exactly to the model of either Poland or Russia. Poland is a case that enjoys a compliant society cooperating with a citizen-based state so that tax compliance depends greatly on trust in the government. Russia, meanwhile, has a society interacting with a state that strongly employs a coercion-based approach to tax collection in an environment with decreasing opportunities to be critical of the state through the media and through political contestation, or even to become aware of the state's shortcomings. There, tax compliance appears to depend largely on citizens' being susceptible to coercion and deterrence.

<sup>2</sup> Coynash. <sup>3</sup> Hardin, 2002, p. 167.

Ukraine is a different case. The use of coercion – to a degree that is not as extensive as in Russia – has been the state’s primary method for securing tax compliance through its State Tax Administration, now renamed the State Fiscal Service. Yet the prevalence of greater media freedom than in Russia, which helps expose the failings of the state and its leaders, might have allowed Ukrainians as a whole to square their support for tax compliance between reactions to coercive measures of the state and their trust in the state.

Ukrainians are not as trusting of their state as Poles are of theirs, and with such low levels of trust in the state, Ukraine demonstrates the lowest support for obeying tax laws among the three states surveyed. Clearly, Ukraine’s transition from a coercive, corrupt state to a more open, democratic one has taken place without (re-)establishing citizens’ trust that their state will act fairly and will supply goods and services; the failure to build and draw upon such trust may very well limit the state’s ability to administer its own policies.

Hence, the Ukraine Taxpayer Compliance Attitudinal Surveys suggest that the state probably needs to continue to undertake its own revolution and to embark on an overhaul of its own relationship with its citizens in order to gain (if not regain) their trust. The tentative position of critical state reforms in the aftermath of the Orange and EuroMaidan Revolutions raises the question of whether Ukraine’s political leaders will lose a great opportunity to undertake such an overhaul so that the Ukrainian state actually will be able to govern on the ground to a greater extent. In Ukraine, you have the worst of both – a society that neither trusts nor fears the state, and one that is very capable of shunning obligations anyway and getting away with it. Twenty-five years after Ukraine secured its independence, Ukraine’s statehood is no longer questioned by its citizens, but the Ukrainian state itself is.

Clearly, the trust that a bureaucratic rational state and a compliant society have in each other, as shown in the case of Poland, provides for greater implementation of state policies than the fear and distrust that exist between a more coercive state and its society, as demonstrated in Russia. Ukraine’s present difficulties in building trust in the state rightly raise the question of how possible making such a transition can be without a short-term loss in the capacity of the state to function becoming permanent. Ukraine has never been able to reconcile a state–society divide, and this has been a mutually reinforcing process, fuelling antagonism between state and society. Yet, if the immediate hurdles can be overcome, a successful re-creation of the state will yield far more stable and successful governance, mutually empowering both state and society.

To build trust across the state–society divide, there also needs to be an enlarged, spirited intellectual and political debate over the future of Ukraine – not just regarding its independence, but as to what type of state and what type of society should develop there. Admittedly, most of the conversation recently has been about the war in the East, whether and how the state should be decentralized and the desired return of Crimea. But there has been little intellectual debate among prominent civil society members with respect to where Ukraine is going and how the old regime’s void should be filled. Ukraine needs a much more vibrant debate regarding its future direction, what type of democracy should develop and how the society should interact with the state.

Despite the absence of such discussion, there has been much – and perhaps surprising – consensus within Ukraine and its parliament, the *Verkhovna Rada*, regarding the need to push further with reforms, as well as lively discussion as to whether the Yanukovich-era elites should be allowed to work for the state. A legal basis also has been created to push forward the process of decentralization, by allowing local taxes and granting budgetary powers to local governments.

Tax administration reform is currently also on Ukraine’s reform agenda.<sup>4</sup> In addition to the efforts of key members of the *Rada* and the government, both the IMF and the OECD have been pushing Ukraine to make progress in this arena in order to help restore the country’s financial stability and investment climate.<sup>5</sup> In the autumn of 2016, Ukraine and the IMF signed a Memorandum of Economic and Social Policy that included a commitment to reduce the tax administration staff from about 58,800 to about 44,000; to dissolve the tax police and, in consultation with IMF staff, establish ‘a new civil service with new staff under the Ministry of Finance that will be responsible for investigation of financial and economic criminal offenses against the State, including tax-related offenses, while removing the role of other government agencies in this area’; to implement targeted compensation reform at the State Fiscal Service, in order to make salary levels comparable with those in other reformed government agencies, such as the new National Patrol Police in many Ukrainian cities; to establish a new internal investigation division at the State Fiscal Service with new staff who will assess risks, analyze reports on assets of high-ranking State Fiscal Service officials, and carry out investigations as part of efforts to tackle corruption – all under the control of a recently established independent expert group; and to conduct regular independent surveys to monitor public perception.<sup>6</sup>

<sup>4</sup> Interfax-Ukraine.    <sup>5</sup> Talant.    <sup>6</sup> IMF, 1 September 2016.

Such recent reform efforts highlight that a discussion has begun as to how the state institutions, agencies and bureaucracies – the real guts and heart of the state apparatus that sit below the elites and interact at the street level with citizens – should be reformed and made less corrupt in Ukraine.

### **Policy Recommendations for Tax Administrations Transitioning to Trust**

Transitioning from fear and distrust to trust can provide greater state viability. How to create ‘good governance’ and especially how to create a high level of administrative capacity after regime change is very high on the academic and global policy agendas. While the book has focused on former communist ‘transition’ countries, the approach taken and the results obtained are very likely to have ‘universal’ value, applicable to others who study, work in and advise developing countries.

Transitional states such as Ukraine must find ways to create and to build up levels of trust in the state on the part of citizens and to focus on ‘procedural fairness’ in order to improve compliance with state regulations within the tax administration and across other government agencies and services. How government behaviour impacts societal trust – that is, how the state maximizes or minimizes the levels of trust that society has – will affect, then, how well the state goal of ensuring the public’s compliance is accomplished.

But how can states accomplish the two policy objectives – to build up trust and to emphasize ‘procedural fairness’? The most fundamental question of all, perhaps, is how the tax administration officials identify who the client is. Is the client the government or the taxpayers? In Russia and Ukraine, the tax administration was established to serve the authorities in power, not the people. Going forward, the success of the reforms will depend on to what extent ‘taxpayers’ become the answer to that basic question, in recognition that the state bureaucracy should be ‘rationalized’ in a Weberian sense rather than ‘empowered’.

More broadly, though, in the tax arena, the post-transition tax administrations should look for ways to rationalize their bureaucracies and to make them more society- and outward-oriented. Further, detailed suggestions on how to create trust and improve ‘customer service’ might include utilizing constructive *historical references, structures, human and technological resources* and *work philosophies*, which are all oriented towards society.

*A. Historical References*

How the state has treated citizens in the past and how the state and society view past state activity vis-à-vis citizens are important in determining how well citizens currently fulfil their obligations. Therefore, what may matter in terms of helping create better citizens is which historical model a current state applies or references when attempting to make itself capable and legitimate before society. At the crux is a need to focus on repeating and routinizing past and current experiences of well-perceived procedural fairness whenever and wherever possible, even for those states that may have a scarcity of such experiences in the past. Specific policy activities might include the following:

- Good governance at the street level can yield greater citizen trust and a greater ability to implement policy across transitional states like Ukraine – both across the state and within its tax administration.
- Improving trust on the part of all citizens and taxpayers toward the state, which has been low, for example, throughout post-Soviet Ukraine's history, must be deemed a prime, focal point for the entire state – including leading politicians, political leaders, administrative agencies and government bureaucracies alike. Indeed, as the findings from Chapter 7 showed that Ukrainian willingness to pay taxes can be highly dependent upon individual attitudes towards the president – even more than past positive experiences with the tax authorities – it is incumbent upon all political leaders to seek out and maintain long-term trust among citizens.
- Building upon good, healthy experiences – even if they are relatively new – should be a key focus. For example, Ukrainians, who have very low expectations that the state will treat them fairly, need to experience and witness first-hand that the post-2014 state will interact with them differently henceforth. Just as the public relations surrounding the National Police of Ukraine, launched in July 2015 by Poroshenko, has showcased a new manner of state authorities relating to the public, so, too, must other administrative services, including the tax administration, be re-launched to highlight a new manner of working with citizens at the ground level. The police reform in cities across Ukraine shows that the state can overhaul an agency and gain trust at the grass-roots level. Good 'customer service', copied and mimicked from other state agencies, can make a real difference.
- Create new historical trends. When tax policy reforms are changing how much citizens are paying, it is also vital to make public spending and budget expenditures effective, less costly, transparent and visible.

Since 2014, Ukrainians have been voluntarily giving money to their state's military directly or through friends even while they do not trust the state itself to allocate tax revenue effectively to the military. In other words, Ukrainians are voluntarily giving if they know such contributions will be targeted and go to the right place, but they do not trust the state to fund those places directly through taxes.<sup>7</sup> 'In this kind of situation, even ideal tax reforms will not succeed if the state fails to learn to manage taxpayer contributions in an efficient, thrifty manner', Lyubomyr Shavalyuk has written, 'because ordinary Ukrainians will continue to distrust it and not pay taxes.'<sup>8</sup> The lower the tax compliance, the greater the need for the state to show it is spending tax revenue wisely.

### *B. Structures*

A rational structural design is one that is infused with both flexibility and constraints. In general, it is critically important to limit the degree of discretion afforded to tax officials in order to constrain corruption so that citizens can trust the system. This can be done, in part, through an organizational structure that has direct lines of subordination both between offices and within them, eliminating all forms of opportunity for partiality as much as possible. Suggested policy activities in this area might include the following:

- In transitional states such as Ukraine, reform of the tax bureaucracy needs to happen at the top, bottom and middle layers of the administration – simple lustration for a few is not sufficient. Such thorough reforms would empower tax officials and employees to behave more like true Weberian bureaucrats in a more publicly transparent organization.
- Monitoring activities need to be undertaken as new procedures, activities and reforms are carried out.
- Further, the establishment of departments inside the tax administration to conduct internal audits and checks and the establishment of an external watchdog – such as an empowered, independent national accounting chamber like Poland's Supreme Audit Chamber (*Najwyższa Izba Kontroli*, or NIK) – to produce critical financial and performance audit reports, available for the public, are critical to providing for a more effective administration and for gaining citizen trust in government activity.

<sup>7</sup> Bychenko.    <sup>8</sup> Shavalyuk.

*C. Human and Technological Resources*

In addition to seeking out and employing professional, capable personnel and new, cost-efficient technologies, the tax administrations can employ a variety of employment training techniques and outreach activities to help bureaucrats better interact with the public in explaining how the (new and old) taxes work. Such public-outreach procedures taken up by tax administration personnel might include the establishment within local tax offices of low-tech ‘information checkpoints’, staffed by employees who know the tax laws well; a more high-tech mass media campaign, in which local tax bureaucrats appear on radio, television, web and social media to explain new laws and procedures; and the maintenance of websites, which enable taxpayers to write to their own tax offices, as detailed below:

- Real taxpayer outreach programmes (such as those that took place in Poland in the 1990s when that country rolled out its new tax system) need to be undertaken in transitional countries. In the early 1990s, Poland truly was unique among the three countries in this study in that tax bureaucrats really went out into the public to educate people as to what these newly founded things called taxes were. The Polish experience, which saw ordinary, local tax bureaucrats go on local television and radio programmes and open special tax assistance booths inside the tax offices in order to explain what the new tax system was all about, did help improve citizen perception of the state and increase the numbers of those filing taxes. By the end of the 1990s, Poles rated the tax administration – yes, the tax administration! – as *the* most favoured state agency due to this type of outreach.<sup>9</sup> That type of public interaction did not take place farther to the East, but states such as Ukraine now have the opportunity to re-boot their tax outreach reforms alongside tax policy reforms. One of the Ukraine Tax Administration’s more successful civics activities has been colour drawing competitions for elementary schoolchildren, but outreach can be much more than that.
- In lieu of individual personal income tax filing, employees should be made much more aware of the fact that they are paying taxes, what their pre-tax and post-tax salaries are, the tax rate and the withholding process in general, even if their employers file for them. By being informed how much and at what rate employers are deducting, citizens will become more aware that they actually are paying taxes and that the state should be accountable to them.

<sup>9</sup> Wrobel.

- An advertising campaign employing websites and social media, as well as literature distributed along with monthly pay cheques, should be targeted at all citizens who pay taxes to inform them of the new tax changes regardless of who files taxes. At times when there are changes in tax rates, especially a lowering of rates, it is not sufficient that the tax policy reforms simply yield larger pay cheques. Citizens and employees should also be made aware of what the old tax policy was and what the new tax policy is. (In Ukraine's case, only some 9 to 13 per cent of Ukrainians knew the correct personal income tax rate.)
- In countries where individuals file their own personal income taxes, the taxpayer takes on a greater role as a citizen by completing self-assessments and tax declaration forms. Such an interactive mode of paying taxes was even understood by Imperial Russian tax authorities, as Yanni Kotsonis has described, as a way of making citizens out of them. Such an assessment process 'produced the notion that the citizen, not the state, was doing the taxing or that the state was taxing only to the extent that it comprised the citizenry. The mode of thinking was expressed in taxation as "self-assessment."' <sup>10</sup> While more complicated, individual filing of taxes has been shown to increase citizens' interest in and sense of accountability over the state; by simply recognizing that they are paying for the state's income, individual filing encourages citizens and society to take a more accountable view of the state.
- Citizens must become more aware of the availability of reimbursements through the tax system for items such as medical, prescription and/or education expenses, and the tax administration should be encouraged to make such 'tax refunds' easier to claim with new technologies. Being able to claim money back from the state will encourage greater interaction with the state and encourage compliance, as was the case in Poland in the 1990s when within a period of about five years the number of citizens filing taxes in order to get reimbursements from the state increased dramatically.
- Surveys should constantly be undertaken by tax administration staff of those directly affected by reforms in order to get feedback and to fine tune reform actions to get best results, as well as to showcase wins and to demonstrate that the state is listening to public.

#### *D. Work Philosophy*

A primary basis for differences in the degree of discretion given to tax officials often can be accounted for by the overall work philosophy (esprit

<sup>10</sup> Kotsonis, p. 16.



de corps) of the tax system – specifically, whether the system focuses to a greater extent on compliance than on reaching collection target goals:

- A compliance-driven approach promotes a work ethic that tends to treat the taxpayers more like clients, which can encourage good citizenship. Further, whether a system is compliance- or target-driven provides different incentives for tax inspectors. A more target-driven approach can lead the focus away from ensuring compliance with tax laws and towards making tax inspectors merely try to fulfil quarterly or yearly targets, and to seek additional payments from those firms and individuals who have paid their dues rather than to locate those who have not paid at all. In Russia and Ukraine, such internal target levels have never really gone away. A system built on incentives and bonuses for collecting revenue – and for levying more fines on taxpayers – leads to firms being pressured to pay taxes in advance and takes away from the prime tax collection function of aiding and helping taxpayers to comply with the law.

In short, the extent to which state tax administrations utilize *historical reference points, structures, human and technological resources* and a *work philosophy* that are oriented outward towards the public may well impact the extent to which taxpayers can trust their tax system, leading them to be more compliant. Identifying and implementing policies that raise both levels of public trust in the state and the level of ‘customer service’ offered by the tax administration does assist taxpayers in becoming true citizens, who then can follow through on their obligations to their state. By making changes and adopting some of the above policy prescriptions, tax administrations will find that their personnel’s mentality will change as well.

Borderland states are always concerned that their friends one day will abandon them. And, with agendas of those in the European Union and North America always susceptible to adjustments, whether out of fatigue or in pursuit of new interests elsewhere, it is important to recognize that transition states are not failed states, but simply weak ones, requiring effective guidance and support to see the transformation through. By being at the heart of the state, the tax administration becomes the epicentre of this state transformation process.

So how does a state transition from a coercive state to a legal, legitimate tax state? Poland’s path, of course, is the ideal one, but Ukraine’s protracted route is the reality for too many states – including one day, perhaps, Russia.

Those interested either in the establishment of an accountable, highly capable state or in the transition of any coercive state to a more compliance-oriented one must be concerned with states such as Ukraine, caught in the middle. Ukraine matters not just because of its location and geography, but also because its development will show whether a state can transition successfully from post-Soviet rule to the rule of law relatively late in the game – and tackling such a task is in the interest of the West.