Legitimacy of the State and Taxation

Legitimacy of the state

In many articles and books about tax administration and taxation, the concept of “compliance” is introduced and explained. However, the paradigm of the legitimacy of the state is mostly forgotten. It is taken for granted that an essential and common understanding exists between the taxpayer and the state about the obligations of both and about the individual rights of the citizen. Implicitly, we acknowledge the supremacy of the law (Iusticia est fundamentum regni), which is the most significant paradigm in understanding the evolution of civil society over the previous centuries, and which sets the well-being of the individual as its ultimate goal. Nevertheless, one does not have to go back long in history to see the consequences of a state that has no legitimacy among its citizens. In the Soviet Union and many of its vassal states in Central and Eastern Europe, supremacy of the law was non-existent. Problems in society and conflicts between citizen and state were not solved by interpretation of a supreme legal system, but were suppressed and “solved” not by means of law of justice but by power abuse, psychological and physical violence and legitimization by a law system that was in place solely to serve as a tool for totalitarian concepts.

Supremacy of the law is the starting point of a legal democratic state, in which the state itself and its citizens, legal persons and social units are equal partners – with different interests and different rights and obligations, but all subservient to the law. The protection of the legal status of a citizen is an indicator of democracy and the implementation of legal ideas and values in society. In such a state it can be concluded that supremacy of the law (citizens and state are only subject to the law) and justice (the relation between citizens and state is based only on law and justice) are respected and perceived by all actors as “the rules of the game”.

During the years of Soviet suppression, a lack of understanding existed among citizens that the supremacy of the law can be effective. This lack even lead to a passive culture, in which citizens had no confidence in the legal behaviour of the state. Implicitly, the citizens recognized that the notion of justice is related to moral values, and that the related norms can change over time, meaning that justice may be subjective, conditional and the outcome of the evaluation of various relations. To this extent, perceptions did not differ from those of a citizen of a traditional democratic society. However, the difference lies in that the latter can exert influence on the changing norms in society. The citizen of a totalitarian regime knows that rules will change, but that the outcome is unpredictable, that unforeseen will aberrations occur and that no safety net exists. Even almost two decades after the introduction of democratic concepts in the new EU Member States in Central and Eastern Europe, the passive culture still exists and confidence in the supremacy of the law is rather...
low. Moreover, when the absolute power of the state was curbed, an era started in which big enterprises and conglomerates of industrial power took the place of the state, so that the citizens just saw that the “always-rightness” of state institutions and its officials transferred to the “alwaysrightness” of the new entrepreneurial nomenklatura. Of course, this has not fostered acceptance of the supremacy of the law in these newly created states, or rather states that recently re-established their independence and sovereignty.

It has to be kept in mind that legal nihilism can find its cause in:
– overabundance or imperfection of laws;
– conflicting legal acts;
– absence of a legal mechanism for security of personal freedom;
– perverted concepts of morals, justice and legality;
– partially applied legal norms;
– subjective legal practice; and
– overly often changing the rules of the legal system and procedures.

In the European Union, the European Court of Justice plays an enormously important role in the protection of the individual against abuse of powers by the public institutions. For the new EU Member States, the ECJ jurisdiction also played a covert role in slowly introducing the supremacy of the law.

Another aspect that has significant correlation with the legitimacy of the state is the concept of democracy. In Western societies, democracy was introduced to serve the needs of certain classes – firstly those of the nobility, who as vassals wanted more protection by the law and more individual powers toward their monarch (starting with the Magna Charta in 1215), and later those of the emancipating middle classes (starting with the French and American Revolutions, followed by a turbulent 19th century, in establishing and securing civil and human rights). Essentially, certain interest groups built their political influence around their class interests – a concept that still can be observed in political movements such as labour parties, green or environmental parties, conservatives, monarchists, liberals, farmers, etc. However, it is important that every individual can freely change loyalty from one party to another. Democracy changed by the evolution and development of classes in society. If such mobility in classes is non-existent, if political parties are based on ethnic divisions, or if parties only represent the entrepreneurial conglomerates, then the idea that the majority rules without disregard for the minority is lost, and citizens will see the political groups not as frontrunners for their emancipation but as representatives of a “greed is good” culture. This would feed nihilistic sentiments even more, as confidence would be non-existent and expectations very low.

An aspect of democratic control that correlates with compliance is the right and freedom to give feedback, to evaluate and to monitor. A healthy opposition is probably the most important factor in the development of a democratic system, for when opposition and citizens start censuring themselves, the end of democracy is near. Yet, how is this related to compliance? The answer is that politics and enforcement by public institutions follow the same pattern. A policy, vision, theory or concept is only in order to the extent it can be tested through operational results and feedback. This is reflected by the cycle in which a strategy is followed by operational plans and implemented actions, operational results are evaluated and the outcome of such evaluations can lead to
adjustments to the chosen strategy. For a policy concept such as compliance, a similar cycle of actions and reflection should be in place, requiring an open atmosphere within the administration which allows for criticism and improvements. Managers should not form a closed caste of authoritarian untouchables, but should be aware of their roles and responsibilities. If in a particular country these basic lessons for democracy are not heeded, then effective compliance surely will be far away.

Supremacy of the law is closely correlated to democratic control; democracy is closely correlated to individualism and self-empowerment of the citizen. This should be kept in mind when reflecting on the concept of compliance, in order to see whether the notions of democracy and supremacy of the law are truly implemented in the statutory regulations and – more importantly – in the thinking and beliefs of citizens.

**Legitimacy of taxation**

For a better understanding of the role of taxation we have to go back to the turbulent ages of the 5th and 6th centuries AC. After the collapse of the Roman Empire and the decline of the cities in Europe, the citizens fled to the countryside and found refuge in the vicinity of castles ruled by a new class of knights and warlords. They paid a high price for their protection: obedience to the new ruling class. This was the beginning of a new era, in which the middle class disappeared and civil rights had no meaning anymore. The Merovingian rulers, in the area what we call France nowadays, were unable to maintain the Roman stately infrastructure and the related financial sources by taxation. The Merovingian kings headed a powerless state and witnessed a process of disintegration. During these years of the early Middle Ages, a new system appeared which was based on a close connection between the owner of the soil and the labourers working on his land: feudalism. Three dominant classes appeared in society: lords, priests and peasants. Between the 8th and 11th centuries, the society of Charlemagne took shape and the ruling class transformed into a military aristocracy. The economy became a closed system, based on self-support. In this rigid hierarchy, the rules between the lord and his vassal were fixed. The lord gave exclusive rights (but not the ownership) of the land to his loyal vassals, demanding for this fief (or benificium or feodum) certain services and an oath of allegiance. For many centuries the economy was based on barter trade instead of on the principles of the money economy. Illustratively, if coins were used they only had the value of the involved metals – any guarantee by the ruler had no meaning. There was limited circulation of coins, due to the fact that each feudal entity could have its own coins, and the distribution of currency between the feudal entities was extremely limited. In this kind of society taxation was not needed because the ruler provided shelter and protection and the subjects returned this in aid, advice and part of their harvests.

Grapperhaus (at p. 11) described the period after the purest form of feudality, when a simple form of taxation returned:

“The imposition of taxes in Europe grew out of this mutual obligation. The subjects gradually began offering their ruler an impersonal monetary payment in lieu of personal services. This development occurred in conjunction with a return to a monetary economy, the rise of cities and the creation of mercenary armies. The general decline in the mutual obligation inherent in the ruler-subject relationship gave rise to greater cooperation and solidarity among various groups in society. The estates which eventually came to represent these groups voluntarily decided to contribute financial aid to the sovereign ruler in exchange for a greater voice in government affairs. Initially, the estates’
interest did not extend any further than their own group. Later, it was expanded to encompass their own city, their own province and eventually their own country, a process spanning several centuries. In theory, it is an ongoing process, as today countries are cooperating on an increasingly broader scale."

Grapperhaus tells us that the process of unification and building of the legal infrastructure took several centuries. It is hard to imagine that just two centuries ago, in France and Britain, the notion of a nation was only in the mindset of a minority in the country. In most parts of these countries people spoke a different language or a dialect that was not understandable to others. Some locals paid a high price for their linguistic isolation, due to the fact that the French-speaking officers in Napoleon's army were not able to communicate in the local patois – the only language of their servicemen. The inhabitants of these forgotten regions were not aware that they might be civilians of a much bigger area. The system of taxation was merely the same as in the feudal period: the tenant paid in kind, a share of the crop. It is not a surprise that the land tax was the major source of taxation among countryside people.

**Taxation and nation-building**

The Era of Enlightenment was a period in which a new class of traders, businessmen, industrialists and civilians emerged, with a strong sense of emancipation of their class and, at the same time, a sense of the interests of their nations. It seems that a commitment to country and its habits and folklore replaced the restricted rules of the class society. Due to this period, at the end of the 18th century, nation-building became possible, and at the same time the seeds of revolutionary ideologies were sown. The strength of nations became clearly visible during the Napoleonic wars. More than in the past, wars were between countries, being fought out on a larger scale and lasting longer (meaning that they were also more costly). As an answer to the related financial problems, more forms and ways of taxation were introduced. Napoleon himself was a master in imposing new taxes on society in order to finance his emerging public and military activities, which in the end undermined his personal popularity as the reformer who had reorganized European society. However, civilians, whether they lived in France or in occupied Italy, wanted something in return for their higher share in taxation, and that was representation.

The 19th century saw a long path of nation-building; slowly direct taxation was introduced to lessen dependence on the revenues of customs and excises. Still, the concept of mutual obligation (between state and civilians) was never abandoned. The introduction of an income tax at the end of the 19th century showed that the cornerstone of the nation – the emancipated middle class – needed its own methodology of taxation. It can be seen that the need for representation was connected to taxation, as clearly expressed by the fact that people only had the right to vote if they paid income tax (census suffrage). This restriction has not survived for a long period, but nevertheless there is an evident connection between the state’s demand for money, on the one hand, and the right to vote and be elected given in return for that payment, on the other.

During the 19th century, in many developed countries there was an ongoing struggle between forces in society that favoured abandoning the high protection walls of tariffs and customs duties and replacing them with consumer and/or income tax, and forces that favoured protecting the national economy by high tariffs. For example, American politics were shaped by a continuous fight between these points of view, directly from the country’s independence. The Solid South, which was
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completely dependent on cheap labour for its cotton fields, needed high tariffs to protect its
domestic market from cheaper cotton from the British colonies. This policy had overwhelming
support in the South, which is why all these states voted on the old Democratic Party for decades.
The industrialized North needed a free-trade policy to export its goods to new markets and to
import the necessary raw materials. The Republican Party, founded in 1854, was an invention of the
North. The presidential elections of 1856 and 1860 split the country across this line of free trade
versus high tariffs. With the election of Abraham Lincoln (who hardly got any votes from the South),
the civil war started and, although it may sound nice to mark this war as a fight for the freedom and
emancipation of the black population, in fact it was an ordinary fight about economy, taxation and
customs duties.

Taxation and emancipation
The nature of taxation was changing as well. Of course, the primary reason for taxation was the
raising of money for state operations, but the income tax was also based on principles of
redistribution of income, fair competition and fulfillment of formal obligations. Because of taxation
people became aware of new sets of regulations, and of the importance to have the right to
complain and to appeal\(^2\) against decisions of the authorities. For many people in this century,
independent and neutral judicial systems were a new phenomenon. In this sense we have to pay
tribute to accounting rules and standards, which became necessary for business planning, also
because taxation payments assumed a repetitive character.

The concept of the state, and the related duties, were reinvented during the 19th century.
Emancipation, participation and representation became drivers for the new middle class. To support
these new and ambitious ideas, the state had to invest in education (accessible to more than only
the representatives of the autocracy), in infrastructure (to support entrepreneurs), in independent
court systems and in social support (for those who were unable to be active in a demanding society).
Ultimately, the demanding civilians were responsible for their own higher tax burden. In the
developed world, during the 20th century, there was no or only limited objection to higher taxation (as
came evident after the Second World War, when the public sector expanded), if only for the
reason that the state offered services to all citizens that could not be provided by the private market
(better education, healthcare, social benefits, pension systems, housing programmes, etc.). This
mutual agreement between citizen and state is partial clear in the Scandinavian countries. High
tax rates and high social contributions are generally accepted because the public appreciate the
services rendered by the governmental bodies. The opposite happens in developing countries where
citizens see hardly any contribution to society by the ruling class. Then, taxation is perceived as
officially allowed robbery, and tax evasion and avoidance are seen as the only possible answer.
Legitimacy of taxation in the field of tax policy and legislation is answered by voluntary compliance
in the field of implementation and execution of the tax regulations. Several times, the relation

\(^2\) Independent court decisions and the protection of individual rights also played an important role when new Member States
joined the European Union in 2004. Some of these former socialist states had a bad reputation regarding the independ-
ence of their judicial systems. Joining the European Union meant a significant boost in the protection of civil rights, as judicial
systems (which sometimes contained relics from the past) had to be reformed and decisions could from then on be overruled
by the European Court of Justice. For those citizens who had recently lost their confidence in their national judicial systems,
this was an enormous encouragement.
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between taxation and rendered services was the main issue during American presidential elections and for individual states’ legislature. The inhabitants of a state such as California have witnessed the difference between the election of a governor in favour of tax reduction (Ronald Reagan, 1967-1975) and a governor (Jerry Brown, 1975-1983) who wanted to expand and improve public services. Another example of the relation between legitimacy of taxation and compliance is Rwanda, where after the genocide in 1994 the new government did its utmost to show that paying taxes is necessary for building up the nation. Nowadays every visitor can observe that Rwandan public services are of a higher standard than those in neighbouring countries and that the infrastructure is of a higher quality. The mission statement of the Rwandan Revenue Authority says, in the most profound and clear wording: “Mobilise revenue for economic development through efficient and equitable services that promote business growth.”

Taxation and representation

The “Boston Tea Party” of 1773 is regarded as the beginning of the American Independence War. The reason underlying this conflict was that Britain was almost broke after the Seven Years’ War (1756-1763) – and the fact that Canada was conquered from the French did not make things easier. Although the American colonists need not fear a French invasion anymore, the British homeland suffered the costs of the war (the post-war national debt was so big that five eights of the national budget were allocated for payments of interest). Furthermore, the massive territorial expansion forced the British to have a permanent military presence. For the House of Parliament in London, it was obvious that the Thirteen Colonies had to contribute more on behalf of their own defence. However, the American colonists felt more secure than ever and saw no threat from the beaten French. Why then pay more for a military presence that was perceived as unnecessary and even as a bigger threat than the French? This is a clear example of taxpayers’ doubts regarding the legitimacy of taxation. “No taxation without representation” became the slogan of the American Revolution, and from that time on politicians have to admit that imposition of a tax without the consent of those governed is a form of tax tyranny. This is a reason why taxation under democratic regimes has greater moral legitimacy than taxation under non-democratic regimes.3

Colley (p. 143) writes regarding this fact:

“And what right had Parliament to tax them anyway? Their allegiance was owing to the King of England alone and, as far as taxation was concerned, only their own elected colonial assemblies had the right to demand it of them. ‘Acts of Parliament have been passed to annex Wales … to the realm’, the leading patriot and future President, John Adams, reasoned in 1775, ‘but none ever passed to annex America …. The two realms of England and Scotland were, by the Act of Union, incorporated into one kingdom by the name of Great Britain; but there is not one word about America in that Act’. Since the colonies owed neither their existence nor their connection with Great Britain to acts passed by Parliament, but only to the king, the former could have no powers of taxation or legislation over them.”

The correlation between representation and taxation was proven by the French Revolution. Perhaps it was not the fall of the Bastille on 14 July 1789 that was the major event and start of the Revolution, but rather the gathering of Les Etats-Generaux. On 5 May 1789, the representatives of the nobles, clergy and commoners (the 1,000-year old class distinction formalized by Charlemagne),

of the towns and parishes of France, were invited to list their grievances. In his book The Discovery of France, on p. 80, Robb gives a clear example of the main complaints in French society at the dawn of the Revolutionary Era:

“Most of the Cahiers list the same grievances: the corvée (road-repairing duty), impassable roads and broken bridges, hospitals that no one could reach though they paid for them in taxes, the billeting of troops and their hungry horses, lack of representation and arbitrary or unaffordable justice, ineffective policing, the proliferation of con men, uncertified surgeons and beggars and of course ecclesiastical and seigneurial privilege.”

Reading these complaints of two centuries ago, one can note the same issues as are found in developing countries. The quality of public services, the protection of the individual citizen, public intervention by abuse of powers and respect for civil rights are significantly correlated to taxation, as paying taxes (based on voluntary compliance) is necessary to finance the services of the state.

In this century, we may have to return to the lessons of the 18th century because of the increase of Western involvement in post-conflict reconstruction and a growing number of failing states or no-go areas in great parts of Africa. In the post-conflict regions, national states almost fully depend on donor money (Iraq, Afghanistan, Bosnia-Herzegovina, etc.); the contribution of citizens and companies to their ruling authorities is almost zero. The dilemma for the foreign powers is that they are forced to stay much longer than their initial commitment, only because the local authorities do not have the resources (in money, regulations, human capital, policy, etc.) to take over the real command and steer their countries. Maybe good governance issues are even more critical here than in the developed world of taxation. If the trust in society and public services is not increased, with a concomitant higher share of taxation in GDP, the attempts of foreign donors to restore the function of the state may be in vain. The inhabitants of no-go areas – in particular in central Africa – have been thrown back to a situation similar to Europe at the end of the (western part) of the Roman Empire in the 5th and 6th centuries. The only protection that could be offered was through absolute surrender to a local warlord, paid by the exclusive right of the ruler to own the obedient commoners in all of his or her assets.

**Taxation, execution and Weber’s model for bureaucracy**

For the legitimacy of taxation, the legitimacy of the execution also has to be considered. In this sense we have to refer to Max Weber (1864-1920), the German sociologist who was one of the architects of the concept of the public administration. Bureaucracy nowadays has a negative connotation, but around 1900 his ideas were revolutionary in a society where parliamentary democracy, an emancipated middle class and new taxation in the form of an income tax shaped the nations. Weber’s ideas were based on the presumption that the public administration has to be neutral, independent, stable and reliable. Looking at the mission statements of revenue authorities, it can be seen that these values are still used.

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4 The corvée was instituted in 1738 and became a symbol of the non-functioning communality service in France. In some parishes the entire male population could be forced to work on the roads for up to 40 days a year. On p. 219 of his book, Robb mentions: “Many of the road-builders had no idea where the road went and never used it. The main beneficiaries were merchants and nobles”.
Weber’s analysis of bureaucracy concerns:
– the historical and administrative reasons for the process of bureaucratization;
– the impact of the rule of law on the functioning of bureaucratic organizations;
– the typical personal orientation and occupational position of bureaucratic officials as a status group; and
– the most important attributes and consequences of bureaucracy in the modern world.

According to Weber a bureaucratic organization is governed by the following seven principles:
(1) official business is conducted on a continuous basis;
(2) official business is conducted strictly according to the following rules:
   – the work duties of each official are delimited in terms of impersonal criteria;
   – the official is given the authority necessary to carry out his assigned functions; and
   – the means of coercion at his disposal are strictly limited and conditions of their use strictly defined;
(3) every official’s responsibilities and authority are part of a vertical hierarchy of authority, with respective rights of supervision and appeal;
(4) officials do not own the resources necessary for the performance of their assigned functions but are accountable for their use of these resources;
(5) officials and private business and income are strictly separated;
(6) offices cannot be appropriated by their incumbents (inherited, sold, etc.); and
(7) official business is conducted on the basis of written documents.

Furthermore:
– a bureaucratic official is personally free and appointed to his position on the basis of conduct;
– a bureaucratic official exercises the authority delegated to him in accordance with impersonal rules, and his or her loyalty is enlisted on behalf of the faithful execution of his official duties;
– a bureaucratic official’s appointment and job placement depend upon his or her technical qualifications;
– administrative work is a full-time occupation;
– work is rewarded by a regular salary and prospects of advancement in a lifetime career; and
– an official must exercise his or her judgement and his or her skills, but his or her duty lies with a higher authority; ultimately he/she is responsible only for the impartial execution of assigned tasks and must ignore his or her personal judgement if it runs counter to his or her official duties.

Weber’s bureaucratic organizations were criticized, but a closer look at these seven principles reveals that they are elementary for a well-functioning tax administration and that they can be used to improve integrity. Sadly, it has to be admitted that many of these principles are seldom applied in many developing countries.

**IBFD welcomes your feedback as follows:**

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