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From Milan to Mumbai, Changing in Tel Aviv: Reflections on Progressive Taxation and “Progressive” Politics in a Globalized but Still Local World

Progressive income taxation is often said to be on the defensive as a result of globalization and related changes that encourage reduced taxes especially on higher income individuals. This article tests that hypothesis against the experience of three nations—Italy, Israel, and India—each of which has a sophisticated tax policy apparatus but which differ significantly in culture, income levels, and historical situation. Following a brief discussion of each nation’s tax system, the article proceeds to a descriptive account of the tax debate in each country, emphasizing the issue of progressivity and its relationship (if any) to the more general debate on equality and social justice in the country at issue. The article further evaluates the “tax culture” in each country, including public attitudes, the role of various professional groups, and unwritten rules or traditions that may affect the perception of the progressivity issue and its political outcome. The article concludes that, while there is a tendency toward lower tax rates and somewhat broadened tax bases in all three countries, the process is highly unstable and dependent upon unsystematic, local factors as much as or more than underlying international trends. In particular, perceptions and outcomes are affected by quirks of national tax culture—the exemption of agricultural income in India, the individualized nature of Israeli tax administration, the Italian propensity for tax evasion—that are difficult or impossible to fit into a larger theoretical scheme. While not denying the reality of globalization or its tendency to encourage a harmonization of tax policies, the article suggests that this tendency must be filtered through a variety of legal cultures that make predictions in the short- or intermediate-range future extremely hazardous.

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Progressive taxation—the idea that people with higher incomes should have to pay a higher proportion of that income in taxes—continues to be on the defensive in many quarters. The reasons for this defensiveness range from political changes, including the decline of Marxism and the spread of a conservative political philosophy in the U.S. and other countries; economic developments, including increasingly sophisticated tax shelters and a growing mismatch between tax evaders and national enforcement bodies; and, perhaps, a sense that progressivity has failed to meet its goals of promoting social welfare and achieving at least some redistribution of income.¹ Globalization is a particular challenge, since high tax rates tend to be imposed on precisely those people who have the greatest capacity to shift all or part of their income to lower-tax jurisdictions.

Although there is a great deal of scholarship on progressivity—and much of it is very good indeed—it tends to emphasize the experience of the United States and a few other countries, such as the United Kingdom, Germany, and Japan, that have rather similar economic and political structures. This focus makes it difficult to know if the apparent limitations of progressivity are inherent in the concept itself or are instead the products of a particular time and place. In particular, the role of globalization is difficult to pin down from the study of one country alone. A comparative approach, which considers the fate of progressivity in different nations and cultures, offers a better chance to evaluate these issues. By focusing on a relatively specific problem, such a study might also offer important insights into the intersection of tax and culture and the broader globalization phenomenon.

This article attempts such a study. It considers progressive taxation and its fate in three foreign countries—Italy, Israel, and India—as well as the United States, for a total of four case studies. The countries were chosen in part for my linguistic capabilities and, in part, because of their distinctive features. Italy is an advanced industrial society and a member of the European Union but with a highly idiosyncratic political system and an unusual degree of regional differences in economic and social indicators. Israel is a Middle Eastern nation with First and Third World characteristics and a high degree of inequality that is correlated with ethnic rather than regional status; the country's shift from a collectivist to an individualist economic philosophy at the same time as it faces serious internal and external challenges makes it an especially interesting test case. India is a Third World country which has similarly moved from a socialist to a capitalist economic policy but which continues to face enormous poverty and whose limited administrative resources place

1. See Michael A. Livingston, *Blum and Kalven at 50: Progressive Taxation, "Globalization," and the New Millennium*, 4 FLA. TAX REV. 731 (2000).

a serious constraint on its tax policy choices. All of the three countries are thus advanced enough to have a sophisticated tax policy discourse, but each has political and cultural features that make its tax policy necessarily different from that of the others and the United States. By a happy coincidence, all three countries have recently been involved in substantial tax reform projects, which have as common features the substantial reduction of income tax rates and at least some effort to broaden the corresponding tax base. By comparing them to one another and to the United States, something approaching a cross-section of contemporary progressivity and its problems can be achieved.

In order to evaluate the progressivity of a particular tax system, at least some technical issues must be addressed. These include, *inter alia*, the nominal tax rate structure; the tax base to which these rates are applied; enforcement and compliance issues; and the scope of the inquiry, i.e., is one concerned exclusively with income taxation or must other taxes (wealth taxes, inheritance taxes, excise taxes, etc.) also be taken into account. The article thus devotes some space to a description of each individual country's tax system and an evaluation of its progressive or regressive nature.

The bulk of the article, however, is devoted to the public tax debate in each country. What is the attitude toward progressive taxation of the country's principal political movements, and of its professional tax elite? Is there a consensus in favor of progressivity, or is there a strong movement for a flat or significantly flatter levy? How, if at all, is the tax debate connected to the broader debate about economic and social equality in the country, and are there particular "cleavages" within the society—ethnic, religious, regional—that affect the country's perception of economic equality and (indirectly) of the progressivity issue? Is there a serious debate about tax matters at all, or does it tend to be subservient to other, arguably weightier issues?

Finally, the article asks how the debate is affected by what might be called the tax culture or tax anthropology of the country in question. Among the factors considered are the education and training of tax elites; the relationship between lawyers, economists, and other tax professionals; the nature of tax administration; attitudes toward tax compliance and evasion; and the unwritten traditions that govern the making and implementation of tax policy in the country in question. A recurring theme of the article is the extent to which these relatively narrow, tax-specific considerations may be as or more important than broader political and social factors in determining the fate of progressive taxation and of tax reform generally. A further, related theme is the degree to which tax systems are or are not converging with one another, on both a technical and a political level, as

reflected in progressive taxation and other policy issues. The paper is thus on one level a study of tax progressivity, but on another level an inquiry into the fate of national legal systems in a globalized world, and the potential and limits of comparative law scholarship in addressing this question.

Part I of the article discusses the concept of progressive income taxation and the principal arguments for and against it, using the American experience as a guide. Parts II through IV consider the progressivity issue in Italy, Israel, and India respectively, emphasizing the impact of globalization and the relationship between the tax debate and broader political discourse in the country concerned. Part V presents the author's conclusions regarding the fate of progressivity in a globalized world, the elusive concept of tax culture, and directions for future research.

I. BACKGROUND: A BRIEF PRIMER ON PROGRESSIVE TAXATION AND THE AMERICAN EXPERIENCE WITH IT

A. *Traditional Arguments For and Against Progressivity*

Progressive taxation has always been a phenomenon that is easier to describe than to explain. Although nearly all advanced societies have some form of progressive income tax, the justification for it is difficult to pin down, and (perhaps for that reason) progressivity has frequently been on the defensive although rarely if ever completely eliminated from a tax system. After two generations, Blum and Kalven's famous phrase, that the case for progressivity was "stubborn, but uneasy," remains as true as ever.

I summarized the arguments for progressivity in a previous article and need only briefly to recapitulate them here.² These arguments traditionally divide into two categories. The first are direct arguments for redistribution of income, based upon the alleged injustice of pretax income allocations or (more broadly) the notion that resources should be allocated at least partially according to the needs of individuals rather than their abilities. The second is the notion of the diminishing marginal utility of money, that is, the idea that wealthy people derive less advantage from each additional dollar of income so that—by taxing them at a higher percentage—we may in fact be de-

2. See Livingston, *supra* note 1, at 733-36. For a classic statement of arguments for (and against) progressivity, see Walter Blum & Harry Kalven Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417 (1952). While Blum and Kalven's article is unquestionably the principal source on this issue, many of the arguments contained in their study were made by earlier European and American scholars. See, e.g., EDWIN R.A. SELIGMAN, *PROGRESSIVE TAXATION IN THEORY AND PRACTICE* (1908); LOUIS SURET, *THEORIE DE L'IMPOT PROGRESSIF* (1910). For an interesting exchange on progressivity, taking place just under halfway between Blum and Kalven and the current era, see CHARLES O. GALVIN & BORIS I. BITTKER, *THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE* (1969).

manding an equal or lesser sacrifice from them than from their poorer compatriots. This argument has the advantage of appearing scientific in nature and avoiding some of the more overt politics of the redistribution issue; the problem is that utility is difficult to measure and nearly impossible to apply to tax system design. A third historical argument, the so-called benefit theory, suggests that the wealthy derive more benefit from government services and should therefore pay more to support them.

If the arguments for progressivity emphasize its (alleged) social and political consequences, the arguments against it focus on individual behavior. The principal argument relates to incentives, that is, the notion that people will work less hard if they have to share more and more income with the government. Thus the metaphoric pie representing national economy will become smaller while people argue over who is to receive a larger slice. A further argument is more libertarian in nature, relating to people's inherent "right" to enjoy the fruit of their labors and the strong burden that must allegedly be overcome before they are required to share it. These arguments are likewise difficult to quantify, but—like the arguments in favor of progressivity—maintain a strong hold on the popular imagination, particularly in more conservative circles.

In my previous article, I suggested that—while the arguments for and against progressivity were largely unchanged—there was a long-term erosion in the support for progressivity, with the result that its opponents had generally become more assertive with the passage of time and its adherents had adopted an increasingly defensive posture. I attributed this to three distinct but related processes. First, the conservative direction of politics in the U.S. and other countries weakened the support for progressivity at a philosophical level. Second, the identification of poverty with women and minorities—while enhancing the moral case for redistribution—tended to weaken it politically, since other factions of society saw an interest in reduced taxes and "progressive" forces were increasingly concerned with specific women's and minorities' issues. Finally, the globalization process weakened the case for progressivity by suggesting that a country which maintained highly progressive taxes would simply lose business to countries that were more forthcoming in this area.³ This last argument was especially forceful, for it suggested that—even if a

3. For a more complete summary of these arguments, followed by suggestions for revised arguments by progressivity advocates, see Livingston, *supra* note 1, at 737-66. For an effort to apply contemporary philosophy in support of progressive taxation, see, e.g., Donna M. Byrne, *Progressive Taxation Revisited*, 37 ARIZ. L. REV. 739 (1995) (citing Rawls, Nozick, Dworkin, and others on the issue of progressive tax rates); but see Charles R. O'Kelley, Jr., *Tax Policy for Post-Liberal Society: A Flat-Tax Inspired Re-definition of the Purpose and Ideal Structure of a Progressive Income Tax*, 58 S. CAL. L. REV. 727 (1985) (applying some of the same authors in support of an argument for a flat tax with a generous exemption amount).

country wished to maintain progressive taxes—it would be prevented by economic forces from doing so.

Whether I am right that there is a long-term trend against progressive taxation remains to be seen, and indeed progressivity has shown surprising resilience despite the factors above. Yet the very suggestion of a decline suggests some interesting questions. If progressivity is indeed on the defensive in the United States, is this a temporary or an ongoing phenomenon? Does it result from conditions specific to the United States—conservative politics, individualism, a tradition of antitax rhetoric—or from more universal factors? Are other countries likely to encounter the same resistance to progressive tax rates, or will their tax systems remain more progressive even if the U.S. goes in a flat or flatter direction? Do the answers vary between rich and poor countries, or between countries with a history of socialism and those with more conservative or traditional governments? While primarily interesting as comparative tax issues, these questions are also important for the U.S. itself: for if opposition to progressivity is temporary or local in nature, it is likely to be overcome, while if it is universal and permanent progressivity is likely doomed.

B. Progressivity and Tax Culture: Distinctive Features of the American Tax System

To answer these questions, it is necessary to consider the American tax system from a comparative perspective, i.e., to evaluate what might be called American tax culture or tax anthropology. Tax culture is an elusive concept, but may be defined to refer to the body of beliefs and practices that are shared by tax practitioners and policy-makers in a given society and thus provide the background or context in which substantive tax decisions are made. Put differently, tax culture may be thought of as the noneconomic or nonquantifiable side of taxation, which varies between different countries even as underlying economic principles remain more or less the same.⁴ Tax culture is related to but distinct from a country's broader political and social culture, so that (for example) a country might have a political or social culture that favored a progressive distribution of tax burdens, but a tax culture that somehow or another impeded it; or conceivably the other way around.

4. The definitions are taken from Michael A. Livingston, *Law, Culture, and Anthropology: On the Hopes and Limits of Comparative Tax*, 18 CAN. J.L. & JURISPRUDENCE 121 (2005). My definition is broader if perhaps less systematic than that of (e.g.) Ann Mumford, who approaches tax culture primarily in terms of tax compliance and tax evasion phenomena, and similar authors. ANN MUMFORD, *TAXING CULTURE* (2002).

As compared to most other countries, the United States tax culture is distinct in several respects.⁵ The first is our relatively sophisticated system of tax administration and (by most accounts) the relatively high level of compliance with income and other taxes. For all the talk about Americans evading or hating to pay taxes, voluntary tax compliance appears to be as high or higher in the United States as in most comparable countries, a situation that highly publicized tax shelters and other techniques of evasion only partially detract from. (One reason for the publicity is that people are genuinely surprised by such tactics.) The relatively large administrative resources at the disposal of the U.S. government, and the large size and power of the country generally, put it in a relatively strong position to enforce its will on progressivity and other tax-related matters, so that we generally think of tax policy as a series of autonomous choices rather than decisions forced upon us by outside actors. This relative independence of thought and action is something that we have become so accustomed to as to take it more or less for granted; but it distinguishes us from most countries, and even in a globalized world, remains an important factor.

A second point concerns the structure of American tax institutions and the nature of the tax-writing process. These are characterized by a high degree of partisanship on tax matters, but also by a surprising degree of consensus, and a series of institutional arrangements, like the congressional Joint Committee on Taxation and the Treasury Department Office of Tax Legislative Counsel, that both promote the interests of "nonpartisan" tax policy and tend to insulate it from other policy areas. For example, there is a remarkable degree of consensus on the need for at least some form of scaled rate income or quasi-income tax, and a longstanding consensus against a federal sales or value added tax, together with a similar consistency in tax systems between the various states, the latter being partially enforced by federal constitutional standards. The tax legislative process is further characterized by a division of power between a large

5. The ensuing analysis is based largely on personal observation of American tax culture and its differences from other countries: since this "external perspective" differs from that normally adopted by American tax scholars, it is difficult to cite documentary support for each individual assertion. For a comparative perspective on American tax law, see generally James R. Repetti, *The United States*, in HUGH J. AULT & BRIAN J. ARNOLD, *COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS* 137-55 (2d ed. 2004) (general description of history, structure, and style of American tax law and administration); VICTOR THURONYI, *COMPARATIVE TAX LAW* 28-29 (2003) (brief description of the "American family" of tax systems). The Thuronyi book is arranged by themes rather than geographic materials so that the material on the U.S. is distributed throughout different parts of the book, but the material is no less and perhaps more effective for this reason. See *id.* at 68-70 (describing U.S. approach toward taxes and constitutional law); 160-71 (U.S. approach to tax shelters and tax avoidance); and 206-30 (tax administration and procedure in U.S. and other OECD countries).

number of congressional and other actors, and between state and federal governments, with the effect that change tends to be slow and incremental and it is difficult to ascribe any clear ideological direction to it. American tax policy also ascribes an unusually large role to lawyers, many of them rotating between government and private sector positions, a situation that tends to augment the pragmatic inclination of tax policy and (arguably) militates against radical changes in political direction.

Third, there is the matter of political philosophy and its impact on tax policy. This matter I believe is more complicated than generally realized. Certainly there is a strong strain of individualism in the United States and the country is by and large more conservative than (say) the Western European or other industrialized nations. Yet there is also a strong strain of egalitarianism and civic duty which—in addition to arguing in favor of “fairness” in the allocation of tax burdens—also makes it more likely that Americans will actually pay those taxes that are imposed upon them. This contradictory situation was described by Louis Eisenstein in his book, “The Ideologies of Taxation,” which noted that the argument for fairness (“the creed of ability”) and that of efficiency (“the ideology of barriers and deterrents”) were always present in tax arguments and—depending as they did upon differing assumptions about human behavior—had the additional advantage that neither was readily susceptible to disproof.⁶ There is also some question whether the supposed anti-tax sentiment is really based on taxes or upon the uses to which the tax revenues are put. Many of the same Americans who oppose federal income taxes willingly pay high social security as well as local school and property taxes, because they believe the money is either for their own benefit (social security) or for the benefit of their own community.

Finally, there must be added the particular way that Americans think about equity and fairness as applied to tax matters. This thinking is characterized by an emphasis on measurable economic data—e.g., what percentage of tax is paid by each “quintile” of the population, as described above—and a rather rigid distinction between horizontal equity (similarly situated taxpayers should be taxed similarly) and vertical equity (the allocation of tax burden between rich and poor). While a few scholars have considered the differential effects of taxation on female taxpayers or members of minority groups, this work has until recently been relegated to the margins of the field, with the emphasis (when vertical equity is considered altogether) on income or wealth statistics and a benign neglect of these

6. See LOUIS EISENSTEIN, *THE IDEOLOGIES OF TAXATION* 16-33 (the troubled creed of ability) and 57-88 (the ideology of barriers and deterrents) (1962). Eisenstein is also noteworthy for his observation that, although people's tax ideologies may be consistent with their or their client's self-interests, this does not necessarily mean that they do not sincerely believe them. *Id.* at 13-15.

supposedly extraneous factors. This is consistent with the prevailing national mythology under which there is equal opportunity for everyone, and race or gender differences, if not wholly eliminated, are at least in the process of being so. The perception of equity thus differs from other societies which are perhaps more cognizant of regional or ethnic differences and which tend to see these as inseparable from class differences or other more purely economic phenomena, as will be described further in the following, country-specific discussions.⁷

The result of all this is that Americans talk a lot about flat taxes but in practice tolerate a surprisingly progressive tax system, certainly when the income tax is considered alone and to some degree even when the entire system is considered together. Although conservative legislators have succeeded in enacting enormous tax cuts, a strikingly large percentage of individual taxes continue to be paid by the top ten or even one percent of taxpayers. These figures change significantly when non-income (notably social security) taxes are included in the mix, but the system remains at least somewhat progressive even in this broader analysis.

Although necessarily brief, the survey above suggests that U.S. tax culture is characterized by several factors that are unusual or even outliers as compared to most other nations: what happens accordingly may, or more often may not, be a good guide to what happens elsewhere. Understanding the future of progressivity thus requires that we consider the experience of other countries. It is to this effort that we now turn.

II. ITALY: RESISTANCE, REGIONALISM, AND THE WEIGHT (IF ANY) OF CONSTITUTIONAL TAX PROVISIONS

The first "foreign" country that I studied, Italy, is on the surface probably most similar to the United States.⁸ An advanced industrial

7. In recent years a number of scholars have challenged this consensus, producing scholarship that considers the effect of taxation on women, minorities, and other distinct groups within the broader society; but they have also been subjected to withering criticism in doing so. See Lawrence Zelenak, *Taking Critical Tax Seriously*, 76 N.C. L. REV. 1521 (1998) (taking a generally skeptical stance toward efforts to apply the methods of critical legal scholarship in the tax area); Michael A. Livingston, *Radical Scholars, Conservative Field: Putting "Critical Tax Scholarship," in Perspective*, 76 N.C. L. REV. 1791 (1998) (defending critical scholars but calling for integration of their work into the mainstream of tax scholarship). See generally Symposium, *Critical Tax Theory: Criticism and Response*, 76 N.C. L. REV. 1519 (1998).

8. The discussion of Italy is based on interviews with important figures in the Italian government, private law or accounting firms, and various Italian universities; on several years of following the tax debate in *Corriere della Sera*, *La Repubblica*, and similar publications; and (for facts and historical background) on a variety of Italian published and web sources. Individual published and web sources are cited where relevant to specific arguments. By contrast, the anonymity of personal interviews is for the most part protected. For an overview of the Italian tax system, see ENRICO DE MITA, *PRINCIPI DI DIRITTO TRIBUTARIO* (4th ed. 2004); PASQUALE RUSSO, *MANUALE DI DIRITTO TRIBUTARIO* (2002). For an English-language summary, see INTERNATIONAL

country, Italy has (depending on the source that you consult) either the sixth or seventh largest economy in the world, and is a founding member of the European Union. Popular stereotypes notwithstanding, the country has a thriving, hard-working capitalist economy with a per capita gross national product (GNP) approaching \$30,000 per year.⁹ Italy also has a progressive income tax, not entirely dissimilar from our own, and a very highly sophisticated debate on tax issues; indeed the country was the source for many interesting and provocative developments in tax theory. Yet Italy has political and cultural tendencies that distinguish it from the United States, and cause it to approach progressivity in a particular, Italian way. The country's tax system also has various features that both limit its ability to achieve progressivity and its capacity to undertake significant tax reform. All these aspects are on display in the current tax reform process, which began on an avowedly American model but has diverged sharply in both technical content and political fate.

The following discussion considers these issues in greater detail.

A. *The Italian Tax System: A General Outline*

Italy's tax system is similar to those of its principal European neighbors, including a progressive individual income tax imposed at rates of 23, 33, 39, and 43 percent, the maximum rate being reached at an income of 100,000 Euros (currently about \$120,000), and interest and dividend income, for residents of Italy, being taxed in most cases at a flat 12.5 percent rate. There is also a corporate income tax (33 percent rate), a value added tax (VAT) with a standard 20 percent rate, and various additional local and non-income taxes. Consistent with a holding by the Constitutional Court, the income tax is imposed upon individuals rather than family units (i.e., no joint returns or similar aggregation of income).

Following a more modest reform in 2003, the Italian government, then headed by Premier Silvio Berlusconi, proposed an extensive overhaul of the Italian tax system in 2004 which was loosely modeled on the 1986 U.S. tax reform and including a reduction to three tax rates (*aliquote*) with the maximum rate falling to a level below 40

BUSINESS PUBLICATIONS USA, ITALY TAX GUIDE (4th ed. 2002); for a (briefer) on-line summary, see the Worldwide-Tax website, www.worldwide-tax.com/italy/italy_tax.asp.

9. See Organization for Economic Cooperation and Development, *OECD in Figures: Statistics on the Member Countries*, at 13 (2005) (citing 2004 Gross Domestic Product per capita of \$28,800 at current dollar exchange rates and \$27,700 using the method of Purchasing Power Parities (PPP)); THE ECONOMIST: THE WORLD IN 2005, at 92 (citing 1995 figure of \$31,410). The equivalent OECD figure for the United States was \$39,700 according to both methods. PPPs are intended to correct for price differentials by estimating the value of GDP in terms of a "basket" of equivalent goods and services in each country; the difference tends to be more pronounced in Third World countries.

percent. Following intensive debate and popular protest (see below), a version of the reform was approved in late 2004, providing for a three-rate system (23, 33, and 39 percent); the substitution of tax deductions, some phased out at higher incomes, for many of the previous tax credits, and additional changes. There is also a (nominally temporary) "solidarity" surcharge which results in a 43 percent tax rate for incomes over 100,000 Euros. A significant aspect of the reform was the expansion of the 23 percent bracket from a ceiling of 15,000 to 26,000 Euros, as well as a parallel increase in the untaxed (zero bracket) amount, which arguably make the reform less regressive than recent U.S. tax legislation; nonetheless it has been calculated that 60 percent of the benefit of the reform will go to the wealthiest sixth of Italian taxpayers.

Following the defeat of Berlusconi in a hotly contested election in April 2006, attention shifted toward the possibility of tax increases or at least a slowing down of reduction under the left-center coalition headed by Romano Prodi. Indeed the Finanziaria (budget bill) currently awaiting passage would reverse, if modestly, the Berlusconi tax reduction approach, extending the 43 percent tax rate to incomes over 75,000 Euros with concurrent reductions for lower-income taxpayers. There would also be an increase to 20 percent in the tax rate on most financial transactions, together with a small new estate (successions) tax and a renewed war on tax evasion, which is something of a national sport in Italy.

B. Resistance, Regionalism, and Reaction: The Italian Perspective on Progressive Taxation

In evaluating Italian tax policy, and specifically the matter of progressivity, one must consider the country's somewhat unusual history and political culture. Italy was unified in the 1860s over the fierce opposition of the Roman Catholic Church, although church-state issues were at least nominally resolved by the Lateran Treaties of 1929. Following the defeat of fascism and the rejection of the monarchy in a postwar plebiscite the country became a Republic, the prevailing mythology of which concerned the Resistance struggle against the "Nazi-fascist" occupation of 1943-45 and whose Constitution reflected the influence of the two principal groups (Communists and Christian Democrats) that participated in the Resistance and inherited power in the postwar Republic. The so-called *Prima Repubblica* (first republic), which was governed by the Christian Democrats in an endless series of coalitions and characterized by an uneasy mix of political polarization and personal corruption, collapsed in the early 1990s under the weight of the *tangentopoli* bribery scandals and was replaced by a new party structure which, although following the same nominal constitutional arrangements, effectively amounted to a

new political system. Following a series of left-wing governments—the first in modern Italian history—the industrialist Silvio Berlusconi was elected Prime Minister in 1999 at the head of a rather unstable coalition held together by his personal charisma and, some would say, by a continuation of the old corruption in newer, less obvious garb (Berlusconi himself has been indicted more than 40 times although he has yet to be convicted of any crime). Berlusconi's government achieved numerous successes including accession to the Euro currency and various additional reforms although a substantial amount of its energy was devoted to the Prime Minister's legal problems; its defeat in the 2006 elections was not a surprise and indeed was expected to be rather more dramatic than was actually the case. It must be noted that, while both the Communists and Christian Democrats essentially collapsed in the 1990s, many or most current politicians (including most of Prodi's coalition partners) were previously members of one or another of these parties and the issues as well as flavor of the *Prima Repubblica* continue to set the tone for much of Italian politics.¹⁰

The chronic instability of Italian politics, and the uneasy heritage of the Resistance and the *Prima Repubblica*, affect Italian tax policy in various ways. One obvious result is that there tends to be a high degree of polarization surrounding tax (and other) issues and relatively little middle ground on which to construct a compromise position. For example, the Berlusconi government's 2004-05 tax rate reductions and accompanying spending cuts were met with large street demonstrations—a historically rare demonstration in favor of high taxes—as well as a sit-in by several thousand forest workers in Calabria (southern Italy) who succeeded in blocking a major rail line for a period of several days.¹¹

A second, more subtle effect is that the concept of income redistribution, which was in theory favored by both Communist and Christian Democrat (i.e., Catholic) thinkers, tends to be seen as a quasi-constitutional provision rather than a mere public policy choice. This is literally true, in that the Constitution includes a requirement that the tax system be based on the twin concepts of progressivity and *capacita' contributiva* (ability to pay or taxpaying capacity), although these provisions have only rarely been applied to void a specific provi-

10. For a political history of post-unification Italy, see DENIS MACK SMITH, *MODERN ITALY: A POLITICAL HISTORY* (1997). For a classic work on Italy generally, now dated but with an incomparable perspective on the Anglo-American understanding and misunderstanding of the country, see LUIGI BARZINI, *THE ITALIANS* (1964). For an up-to-date popular perspective (in Italian), see BRUNO VESPA, *STORIA D'ITALIA DA MUSOLINI A BERLUSCONI* (2004).

11. See generally *Il Giorno* (Oct. 28, 2004), <http://ilgiorno.quotidiano.net/art/2004/10/28/5361280> (describing strikes and street protests against proposed fiscal reform which allegedly "rewards the rich" and results in unfair spending reductions).

sion of law.¹² But it has a symbolic significance that goes well beyond the written language. Put simply, progressive taxation is one of a number of Italian laws and institutions, including generous welfare and retirement benefits, aid to depressed (primarily southern) regions, the effective ban on firing anyone who works for a company that has 15 or more employees (Article 18), and other similar provisions, that are viewed as essential elements of the postwar structure and without which, many Italians fear, the country would slip back into the fear and insecurity that made fascism possible. The philosophy of redistribution (and hence progressive taxation) is buttressed by the concept of *solidarieta'*, a rather vague notion of civic duty which has the advantage of finding support among both Catholic and Marxist thinkers and tends to emphasize the moral rather than the utilitarian side of the progressivity equation.¹³ It should be added that Italy also has a large and vocal class of *imprenditori* (entrepreneurs) as well as increasingly vocal economists and public finance experts who see the postwar consensus as the source of Italy's problems rather than their solution: the effect is not so much to turn the debate in favor of progressivity as to increase the stakes for the participants, and give the tax discussion a moral and political significance that might be less formidable in other societies.

A third effect of Italian political culture relates to the impact of regionalism and the continuing inequality between north and south. This issue is considered further in the following section.

12. The language of these provisions has been translated as follows:

Art. 53

1. Everyone has to contribute to public expenditure in proportion to their capacity.
2. The tax system has to conform to the principle of progression.

See Italy-Constitution, International Constitutional Law series, at website of the Universitat Bern, Institut für Öffentliches Recht, www.oefre.unibe.ch/law/icl/it00000_.html. "Capacita' contributiva" has been alternately translated as "taxpaying capacity" or, somewhat more poetically, "ability to pay." The effect of these provisions has been somewhat muted by the courts' position that they apply to the overall tax system rather than any specific part of it; it has accordingly been fairly rare for a specific tax rule to be struck down for violation of these provisions. Nevertheless, they state a clear policy of progressivity and respect for taxpaying capacity and as such retain at least an inspirational role in the Italian tax system. See generally DE MITA, *supra* note 8, at 83-104; RUSSO, *supra* note 8, Parte Generale at 48-50, 60-61; LA CAPACITA' CONTRIBUTIVA (Francesco Moschetti ed., 1993). One noteworthy application of the taxpaying capacity rule was the constitutional court's decision banning the use of joint married returns, on the grounds that they failed to base income taxes on the taxpaying ability of an individual rather than his or her spouse. This decision notably complicated tax progressivity since two-earner couples tend to be concentrated at the high end of the Italian income scale. Corte Costituzionale n.179 (1976); see DE MITA, *supra* note 8, at 90.

13. On the concept of *solidarieta'* and tax policy relevance, see generally SERIO GALEOTTI, *IL VALORE DELLA SOLIDARIETA'*, RIVISTO DI DIRITTO SOCIALE (1996); Università di Bergamo, Fondazione Antonio Uckmar, Giornate Europee di diritto costituzionale tributario, 5th ed.: *Il Dovero di Solidarieta'* (conference proceedings Nov. 14-15, 2003).

C. *Avoidance, Amnesties, and Life in the European Union: The Peculiarities of Italian Tax Culture*

If Italian political life is distinctive, the country's tax culture is no less so. Three factors are especially important here: a high degree of perceived and probably real tax avoidance, sometimes with effective governmental complicity; a particular difficulty in the taxation of income from capital; and membership in the E.U. (European Union) and European currency (Euro), which provide significant advantages to Italy but also restrict its flexibility in tax and spending matters. Together these items have an equal or perhaps greater impact than the "deeper" differences discussed above.¹⁴

Tax evasion is sometimes exaggerated and is probably greater for property, inheritance, and similar levies than for the income tax, a very large portion of which is withheld at the source. But it remains an important factor particularly with respect to business taxes. Tax evasion is exacerbated by Italy's tradition of "family capitalism" which makes it difficult to measure income and to police the boundary between business and personal expenses. A series of extraordinarily generous tax amnesties, some of which have allowed taxpayers to get off the hook by paying only a small fraction of tax liability, amount to a tacit recognition if not acceptance of this phenomenon.¹⁵ The tax amnesties have also had a negative effect on taxpayer morale suggesting that it is somewhat foolish to pay tax honestly and (for opponents of Berlusconi) confirming what they see as the essentially corrupt nature of the overall fiscal system.

Italy faces a particular difficulty in the taxation of income from capital owing to the presence of easily accessible tax haven countries (notably Switzerland and Luxembourg) and a more general fear of capital flight if taxes are strictly enforced. Switzerland in particular is closer to Milan, the principal financial center, than are most other Italian cities and has a reputation for financial stability as well as secrecy that may attract capital away from Italy even beyond the tax consequences. Partly for these reasons the Italian tax system provides a flat 12.5 percent rate on capital income which severely compromises the progressivity concept and increases the pressure for higher tax rates on remaining forms of income. (The current budget bill proposes an increase to 20 percent in most taxes on financial income.)

14. For an overview of Italian tax administration and taxpaying culture, see generally DE MITA, *supra* note 8, at 31-79; PRICE WATERHOUSE, *DOING BUSINESS IN ITALY* (2006).

15. Perhaps the best single evidence of the role of *condoni* (amnesties) in Italian life is the existence of an entire commercial web address devoted exclusively to the subject. See IPSOAit: A Walters Kluwer Company, *Speciale Condoni & Concordato 2004*, www.ipsoa.it/condono/modulistica_0.asp (providing information on tax, building code, and other amnesties of interest to Italian business and professional readers).

Together with these items must be mentioned the role of the E.U. and of Italy's participation in the Maastricht agreement which adopted the joint European currency or Euro. As part of Maastricht, the participating nations agreed to keep their budget deficits below three percent of GNP which for Italy has historically been more difficult than for other countries. Tax reductions must accordingly be met by equal and offsetting reductions in spending and thus have an immediate and visible political impact greater than that in the U.S. where deficits may avoid or (more likely) postpone the more difficult fiscal choices. The E.U. itself has a lesser role in income taxation although there is increased pressure for harmonization at least of corporate taxes, and reduced tax rates for economically underdeveloped regions (i.e., the South) have been held to constitute impermissible subsidies under prevailing E.U. doctrine. In this sense the E.U. restricts tax competition, although by reducing the ability to fix separate national policy in other areas (tariffs, licensing, etc.) it may in a relative sense actually encourage it.

Also relevant is the ban imposed by the Italian constitutional court on the aggregation of income of married couples and the corresponding reliance on an exclusively individual basis.¹⁶ This is significant because it makes progressivity between married couples more difficult to achieve, and may tend to exacerbate the inequity between two career couples and single earner families in which are concentrated the majority of Italy's poor.

D. Theory and Practice: Do the Differences Matter?

Italy thus faces a situation in which its political culture encourages a relatively high level of at least nominal progressivity, while its tax culture and the realities of its economic situation make real progressivity difficult to achieve. This is particularly true given the effective exclusion of capital income from the progressive tax base which means that the impact of redistribution will be limited to wage earners. Both the forces encouraging and discouraging progressivity are thus exaggerated in the Italian case as compared to most First World countries.

Do these differences matter? It is striking that, notwithstanding its special features, Italy in 2004 adopted a tax reform program that has many features in common with earlier U.S. legislation: a reduction in marginal tax rates and in the number of tax brackets although perhaps with a greater effort than in the U.S. at softening the resulting inequity with respect to poorer taxpayers. Yet the response to this legislation differed from that in the U.S. and the other countries studies. While the U.S. and (to a degree) Israel and India appear to

16. See *supra* note 12.

have accepted tax changes rather quietly, in Italy the response has been highly polarized, with the Berlusconi government arguing that the changes were necessary to promote competition (and that progressivity is in any case illusory given the persistent failure to include capital income) while much of the public appears to remain attached to a more steeply progressive system. The debate in Italy is also more tied to general political trends, with Berlusconi's supporters tending to support tax reform and Prodi's tending to oppose it; the temptation to leave tax policy to the "experts," so prevalent in some countries, appears to have made fewer inroads here.

Italy thus presents a case in which both general and tax culture have an important impact on progressivity, but it is as yet unclear which will be decisive, or if either will be able to resist the impact of raw economic forces. The notion of a fiscal "life cycle," in which steeply progressive tax rates become attractive at a certain phase of political and economic development but come to be seen (at least by the elites) as an unaffordable luxury at a later stage, is an intriguing aspect of the Italian situation: the Berlusconi government indeed made a rather forceful effort to portray matters in this way. But it is not clear that a majority of Italians, let alone the new left-center government, accept this analysis or will do so anytime soon; or how exactly they would behave if they did.

III. ISRAEL: ZIONISM, SOCIALISM, AND THE POLITICS OF ETHNO-RELIGIOUS COMMUNITIES: DOES "DISTRIBUTIVE JUSTICE" HAVE A FUTURE?

The second country, Israel, is the smallest and arguably the most Americanized of the three countries studied, but has many unique features that distinguish it from both the United States and the Italian example above.¹⁷ These differences concern partially political and social characteristics—the socialist tradition, ethnic conflict, and the

17. The discussion of Israel is based on similar sources to that of Italy, i.e., interviews conducted during recent trips to Israel as well as by telephone, e-mail, etc.; several years of following the issue through the on-line English edition of *Ha'aretz*, the most influential Israeli newspaper, together with numerous forays into the mass circulation Hebrew-language press; and a somewhat smaller but not insignificant number of written sources. For a brief general overview, in English, of the Israeli tax system, see ARIEL BIN-NUN, *THE LAW OF THE STATE OF ISRAEL* 97-103 (2d ed. 1992); for a more complete introduction, in Hebrew, see AMNON RAPHAEL, *DINE MAS HACHNESA* (Income Tax Law) (2d ed. 2005). For a more comprehensive survey of the nature and history of Israeli tax administration, now about a generation old, see HAROLD C. WILKENFELD, *TAXES AND PEOPLE IN ISRAEL* (1973). An excellent collection of articles on the allocative effects of contemporary Israeli tax, spending, and other economic/social policy, in Hebrew, is TZEDEK KHALUKATI BE'YISRAEL (Distributive Justice in Israel) (Menachem Mautner ed., 2000); the introduction by Prof. Mautner and articles by Yechezkiel Lein on the politics of stock market taxation, Tsilly Dagan on the "hidden" distributive implications of the Israeli tax code, and Yoram Margalioth on the concept of a negative income tax in an Israeli context are of particular interest. See also Adva Center, *The Social Implications of Fiscal Policy: Looking at Israel's 2005*

prevalence of security concerns—for which the country is famous, but also more tax-specific features such as an unusual system of tax administration and a history of large, arguably illogical tax exemptions that make the achieving of real as opposed to nominal progressivity more difficult than it might otherwise be. As in the Italian case, the latter factors often threaten to overwhelm their former, better known counterparts; although both the nature of the factors and the balance between them is different here. The combination of these factors ensures both that tax reform in Israel will be a messy process, and that it will never be entirely separate from other, more prominent issues facing the country.

A. *The Israeli Tax System: A General Outline*

Israel is a parliamentary democracy with a per capita income of approximately \$18,000-\$20,000 per year.¹⁸ The country has a progressive income tax with six tax rates ranging from 10 to 48 percent on incomes exceeding IS 413,000 (approximately \$100,000). There is also a corporate income tax at a flat 29 percent rate; a flat 20 percent tax rate on capital gain in excess of inflation (although subject to various exceptions); and a 15.5 percent national VAT. The effective tax bite has traditionally been higher than income tax rates might indicate both because of the effect of social insurance and health charges and the fact that a rate of 30-40 percent is reached at a relatively modest level of income. When phase-ins adopted in the 2005 tax reform are fully effective the maximum combined rate of income and social insurance taxes will be 44 percent as compared to more than 60 percent when the current wave of reforms began, along with further reductions in corporate and value added taxes.

The present tax system reflects a rather extensive series of reforms, the most recent of which was undertaken in 2005 and included significant tax rate reductions (as described above) together with reform in interest and dividend taxation, taxation of trusts, and the treatment of foreign taxpayers.¹⁹ A previous reform, in 2003-04, was still broader and contained provisions including the taxation of capi-

Budget Proposal (presentation for Knesset (Parliament) Members), Nov. 16, 2004, available at www.adva.org.

18. See THE ECONOMIST: THE WORLD IN 2005, at 92 (citing 1995 figure of \$17,540). These figures include both Jewish and Arab citizens but not the populations of the West Bank and Gaza Strip nominally under control of the Palestinian Authority.

19. A convenient English-language summary of the 2005 amendments may be found at www.pwcglobal.com/il/eng. Israeli tax reforms typically initiate with a report by a blue-ribbon commission, chaired by a well-known economist or other expert; depending upon political factors all or part of the commission's proposals are then enacted into law. Given Israel's small size and the well-traveled nature of its academic establishment, the reports often pay extensive attention to the treatment of similar issues in other countries, giving its tax policy arguably the most "international" character of the countries studied. See, e.g., *Riforma B'Mas Hachnasa: Hamlatzot Hava'adah L'Riforma B'mas* (Rabinowitz Commission Report) (2002);

tal gains which were previously exempt from tax; taxation of Israelis on worldwide rather than solely on Israeli income; and a reduction from still higher tax rates previously imposed. The general pattern has thus been one of reduced tax rates with a corresponding effort to expand and level the tax base, having the goal if not necessarily the result of revenue neutrality. Several additional changes have been proposed in recent years, with the goal of further reducing the aggregate tax burden and/or increasing tax equity, although none has yet been adopted.

B. Zionism, Socialism, Tribalism: An Israeli Perspective on Distributive Justice and Progressive Taxation

The starting place for any discussion of Israeli taxation or fiscal policy is the country's Zionist heritage, a rather unique ideology which mixed nationalism, socialism, and the "return to the land" of Israel in an effort to build a new nation and overcome what was perceived as the decadence or at very least the loss of physical vitality among Jews after almost 2,000 years of exile. Although there are numerous contradictions within this ideology, including an inevitable clash between socialism and nationalism and the uncomfortable coincidence between the Zionist critique and European antisemitic stereotypes, and although some observers have derided the entire ideology as lacking in intellectual or moral substance, it was central to the formation of the state and continues to exercise an important influence 60 years later. Without question the structure of the Israeli economy in the first 40 years of statehood, which featured high taxes, an enormous state sector, and a relatively even distribution of incomes for an industrialized country, reflected this dominant ideology.²⁰

In recent years the socialist ideology has been in headlong decline, resulting partly from its own internal failures as represented most noticeably by the relative decline of the Kibbutz (collective farm) movement, but also from pressure by economic reformers and ordinary Israelis who seek a "better life" along an American or Euro-

Duach Hava'adah Hatziborit L'Riforma B'Mas Hachnasa (Ben Bassat Commission Report) (2000).

20. Whether and to what extent Israel ever constituted a "socialist" state, as opposed to a capitalist state with large-scale public enterprises, is the topic of considerable discussion; the debate, as one might imagine, is difficult to separate from controversies regarding external relations and has important implications for contemporary policy issues. For a skeptical view of Israeli socialism, see ZE'EV STERNHELL, *THE FOUNDING MYTHS OF ISRAEL* (1997) (arguing that nationalism took precedence over socialism in Israeli ideology and socialist goals were regularly compromised or abandoned when conflicting with national aspirations). For a somewhat more traditional viewpoint, see HOWARD M. SACHAR, *A HISTORY OF ISRAEL: FROM THE RISE OF ZIONISM TO OUR TIME* (2d ed. 1996) (providing a generally sympathetic treatment of the Zionist enterprise and the rise of modern Israel).

pean model. This change in focus expresses itself both in specific governmental policies and in the allocation of benefits within the private sector, with a widely increasing gap between rich and poor that has raised concerns for *tzedek khalukati* (distributive justice) and indeed the fate of the entire Zionist enterprise.²¹ These concerns are exacerbated by the reality, always present but previously overlooked, of a powerful correlation between ethnicity or social grouping and wealth, with not only the country's Arab minority but also Jewish citizens of Middle Eastern/North African origin (*edot hamizrakh*) and in many cases religious Jews failing to share in the prosperity of the largely secular, European upper middle class.²² While setting the context for the broader debate on social justice, ethnic or religious differences also reflect themselves in highly specific and focused policy issues. For example, family and child allowances in Israel, which historically increase the greater the number of children, are theoretically available to all citizens, but in practice benefit overwhelmingly the religious (and to some extent the Palestinian Arab) communities who tend to have much larger families, and are subject to frequent criticism from various political parties on this basis.

One result of these factors is that, while social justice in Italy tends to be perceived in class and perhaps regional terms, in Israel it is more likely to be viewed in terms of ethnicity, coupled with an ideological, quasi-religious debate about the fate of socialist Zionism and the role of alternative ideologies. Taxation and fiscal policy are also constrained by the country's somewhat unusual tax culture (see below) and by the prevalence of security concerns, which make higher taxes appear almost patriotic and at least until recently made it difficult to propose changes that might result in the loss of even short-term revenues. Perhaps as a result of these factors, redistribution in Israel has traditionally been accomplished more by spending than tax measures, and only recently if at all have taxes come to occupy center stage in the country.

C. *Informality, Confrontation, and an Overreliance on Withholding Taxes: Israel's Unusual Tax Culture*

A further result of Israel's founding ideology, together with its British colonial heritage, is what most Americans would probably

21. See *supra* note 17.

22. On the correlation between ethnicity and economic status, see "The Ashkenazim Earn 36 Percent More Than the Mizrahim," *Ma'ariv* (daily newspaper), Dec. 13, 2005, at 1 (front-page headline for articles citing a study by Adva Center, finding Jews of European origin earn substantially more than those from North African and Middle Eastern families and that benefits of recent economic growth go disproportionately to upper income brackets). The full study is entitled "Israel: A Social Report" and is available at www.adva.org. Arab families in Israel have lower incomes than either category of Jews although somewhat higher than neighboring countries.

consider to be a somewhat unusual tax culture. Taxation in Israel has historically been characterized by several factors, including extraordinarily high taxes on wages, with income tax rates until recently peaking at over 50 percent (higher when social insurance taxes are included) and the maximum rate reached at a lower relative income than in most industrialized countries; a heavy and at times exclusive reliance on salary or wage withholding, with a small number of deductions and credits and many or most individual taxpayers not filing tax returns at all; and a correspondingly leaky taxation of unearned income, with outright exclusion of all capital gain income until recently, and subsequent full or partial exemption of more specific categories of income and inconsistent enforcement as applied to business taxpayers. The tax system is further characterized by a high degree of informality and (some would argue) inconsistency, with many rules unwritten, business taxes often negotiated between the revenue service and business owner, and high-priced or in any event well-connected tax advisors, many of them former tax officials, frequently hired by better-off taxpayers in an effort to reduce tax liability. One result is that non-wage or in any event unreported income tends to be rather highly prized in Israel, being worth at least twice as much on the dollar as the taxable wage variety, a situation which leads to substantial economic distortion and a widespread perception of abuse. A further consequence is that tax reform in Israel typically begins with a discussion of the country's tax base, and particularly the allocation of taxes between earned and unearned income, rather than the nominal tax rates.²³

There is no equivalent to the E.U. or similar regional organization in Israel, although the country's small size and geographic isolation make it unusually suspect to external political or economic pressure.

D. Reaction and Counter-Reaction: The Netanyahu Reforms

Even more than Italy, Israel has recently been involved in a series of tax reforms with a distinctly American stamp. This process involves a tradeoff of reduced tax rates for a somewhat expanded tax base and is part of a larger series of reforms, which were pushed aggressively by (until recently) Finance Minister Binyamin Netanyahu and a largely American-trained cadre of advisors, that had the spe-

23. For an assessment of Israeli tax culture and institutions, paying particular attention to the colonial (i.e., British mandate) origins of the Israeli tax administration, see generally WILKENFELD, *supra* note 17, at 43-81 (tax administrative structure), 177-208 (dispute resolution mechanisms), and 209-51 (responses to tax evasion). For a more recent treatment of the tax evasion issue, including several fascinating insights into Israeli attitudes generally, see Assaf Likhovski, *Formalism and Israeli Anti-Avoidance Doctrines in the 1950s and 1960s*, in *STUDIES IN THE HISTORY OF TAX LAW* (John Tiley ed., 2004).