

APPROACHES FROM THE NEW INSTITUTIONAL ECONOMICS TO MAXIMIZING VOLUNTARY COMPLIANCE IN THE REPUBLIC OF MOLDOVA AND EU COUNTRIES

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Abstract: This paper examines the role of institutional design in fostering voluntary tax compliance, drawing on insights from the New Institutional Economics (NIE), Public Choice theory, and transaction cost economics. Beginning with Buchanan's conceptualization of the necessity of the state in *The Limits of Liberty*, it highlights how public institutions can reduce transaction costs, thereby creating incentives for benevolent compliance among economic agents. The analysis incorporates Coase's framework of transaction costs and North's notion of open-order institutions, showing how well-structured fiscal systems transform state institutions into credible and efficient enforcers of public finance. Further, the paper explores the relationship between institutional legitimacy and revenue outcomes, arguing that higher public trust correlates with greater tax compliance, as evidenced by Scandinavian countries, whereas low legitimacy, as in the Moldovan case, hinders revenue collection. Finally, the European Union is presented as a supranational mechanism that harmonizes fiscal policies across member states, reducing administrative burdens and evasion while maximizing compliance. Overall, the paper underscores the critical importance of institutional legitimacy and coordinated policy design in achieving efficient public finance outcomes

Keywords: voluntary compliance, new institutional economics, tax revenues, public finance.

JEL Classification: H20, H26, D02, D73

INTRODUCTION

Voluntary tax compliance represents one of the essential elements of an efficient public administration, as it reflects the extent to which taxpayers choose to fulfill their fiscal obligations on their own initiative. In the contemporary economy, the way the state organizes institutions, rules, and incentives plays a decisive role in shaping this behavior. The New Institutional Economics provides an analytical framework in which formal and informal institutions, transaction costs, trust, and governance quality can be understood as central factors influencing taxpayer motivation.

Both in the Republic of Moldova and in the member states of the European Union, strengthening voluntary compliance has become a strategic objective. As economies transform and the relationship between the state and taxpayers evolves, new needs emerge: clarity in regulations, simplified administrative processes, accessible digital systems, and a high level of fiscal predictability. Beyond procedures, however, the fundamental question remains: how can an institutional framework be built that reduces tensions between authorities and taxpayers and encourages cooperation?

This paper analyzes how the principles and concepts of New Institutional Economics can be integrated into fiscal policies to support voluntary compliance. It examines the role of rules, incentives, institutional credibility, and the quality of interactions between the state and citizens, highlighting both similarities and differences between the Republic of Moldova and EU countries.

Throughout the paper, several essential elements for maximizing voluntary compliance are emphasized, such as the necessity of a fiscal system and the level of trust in public sector institutions.

The aim is to demonstrate how an appropriate institutional design can transform fiscal behavior and provide a solid foundation for sustainable public policies.

CORE CONTENT

1.1. Fiscal institutions and the minimization of transactional costs

The necessity of public finance can be rigorously formulated through the lens of ideas developed in public choice theory and in the new institutional economics. In the tradition of James Buchanan, the state is not conceived as a benevolent actor, but as an institutional structure created through agreement among individuals to overcome the limits of spontaneous cooperation. In *The Limits of Liberty* (Buchanan, 1975), Buchanan shows that, in the absence of a collective mechanism for establishing and enforcing rules, social interactions tend to deteriorate into a situation where each person pursues their own interest without being able to rely on predictable behavior from others. The state thus emerges as a contractual solution to stabilize expectations, protect property rights, and provide public goods that cannot be efficiently produced through individual action.

This perspective is organically linked to Ronald Coase's analysis of transaction costs (Coase, 1937). Coase argues that in any real economy, exchange is never free. Negotiation, monitoring, enforcing contracts, and coordinating decisions among many agents generate significant costs. Without institutions that reduce these costs, the market would become fragmented and inefficient. From this follows the crucial role of the fiscal-budgetary framework: it functions as a collective mechanism through which society finances the institutions that reduce the transaction costs associated with social order.

Through the existence of a stable fiscal-budgetary system, the state can finance courts, regulatory agencies, information infrastructure, property rights protection, quality standards, and coordination mechanisms that reduce the individual costs of economic interactions. Without these institutions, each economic actor would have to bear much higher costs to secure the same functions: protection, verification, arbitration, access to information, or contract enforcement. The fiscal system thus becomes a necessary instrument for producing those "institutional goods" that enable markets to function.

In Douglass North's logic, institutions that systematically reduce uncertainty and transaction costs contribute to transforming the state from a limited-order structure into an open-order one. In a limited order, access to resources, opportunities, and legal protection depends on belonging to privileged groups or personal relationships (North, 2009). By contrast, an open order presupposes impersonal institutions, broad access to the market, general and predictable rules, and equal treatment. Public finance is the material condition for the existence of these impersonal institutions: without stable collective resources, the state cannot provide the legal, administrative, and fiscal infrastructure that guarantees equal and predictable access for all economic participants.

Thus, from the perspective of the new institutional economics, public finance is not merely a mechanism of redistribution or a technical matter of public accounting. It represents the material foundation of the institutions that reduce transaction costs and enable the functioning of an open, stable, and development-oriented social order.

From the combined perspective of public choice theory, Coasean transaction-cost analysis, and the institutional framework proposed by Douglass North, voluntary tax compliance can be understood not merely as a moral preference but as a rational strategy adopted by economic agents seeking to minimize their own transaction costs. These theoretical traditions converge on the idea that individuals respond to incentives shaped by institutions, and that predictable, rule-based environments lower the costs associated with economic and social interactions.

Public choice theory, following Buchanan, explains that individuals consent to collective rules, including taxation, when those rules create a more stable and cooperative environment than the uncoordinated alternative. In *The Limits of Liberty*, Buchanan emphasizes that the formation of a state is essentially a contractual solution: individuals accept certain obligations because the institutional order financed by those obligations provides benefits that exceed the costs. In this logic, tax compliance becomes a form of rational cooperation. By complying, individuals contribute to

maintaining the institutional structure that protects property rights, ensures contract enforcement, and reduces the risk of opportunistic behavior by others.

Coase's theory adds a crucial layer. If transaction costs define the efficiency of any arrangement, then avoiding or undermining the fiscal system generates additional costs for the agents themselves. Tax evasion or resistance increases monitoring costs, legal risks, uncertainty, and the potential breakdown of the institutional services that reduce these costs in the first place. Contributing to the public budget through tax compliance is, in Coasean terms, a way to sustain the institutions that minimize negotiation, enforcement, and information costs across the economy. Compliance therefore becomes not just a legal obligation but a cost-minimizing strategy.

In North's framework, a fiscal system that finances impersonal, rule-bound institutions is the backbone of an open-access order. When such institutions are credible and predictable, economic agents benefit from a stable environment that reduces the need for constant private enforcement, bilateral bargaining, or reliance on personal networks. Agents in an open-access order face lower overall transaction costs precisely because the state supplies the legal and administrative infrastructure collectively. Voluntary compliance is thus reinforced by the positive-sum nature of the institutional environment: by cooperating with the fiscal system, agents help maintain the very conditions that reduce uncertainty and expand opportunities.

Taken together, these strands of theory suggest that benevolent tax compliance is not an anomaly but a rational outcome when institutions are well designed. Faced with the choice between a low-compliance environment characterized by high uncertainty and high private enforcement costs, or a high-compliance environment where collective institutions lower transaction costs for all, economic agents will generally gravitate toward compliance. They do so not because they romanticize the state, but because cooperating with the fiscal system is strategically aligned with their own interest in reducing transaction costs and securing predictable, open, and efficient markets.

The European Union plays a comparable role in reducing transaction costs for its member states by harmonizing and coordinating fiscal policies across the region. Through mechanisms such as common reporting standards, VAT directives, and anti-fraud frameworks, the EU lowers the administrative and informational burdens that individual states would otherwise face when enforcing tax compliance. By standardizing procedures and increasing transparency, these measures reduce opportunities for tax evasion, limit legal and regulatory arbitrage, and create a more predictable environment for economic agents. Consequently, this coordinated approach enhances voluntary compliance, ensuring that revenue collection is more efficient and consistent across member states, much like a benevolent institutional framework would operate at the national level.

1.2. Public consent and tax collection

Knut Wicksell argued that a public policy achieves the efficiency of a market outcome when it is perceived as fully legitimate by those who bear its costs (Wicksell, 1896). In his view, legitimacy arises when taxpayers regard a policy as fair, transparent, and aligned with their preferences, much like market participants voluntarily enter exchanges because they expect mutual benefit. When citizens perceive a fiscal policy as legitimate, they internalize its necessity, reduce resistance, and comply voluntarily. This voluntary alignment minimizes enforcement costs and reduces the distortions normally associated with taxation. In this sense, a highly legitimate public policy can reach a level of allocative efficiency comparable to private market transactions.

This reasoning provides a conceptual bridge to the logic of the Laffer curve. The Laffer curve illustrates that tax revenues do not grow indefinitely with higher tax rates. Beyond a certain point, higher rates reduce the willingness of taxpayers to comply, encourage avoidance or evasion, and weaken economic activity. Wicksell's insight helps explain why the location of this maximum point varies across countries: it depends not only on economic fundamentals, but also on the legitimacy of public institutions.

When institutions are viewed as fair, transparent, and accountable, taxpayers perceive the fiscal burden as justified. This increases voluntary compliance, shifts the behavioral response to taxation, and pushes the revenue-maximizing point of the Laffer curve to a higher level.

Conversely, when institutions lack legitimacy, taxpayers interpret taxes as extraction rather than contribution, compliance drops, and the peak of the Laffer curve occurs at a lower tax rate.

Table 1.1 provides the data for different European countries regarding the tax to GDP % rate and the democracy index. Our hypothesis is that more democratic countries will have bigger tax to GDP ratio caused by bigger trust in institutions.

Table 1. European countries by Democracy index and Tax to GDP ratio

Country	Democracy index	Tax do GDP ratio (%)
Europe	0.72	40.4
Germany	0.84	40.9
Spain	0.83	37.3
France	0.87	45.3
Italy	0.8	42.6
Luxembourg	0.87	42.7
Netherlands	0.82	39.4
Austria	0.84	43.8
Romania	0.63	28.8
Finland	0.85	42.3
Sweden	0.88	42.5
Norway	0.88	40.4
Switzerland	0.89	27.8
Moldova	0.63	33.9

Source: Prepared by the author based on data presented by the IMF (2023)

Thus, there is a correlation between institutional legitimacy and the revenue-maximizing point on the Laffer curve (Laffer, 2004). Countries with highly legitimate fiscal and administrative institutions can sustain higher effective tax rates without triggering the steep decline in revenues predicted by the Laffer curve, while countries with low trust and low legitimacy reach that peak much earlier. In this sense, Wicksell's theory provides an institutional explanation for cross-country differences in the shape and height of the Laffer curve.

This correlation between institutional legitimacy and the revenue-maximizing point of the Laffer curve is shaped not only by formal institutional design, but also by deeper cultural and national characteristics, as well as the broader political environment. Patterns of trust, expectations regarding the state, historical experience with governance, and the stability of political institutions influence how taxpayers interpret the fiscal burden and how they respond to taxation.

Scandinavian countries illustrate this mechanism clearly. Even though they maintain some of the highest tax pressures in the world, their public institutions are widely regarded as fair, efficient, transparent, and oriented toward the public good. Citizens perceive taxes as part of a reciprocal relationship: high contributions are matched by high-quality public services, predictable rules, and low corruption. This high legitimacy shifts the behavioral response to taxation and allows these states to operate near the upper end of the Laffer curve. In other words, the revenue-maximizing point is higher because cultural norms and institutional trust make voluntary compliance stronger.

Figure 1.1 represents the data from Table 1.1. It can be clearly seen that there is a positive correlation between the democracy index and tax to GDP ratio. The author does not argue for the idea that institutional trust is the only factor that determines bigger rates of tax to GDP in more democratic countries, but it is clearly one factor that has an important contribution.

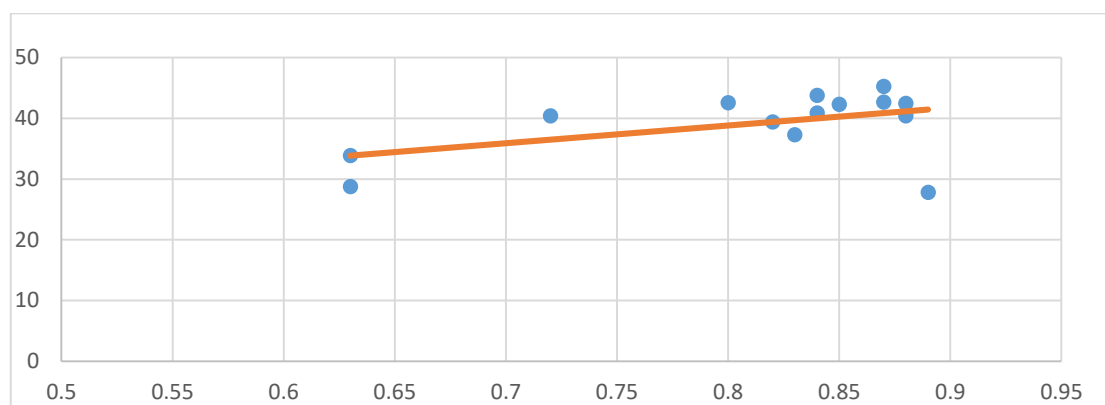


Figure 1.1. The trend line for tax to GDP ratio in dependence of the democracy index.

Source: Prepared by the author based on the data from table 1.1

The Moldovan context stands in contrast. Historically lower levels of trust in government, frequent political instability, and perceptions of weak institutional performance reduce the legitimacy of the fiscal system. In such an environment, citizens interpret the tax burden with more skepticism, and voluntary compliance is more fragile. As a result, the revenue-maximizing point of the Laffer curve occurs at a lower tax rate, because increases in tax pressure are quickly met with higher evasion, avoidance, and informal-sector expansion. The cultural and political environment amplifies these effects: where institutional legitimacy is low, the behavioral elasticity of taxpayers becomes much higher.

Thus, differences in national culture and political context shape the relationship between legitimacy and fiscal capacity. High-trust societies can sustain higher effective tax rates without undermining compliance, while low-trust environments reach the limits of the Laffer curve much earlier.

CONCLUSIONS

The analysis demonstrates that voluntary tax compliance is deeply contingent on the legitimacy and design of public institutions. By reducing transaction costs through transparent, predictable, and well-enforced fiscal policies, states can transform their fiscal systems into instruments of efficiency and public trust. Empirical comparisons, such as the Scandinavian and Moldovan contexts, illustrate that cultural and political factors modulate the effectiveness of these institutions. Moreover, the European Union exemplifies how supranational coordination can achieve similar goals at a broader scale, harmonizing rules to minimize evasion and streamline compliance across member states. These findings highlight that beyond traditional market mechanisms, the legitimacy of public institutions and the rational design of fiscal frameworks are essential determinants of tax revenue maximization and sustainable public finance.

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