

The Percentage Law and the Mediation of Political Conflict

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Abstract

THE PERCENTAGE LAW AND THE MEDIATION OF POLITICAL CONFLICT

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In the last 10 years, a new tax incentive for charitable giving has swept through Central and Eastern Europe. Known as the percentage law, it allows tax payers to give a portion of their income-tax burden to a not-for-profit organization (NPO) of their choice. Hailed as a method for increasing local participation in civil society, a form of the law has been adopted in 8 countries with several others considering its implementation. Using the analytical tools of public choice to frame historical events, this dissertation shows that it is conflict that drove the implementation of the law and not the demand for coordination in civil society. Furthermore, behavioral experiments show greater crowding-out effects under the law, while field interviews with leaders of NPOs confirm that the law has little impact on the participation of all but the largest NPOs. The study predicts that countries with bimodal preference are more likely to implement the percentage law than are countries with normally distributed preferences.

Chapter 1: Introduction

In Central and Eastern Europe a new tax law has gained considerable popularity. Known as the Percentage Law (PL), it has been hailed as a means of increasing public participation in civil society, as well as providing a local source of funding to a burgeoning third sector¹. The law allows tax payers to designate a portion of their income-tax burden to a registered not-for-profit organization (NPO) of their choice. It has been implemented in various forms by 8 countries with several others considering it.

The PL is similar to a tax credit for charitable donations. Like a tax credit, the PL allows the donor to recover the entire amount of the donation from a reduction in tax burden. The limit to which they can claim is set as a proportion of the total tax burden of the tax payer. The proportion varies from country to country and ranges from 0.5% to 2% of the tax burden.

The framing of the PL differs in two aspects. Tax credits normally function as rebates once the donor has made the donation. It is the responsibility of the donor to claim the tax relief after she has completed the donation. The PL is not a rebate for past donations, but a transfer from the government to an NPO upon the request of the tax payer. Therefore, funds are transferred ex ante in a tax credit and ex post in the PL. Although this difference has not theoretical implications, the framing may have behavioral effects.

The second aspect is the set of NPO to which the tax payer can contribute. Most of the countries with the PL require that the organization be registered with the State before they can participate in the law. In several States only religious organizations have the option of

¹The third sector is private organization that produce public goods. A working definition is given by Salamon and Anheier [35], it is used to describe the sector of the economy that is neither private nor public

participating, such as in Spain and Slovenia. These restrictions confine the law to specific subgroups.

The differences between the PL and tax credits are minor. For this reason, the implications of the PL may also apply to tax credits. It is not the express purpose of this dissertation to explore the differences between the PL and tax credits for donation. Therefore, research beyond this dissertation is needed to understand the effects of both framing and subgroup before definite comparisons can be made.

The PL reduces the revenues of the State in return for greater private production of public goods through NPO. Both Buchanan [9] and Niskanen [30] have argued that the State seeks to maximize their budgets and control over resources. The implementation of the PL seems to contradict in that it reduces the governments control over public goods. Why the governments would forgo these revenues and the control of public-good production is not clear.

Research conducted by NIOK², a not-for-profit organization that promotes the development of civil society, suggests that governments pressed the enactment of the PL in order to promote the development of civil society and provide a local source of funding for NPO. Most of this research is anecdotal and lacks an analytical and theoretical framework. As such, accounts of the development of the PL across countries are disjointed and provide no common theme to frame the phenomenon. Therefore, the research is not conclusive and provides little predictive potential.

The purpose of this dissertation is to provide an analytical and theoretical framework to explain why the PL was implemented and where it is most likely to be implemented in the future. Moreover, I show that the PL does not provide a local source funding for NPO nor does it increase participation in civil society. In Chapter 1, I develop an analytical framework predict the circumstances under which the PL is enacted. Furthermore, I use the framework to create an analytical narrative of the first four countries to pass the law. Elements of the narrative are tested using Qualitative Comparative Analysis. In chapter 2,

²See NIOK website: <http://www.onepercent.hu/research.htm>

the effects of the PL on participation are tested in a laboratory experiment using crowding-out as a proxy for participation. In chapter 3, interviews with NPO in Romania shortly after the enactment of the PL exposes the institutional details that affect NPO and tax payer decision making. I conclude with a summary of the analysis presented in this dissertation.

Chapter 2:

The Adoption and Evolution of the Percentage Law

2.1 Introduction

The roots of the Percentage Law (PL) are in a 1984 treaty between the Vatican and the Italian State. As other countries adopted the law, it transformed into a subsidy accessible to all NPO. In this form it was adopted by several of the transitioning countries in Europe. The lack of adoption by other countries with similar civil-society challenges would seem to indicate that the reasons for enacting the law may be beyond the claims of increasing public participation or promoting the growth of the third sector.

The public choice approach to non-market decision making provides a framework to unravel the incentives upon which an individual acts within each State. Methodological Individualism argues that collective decision making can be reduced to the preferences of individual actors within an institutional structure [9]. As such, the enactment of a law can be decomposed into the preferences of the electorate and the electoral system in which they act.

All of the States that have adopted the PL have a parliamentary system and use a proportional representation (PR) system to determine delegates to the parliament. For the purposes of this paper, we limit the scope of the institutional analysis to these two systems for two reasons. First, the generalization to all democratic institutions requires a depth of analysis beyond the question of the Percentage Law's political feasibility. Second, the homogeneity in institutions across the countries of interest seems to indicate that electoral and representative institutions do not effect the adoption of the law. Otherwise, all States with similar institutions would have adopted the law, which is not the case.

Since the institutions are relatively homogeneous¹, the paper focuses on the preferences of the electorate and the political parties within the system. Political parties and candidate reputation have been noted by Wittman [37] as institutional elements that mitigate the potential for principal-agent problems in democratic systems. Moreover, political parties establish a reputation that allows voters to choose from a package of political preferences and therefore reduce the cost of information. On the other side of the coin, political parties reflect the aggregate preferences of the electorate, particularly in PR systems where parties can win delegates on the marginal vote². This paper uses political parties as an indication of the electorate's preferences and the effect they have on the adoption of the Percentage Law.

The distribution of the electorate's preferences may be reflected in political parties, but the type of distribution is as informative as the parties themselves. Most spatial voting models³ have considered the distribution of preferences and its effect on majority-rule outcomes. I expand the spatial model to include voters' relative preference for publicly and privately produced public goods. The predictions from the model are used to inform the actions of political parties, and in extension the government, before the adoption of the Percentage Law. The analytical narrative created offers insight into the political motives for implementing the law and the margin on which it evolves.

With the information for the model and narrative, factors that are common in the development of the law are deduced. Countries with similar characteristics to those that passed the law provide a control by which the relative importance of these factors can be tested. Due to the small number of cases (16 in total), I use a Qualitative Comparative Analysis (QCA) approach developed by Charles Ragin [33] to determine factor impact.

With these methodologies, this paper unravels the complex and dynamic environment in which the PL developed. In section I, I develop an analytical model to investigate voters'

¹The similarities in parliamentary systems are from a similar history of transition and proximity to Continental European institutions. See Lijphart and Waisman for review [25]

²Thresholds in PR systems may determine the degree of error that exist in the aggregation of voters' preferences. See Baron and Diermeir 2001

³See Enelow and Hinich for a review [16]

utility on preferences for subsidy. In section II predictions of the model frame a historical narrative through the first four countries that enacted the law: Italy, Spain, Hungary, and Slovakia. In sections III the historical elements that lead up to the implementing of the law are analyzed with QCA approach. In section IV, I discuss the evidence and provide concluding remarks.

2.2 Model

To model the dynamics of the PL, I first develop a model of an individual voter's utility. Starting from a standard public-goods model, I expand it to incorporate the effects of spatial preferences. I then introduce the option of a privately produced public good. The synthesis of the public-goods model and the spatial voter-preference model provides the conditions which determine the preferred subsidy for the individual voter.

In the second section, the voters' preferences are aggregated. Assuming a majority rule system, the model meets all the assumption of the median voter model. Assuming a particular form of the utility function, I analyze the median voter's preference under three different preference distributions: Unimodal, Uniform and Bimodal.

The public goods discussed in this model account for both physical goods and transfers. Physical public goods are the traditional case where spending creates physical goods which generates utility. An example of this is missiles in national defense or lighthouses in navigation. Transfer public goods generate utility through altruism [3] or warm-glow from giving to the poor. Although Roberts [34] has argued that efficiency conditions with respect to subsidies are different for each type, for reason of tractability, they are equivalent in this model.

2.2.1 Voter's Utility

Let there be n citizens with utility function

$$u_j(y, x_j), i = 1, 2, \dots, n, \tag{2.1}$$

where y_i is i 's consumption of the private good and x_j is the consumption of a bundle of public goods at political preference j . Let E_i be the income of citizen i , which is independent of all other variables.

Citizen i has a preferred bundle of public goods located at x_i . All production that is not at the citizens preferred bundle still produces utility, but it is discounted as a function of the distance from their preferred bundle. Let $|x_i - x_j|$ be the distance from the preferred bundle and $f(|x_i - x_j|)$ be the discounting function, where x_j is the bundle that is produced. When $i=j$, $f(|x_i - x_j|) = 1$ and as $|x_i - x_j| \rightarrow \infty$, $f(|x_i - x_j|) \rightarrow 0$. Therefore, if $U_j(y_j, x_j)$ is the utility of citizen j from the production of public goods at their preferred bundle, then citizen i utility from production at j is $f(|x_i - x_j|)U_j(y_j, x_j)$.

Lets consider a two-stage political game. In the first stage, citizen vote on a bundle of public goods and a tax system. The outcome of the first stage depends on the constitutional details of the political system, which we assume to be fixed. The bundle produced by the government is uniform and does not vary by citizen. Let t_i and x_m be the tax burden of citizen i and the bundle at which the government produces public goods. t_i and x_m generated by the political institutions and preferences of the electorate. For the purposes of finding the optimal subsidy of a citizen, t_i and x_m are exogenous.

Since the citizen is constrained by her endowment, the amount that she can spend on private goods is the endowment minus the tax. Therefore, the y can be replaced with that difference. The sum of all t_i is the revenue of the state, which I define as R . Assume that any appropriation from the State and production technology are accounted for by the utility function of public production. If we define the utility function of the public production as U_g , then (2.2) is the citizens utility from public production.

$$u_i = f(|x_i - x_m|)U_g(E_i - c_i - t_i, R) \quad (2.2)$$

In the second stage, citizen are given the opportunity to vote on a subsidy for charitable

giving. For the purposes of this paper, we define charitable giving as the private production of public goods. The private production is a strict substitute for public production⁴. Therefore, there is no interaction effects between public and private production and the utility of the two production types can be modeled additively. Citizens contribute to organizations that produce a bundle of public goods at their preferred point x_i . Therefore, any charitable giving by citizen i yields the utility of (2.3).

$$u_i = f(|x_i - x_j|)U_p(E_i - t_i - c_i, c_i) \quad (2.3)$$

The utility of all private production of public goods to citizen i is the sum of all citizens utilities discounted to citizen i 's preference. If we combine the sum all citizens discounted utility, sum of (2.3), and the utility from public production, (2.2), then the total utility of citizen i is stated as (2.4).

$$u_i = \sum_{j=1}^n f(|x_j - x_i|)U_p(E_i - t_i - c_i, c_j) + f(|x_m - x_i|)U_g(E_i - t_i - c_i, R) \quad (2.4)$$

Subsidies to charitable contributions lowers the relative price of giving. As such, an increase in subsidy decreases the relative price of giving and increase the amount that a citizen is willing to contribute. Several analytical models and empirical studies support this theory. Therefore, the contributions should be a function of the relative price p . Let $C : p \rightarrow c$ and $\frac{\partial C}{\partial p} > 0$. The subsidy would reduce the price of contributing proportionally. Therefore, if the subsidy rate is s , then the actual price of contributions is defined as $(1 - s)p$. For the purposes of tractability, let's assume that each citizen has the same $C(p)$ function for contributions. In this case, we can replace all c_i with $C((1 - s)p)$ and the utility from all private productions is (2.5).

⁴For the purpose of this paper, strict substitutes are defined as goods that have mutually exclusive utility sets

$$u_i = \sum_{j=1}^n f(|x_j - x_i|) U_p (E_i - t_i - (1-s)C((1-s)p), C((1-s)p)) \quad (2.5)$$

Although a subsidy reduces the cost of giving to a charity for the individual, the government must pay for the subsidy from the tax revenues. Any increase in subsidies must be accompanied by an increase in taxes⁵ or a reduction in public production. Since the tax system was set in the first stage, all increase in charitable subsidies must reduce the public production of public goods. Therefore, the reduction in public production is equal to the sum of all contributions times the subsidy rate, and the savings to the individual is their contribution to the charity times the subsidy rate. Therefore, utility for citizen i from public production is (2.6).

$$u_i = f(|x_m - x_i|) U_g \left(E_i - t_i - (1-s)C((1-s)p), R - s \sum_{j=1}^n C((1-s)p) \right) \quad (2.6)$$

Notice that the amount of private good in both the public and private utility functions is the same. For the sake of analysis, let's hold the private consumption constant. This allows us to isolate the trade off between privately and publicly produced public goods. Note that keeping the private consumption in the utility reduces the preferred subsidy, but does not introduce any new factors into the equation. Therefore, by holding the private consumption constant, we can decompose the elements that affect the voters decisions. With this simplification and by adding (2.5) and (2.6), we can reduce the total utility function of citizen i to (2.7).

⁵Although debt financing can be used to cover budget deficits, the intertemporal tax burden or Ricardian equivalences introduces dynamics beyond the scope of this model. For this reason, the option to debt finances is removed for analysis.

$$u_i = \sum_{j=1}^n f(|x_j - x_i|)U_i(C_j(p(1-s))) + f(|x_m - x_i|)U_i \left(R - s \sum_{j=1}^n C_j(p(1-s)) \right) \quad (2.7)$$

The value of s that optimizes the utility of citizen i is her preferred subsidy. By taking the first order condition and solving for s (see appendix I), we find:

$$s_i^* = \mu + \frac{1}{n} \sum_{j=1}^n \frac{f(|x_j - x_i|)}{f(|x_m - x_i|)} \cdot \frac{\frac{\partial U_i(c_i)}{\partial x_i}}{\frac{\partial U_i(R-s_i^* \sum c_j)}{\partial x_i}} \quad (2.8)$$

Where μ is the elasticity of contributions with respect to the price of giving. Notice that there are two distinct elements in the second term of s^* . The first element is a ratio of citizen i 's average discounted distance from all other citizens' preferences and her discounted distance from x_m . The second element is the ratio of the marginal utility gained from citizen i 's contribution to charity and the marginal utility gained from public production after the subsidies are paid.

$$\frac{\frac{\partial U_i(c_i)}{\partial x_i}}{\frac{\partial U_i(R-s_i^* \sum c_j)}{\partial x_i}} \quad (2.9)$$

(2.9)⁶ can be interpreted as the citizens perception of the relative efficiency between public and private production. If the ratio is less than 1, then public production is perceived to be more efficient than private production. Likewise, if the ratio is greater than 1, then private production is perceived as more efficient than public production. If citizens believe that there is no difference, then the element is equal to 1 and has no effect on the subsidy preference of the citizen.

⁶This is the same equation as Samuelson's condition for pareto-optimal provision of a public good. This is extended by Cornes and Sanders 1986 to show that in a Cobb-Douglas utility function, the ratio of alpha to beta shows the extent over underprovision.

$$\frac{1}{n} \sum_{j=1}^n \frac{f(|x_j - x_i|)}{f(|x_m - x_i|)} \quad (2.10)$$

(2.10) can be interpreted as the effect of political preferences on the demand for subsidies. If the average discount to all other citizens' preferences is greater than the discount from the government's produced bundle, then the ratio is greater than 1 and the citizen prefers a larger subsidy for charity. Inversely, if the average discount to all other citizens' preferences is less than the discount to government's produced bundle, then the ratio is less than 1 and the citizen prefers a smaller subsidy.

2.2.2 Voter's Subsidy Preferences

For the purposes of deriving predictions from this model, assume that there is a majority-rule political system and the moderate is always the median voter from the first stage. Also, assume the elasticity of giving is constant at -1 and, public and private production are equally efficient. This allows us to examine the effects from political preference. Note that the preferences of the citizens in this model are unidimensional, single-peaked and symmetric. Therefore, if we assume that voters are also sincere, then all the assumptions of the median voter theorem are met and the outcome of the political system is the median voter's preferences⁷.

Let each voter be defined as one of five types: far left, left, moderate, right and far right. Each type discounts the bundle of public goods at a rate of 'a' per agent type that they move left or right. For example, if $a = 1/4$ the far-left voter discounts all productions at the left agent's preferred bundle by 3/4. They discount the moderate by twice that amount (1/2) and the right by 3 times that amount (1/4). Therefore, we can construct a vector of the discount rates: $[1 \ 3/4 \ 1/2 \ 1/4 \ 0]$ with indexes that correspond to the agent types: FL L M R FR, respectively. We can then construct a matrix of all the agent types and their relationship to all other agents:

⁷ x_m =median voters preference

Table 2.1: Optimal Subsidy by Voter Type

Agent Type	Number	s* for a=0.35	s* for a=0.4	s* for a=0.45
Far Left	2	-0.35	-0.22	0.24
Left	4	-0.12	-0.06	0.17
Moderate	8	0	0	0
Right	4	-0.12	-0.06	0.17
Far Right	2	-0.35	-0.22	0.24

$$D = \begin{pmatrix} 1 & 1-a & 1-2a & 1-3a & 1-4a \\ 1-a & 1 & 1-a & 1-2a & 1-3a \\ 1-2a & 1-a & 1 & 1-a & 1-2a \\ 1-3a & 1-2a & 1-a & 1 & 1-a \\ 1-4a & 1-3a & 1-2a & 1-a & 1 \end{pmatrix} \quad (2.11)$$

The 'a' parameter is effectively an indication of the tolerance of the voters. Tolerant voters have a small 'a', valuing others political preferences as their own. Intolerant voters have a large 'a', valuing only their own political preference.

Let's consider the median-voter's subsidy preference when there are 20 voters with three different preference distributions: Normal, Uniform and Bimodal. A normal distribution can be depicted by the number of voter types: [2 4 8 4 2] for far left, left, moderate, right, and far right voter types, respectively. Table 2.1 shows the optimal subsidy for each agent type with varied 'a' values.

If we then order them according to their preferred subsidy, we find that the right/left voter type is the median voter for both discount schedules. The median voter's preference for a subsidy for each value of a is displayed in the table 2.2. Note that if the predicted subsidy is negative, then it is effectively 0.

Extending this process to the other distributions, we can compare the impact of preference distributions on the predicted subsidy. Table 2.3 depicts the population of each agent for a given distribution. Table 4 shows the predicted subsidy for each distribution.

Table 2.2: Ordered Optimal Subsidy by Voter Type

Agent Type	Number	s^* for $a=0.35$	s^* for $a=0.4$	s^* for $a=0.45$
Far Left	2	-0.35	-0.22	0.24
Moderate	8	0	0	0
Left	4	-0.12	-0.06	0.17
Right*	4	-0.12	-0.06	0.17
Far Right	2	-0.35	-0.22	0.24

Notice that as the 'a' parameter increases, the median voter increases their preference for the subsidy. This corresponds to the general tolerance of the electorate. In a generally tolerant electorate, we should expect to observe low subsidies. Likewise, in a more intolerant electorate, we should expect to observe higher subsidies.

The distributions of the preferences affects the median voters preferences similarly. If the mass of preferences is centered around the mean, predicted subsidy should be low. As the mass moves away from the mean, the observed subsidy should increase. There are two mechanism by which the distribution of preferences changes the subsidy: by changing the center of private production and the position of the median voter. As the mass of the electorate moves away from the mean, two separate pools of similar voters form. These two pools prefer to produce public goods at the mode of the two pools rather than have a central authority produce them at the median voters preference, which has less mass than the two modes. As such, high subsidies allow the independent modes to create quasi-government institutions through private production of public goods and services.

The second mechanism is changing the median voter. As more of the electorate is in the tails of the distribution, the more likely that the median preference for a subsidy is found in the tails. This is possible because they can not agree on what should be centrally produced, but they can agree that it shouldn't be centrally produced. As such, as the mass moves into the tails of the distribution, the electorate will demand higher subsidies.

Table 2.3: Voter Types by Distribution

Distribution	Far Left	Left	Moderate	Right	Far Right
Normal	2	4	8	4	2
Uniform	4	4	4	4	4
Bi-modal	6	3	2	3	6

Table 2.4: Observed Subsidy by Distribution

Distribution	Total Voters	Median Voter	s^* for $a = 0.35$	s^* for $a = 0.4$	s^* for $a = 0.45$
Normal	20	Right/Left	-12%	-6%	17%
Uniform	20	Right/Left	-3%	12%	61%
Bi-modal	20	Far Right/Left	18%	67%	216%

2.3 Historical Narrative

The development of the PL started in Italy and evolved as it spread from the Mediterranean to Central Eastern Europe. At each stage of its evolution, the electorate chose the PL over other subsidies for charitable donations. The PL are essentially a limited, 100% subsidy for charitable donations. Tax payers have a choice to give or not give, but they can not purchase private goods with that income.

The model predicts that if there is a 100% subsidy, it should be accompanied by the three factors: a general view of government inefficiency, intolerance for others preferences, and a bimodal distribution of the electorate’s preferences. If this is the case, we should find examples of these factors in the political climate leading up to the passing of the law. They may also be manifested in the political parties platforms and rhetoric.

Bimodal distributions of preferences are often a sign of political instability. Political instability can lead to conflict, civil unrest, or rebellion. Adelman and Hihn [28] found that a bimodal distribution of preferences was a good indicator of whether a South American countries would experience a Coup. The existence of diametrically apposed political groups in conflict can be used as an indicator for bimodal distribution. Moreover, the existence of conflict is an indication of intolerance for the others’ preferences.

Mistrust of government and perceptions of corruption are indications of public sentiment toward the government. An electorate that mistrusts the government to produce the public goods without appropriating, would rather have a local charities, which are accountable to the contributors, produce the public goods. Mistrust of the government can change the perceived relative price between publicly produced public good and privately produced public goods. As such, mistrust and corruption are indications that the electorates value of (2.9) is decreasing.

With this framework in mind, let's examine the historical events of Italy, Spain, Hungary and Slovakia before the enactment of the PL. If the predictions of the model are correct, we should find conflict between two political groups who dominate the polity and a general mistrust of the elected government. Moreover, as the law evolves, these forces should shape the law toward the particular conflict in each country. The narrative that it creates illuminates the process that shaped the church tax into the PL that has spread throughout Central and Eastern Europe.

2.3.1 Italy

Since the conception of the first republic, Italy has been dominated by three political parties: Christian Democrats (DC), Italian Socialist Party (PSI), and Italian Communist Party (PCI)⁸. In the transition to the first republic, DC had garnered considerable support in the Rural regions of the South, Center and North-East using its connections in the widespread organization Catholic Action [20]. PSI and PCI, on the other hand, held considerable popularity in the Industrial regions of the North-West and the "Red regions" of the central provinces. In the year leading up to the 1948 general election, DC energized its Catholic base with a anticommunism campaign. The campaign proved effective, capturing almost 50% the congressional seats in the 1948 elections. It was an 18% improvement from the constitutional-assembly election in 1946. DC retained uninterrupted control of the government until 1984 [22].

⁸All three parties made up 75% of the vote

During the 36 year reign, DC enjoyed strong ties with the Roman Catholic Church [22]. The preferential treatment of the Church made it a de facto state religion⁹, which disagreed with the platforms of PCI and PSI. Both PCI and PSI preferred a secular state and were uncomfortable with the cozy relationship between DC and the Roman Catholic Church (CCR). They feared a Franco style relationship with the CCR in Spain would emerge in Italy.

In the 1970's, the PSI sought to distance itself from the PCI. As a result, PSI and associated parties became more moderate and increase the portion of votes by 5%¹⁰. The increase allowed a coalition of PSI, PCI, and associated parties to form a ruling coalition. As a result, Benedetto Craxi of PSI was appointed President of the Council of Ministers. He was the first socialist to hold the executive position since the conception of the First Republic.

Craxi sought to renegotiate the Lateran treaties with the Vatican. His aim was to move Italy towards a more secular state by reducing direct payments and political privileges to the CCR. Reducing direct payments to the CCR also meant reducing public services to many Italian voters. In order for the new concordat to be ratified by a majority of the electorate, it must allow for those that want the services to maintain them and those that do not to redirect their tax dollars else where. As a result, the otto per mille (eight per thousand) law was introduced. In May of 1985, the concordat was ratified under the Law 222.

During the general election of 1983, a new party gained seats in the government. They called themselves the Liga Veneta (Venetian Lions) and later formed the base of Lega Nord (Northern League). They campaigned on a platform of increased autonomy of Veneto, which played to the growing concern of redistribution from the North to the South. In the 1983 general election, they won 4.3% of Veneto, second to DC. Although their impact was

⁹Several laws restricted non-Catholic religions from the 1940's until the introduction of the constitutional courts in the 1960's. These courts ruled many of the law unconstitutional, but they remained in place until the concordat of 1984

¹⁰3 parties made the a socialist contingent

low, they reflected a general dissatisfaction of DC¹¹.

Both the DC and CCR supported redistribution to the South. The North, disenfranchised by DC and suspicious of the centralized institutions of the CCR, began to move their support to new parties, such as the burgeoning Lega Nord. DC politicians that relied on the North for votes, soon realized their offices were tenuous.

In 1986, Radicali Italiani, a far-left party that supported a secular state, introduced a proposal to expand the otto per mille law to all state recognized religions. Without the support from the Northern conservatives, the proposal was passed. In Dec. 1986, the Assembly of God was recognized as a state religion with access to the otto per mille law¹². Although the next religion to be recognized was after the rise of the Second Republic in 1993, the initial step had been taken. As of 2009, dozens of churches have been recognized by the Italian government, including Buddhism and the Latter-Day Saints.

In 1992, an investigation into the ties between PCI and the Soviet Union by Mani Pulite exposed a considerable amount of corruption in the Italian government. Further investigation exposed DC's system of clientelism as well [20]. The extent of the corruption extended throughout the government and the public lost trust. In the aftermath, the government fell and the first republic ended. In the following years, all three of the major parties in the first republic were renamed or absorbed into other parties.

Those that voted for DC were essentially voting for continued support of the CCR and the maintenance of their de facto position. On the other hand, votes for PCI and PSI were votes for a secular state and freedom of religion. These two platforms are not reconcilable and can not exist simultaneously in a State. Moreover, both groups garnered large portions of the popular vote. With the rightward leaning DC holding 33% of the vote and the leftward leaning PCI and PSI holding 41% of the vote in 1983, the Italian electorate displayed a rather bimodal distribution of preferences. As the model predicted, a bimodal distribution of preferences should lead to the introduction of a high subsidy, much like the

¹¹In prior years, DC had reduced its support for artisan privatization which was a part an effort to transition the proletariat into business owners [20] and alienated a large part of the Northern electorate

¹²see LAW November 22, 1988, n. 517 (GU n. 283 SUPPL.ORD. Of 02/12/1988)

otto per mille law.

The lack of cohesiveness between the conservative electorate also allowed the introduction of other religions. Without the support of the North, DC was not able to maintain the monopoly on the subsidies for the CCR. As such, the subsidy was generalized to many religions, even though the CCR had considerable popularity. We will see that in the case of Spain, the conservative electorate was organized and therefore maintain the monopoly on the subsidy for the CCR.

Finally, the collapse of the first republic was caused by corruption. It is not unreasonable to believe that the electorate were aware or even had experience with this corruption. The extent of the corruption should have given the perception that government production of public goods were inherently inefficient due to the "grapping hand" of a corrupt government. Even in 1995, Transparency International's perceived corruption index was only 3.42/10, which was rather low compared to other established democracies in the West. Therefore, the Italian electorate has all the indication that a high subsidy can be passed. The existence of all these factors would suggest that the PL may have been developed in response to them.

2.3.2 Spain

In the three years following the death of Francisco Franco, Spain managed to dissolve the old regime and develop a new constitution. In June of 1977, a general election was held. Four major parties emerged from the fray: Popular Alliance (AP), the Communist Party of Spain (PCE), Spanish Socialist Workers Party (PSOE), and Union of the Democratic Center (UCD) in order of political preference (low to high). Together, they captured more than 80% of the vote. Despite the internal and external dissent, UCD managed to have considerable influence in the drafting of the constitution.

The CCR had maintain a strong relationship with Franco throughout his regime. The Concordat signed between the Vatican and the Franco's government legitimized his regime and brought international respectability [11]. In return, Franco made Spain a confessional state and provide financial support for Catholic institutions in Spain. Although the CCR

had split with Franco's regime more than a decade before the constitutional congress [26], the development of a modern state meant the rejection of a confessional Spain.

In the election of 1977, the CCR chose not to support the Christian Democratic Union (UDC). As a result, the UDC gathered only 1.5% of vote. More importantly, the passive position of the Church allowed them to develop relationships among the Christian Democrats in UCD. This relationship gave them direct access to the drafting of the constitution. As an example, Christian Democrats within the UCD submitted amendments to reverse many of the compromises on religion that were agreed upon by both the PSOE and the moderate elements of the UCD [21]. Although they were withdrawn at the request of the UCD leadership, it is an indication of the representation of the CCR.

With representation within the constitutional congress, the CCR transitioned through the reforms with many of its privileges intact. The new constitution enshrined four fundamental principles: religious freedom, equality, neutrality, and cooperation¹³. The first three essentially separated Church and State, declaring all religions equal and the state neutral to all. The separation meant that churches could no longer receive direct funding from the state. The principle of cooperation, on the other hand, allowed the CCR to retain many of the tax exceptions that it enjoyed under Franco's regime¹⁴. The principle of cooperation also provided tax payers with tax incentives to donation specifically to the CCR¹⁵ and salaries for teachers of religion.

During the years before the 1979 election, UCD began to moving further to the right. In the campaign for the 1979 elections, the leader of UCD, Adolfo Suarez, found allies among the Catholic Bishops who denounced PSOE's and PCE's policies of divorce and abortion. He quickly shifted the party's platform to garner votes from the Catholic electorate. The party sought to offer the Spanish public a "Christian humanism" option to the secular "Marxist socialist materialism".

¹³Law 61/1978 of 27 December - Blanco

¹⁴These tax exemptions also included income from the commercial subsidiaries of the CCR

¹⁵Tax deductions for charitable giving

The political repositioning of UCD proved successful. In the 1979 elections, UCD increased its Congress of Deputies by 2 seats and maintained a ruling coalition. The years following the election revealed the division between the UCD and the PSOE. On May 28th, 1980; the PSOE filed a motion of censure against Adolfo Suarez. Soon after, the vice-president, Fernando Abril Martorell, resigned. He was followed by the president's resignation in early February 1981, amidst a fracturing UCD. With UCD government dissolving, PSOE assembled a ruling coalition and named Leopoldo Calvo-Sotelo president. On the 23rd of February, 1981; a military coup was attempted by Antonio Tejero and Jaime Milans del Bosch, but failed when Juan Carlos I, King of Spain, refused to support the coup.

In the aftermath, Calvo-Sotelo dissolved the government and called an election for October 1982. PSOE won almost 50% of the vote and wielded an absolute majority in the Congress of Deputies (202 seats). PSOE held the absolute majority until 1989 and the ruling coalition until 1996.

Following the elections, tax reforms with respect to the CCR were introduced in 1982 and 1983, which eliminated several tax preferences¹⁶. In 1987, the Spanish government implemented a version of the *otto per mille* laws¹⁷ at the expense of personal tax deductions for charitable giving to the CCR [6]. Undoubtedly, the CCR experience in Italy facilitated the tax reform, promoting PL as an option and drawing on their experiences for implementation.

Although the UCD collapsed, the Christian Democrats quickly found a new home. Alianza Popular (Popular Alliance, AP) absorbed many of the Christian Democrats who had become disenchanted by Suarez. AP was the main opposition to PSOE in the 1982 elections, capturing 26.46% of the vote and 107 seats in the congress of deputies. Using a regional grass-roots approach, AP steadily gained popularity and merged with several other parties to form the Partido Popular (People's Party, PP). In 1996, PP formed a governing coalition and deposed the 14 year reign of PSOE.

Even though SPOE had promised to uphold the 1979 fiscal agreements with the CCR,

¹⁶Law 18/1982 of 26 May and the Law 5 / 1983 of 29 June

¹⁷Spanish tax payers designate 0.52% of their income tax burden

the PSOE pressed the social reforms. In January of 1983, a proposal to decriminalize abortions was submitted. The CCR reacted swiftly using its media outlets to denounce the proposal. In February 1983, while the debate over abortion remained contentious, the PSOE government announced education reform. In the Catholic newspaper *Ya*, the editorials claimed that "the socialist sought to destroy Catholic education by 'fire and blood'" [10]. Christian politicians used the opportunity to energize their base and launch an offensive. In this moment, Christian politicians found themselves consolidated and untied in their opposition to the PSOE government.

In 1994, the Spanish government passed the Law of foundations. It was an agreement with the Evangelical, Jewish and Islamic communities to recognize them as "deeply rooted" religions, which opens access to cooperation with the state. The communities were allowed tax benefits, but did not have access to the percentage law. In December 2006, these communities opened negotiations with the Spanish government for access to the PL. A proposal was submitted in 2007, but the government failed to adopt the proposal prior to disbanding in December of 2007 elections. As of 2008, no action has been taken to expand access to the PL and the CCR remains the sole beneficiary of the percentage laws.

As in the case of Italy, the popularity of both the Socialist and Christian Democrats created a bimodal distributions of preference. The Vatican's experience in Italy acted as a conduit for the percentage law to transfer from Italy to Spain. Although the two laws are fundamentally the same, the environment in which the law was implemented in Spain was different and the outcome was more restricted.

In Spain, Christian Democrats were united and able to provide opposition to social reform. The united front allowed the group to protect the interests of their constituents, which included the CCR. Italian Christian Democrats, on the other hand, lacked cohesion and were divided by an internal conflict. Without the ability to muster opposition to the proposal of expanding access of the percentage law, the Italian Christian Democrats were unable to protect the interests of their constituents, as Spain achieved.

Finally, the Franco era in Spain left a culture of distrust in politicians, institutions and

government. The belief that government is inefficient was a product of the old regime. Transparency International's perceived corruption index for Spain in 1995 was 4.31/10, which was almost 20 years after their transition to democracy. Like Italy, the condition predicted by the model appears around the time that the law was implemented.

2.3.3 Hungary

With the collapse of the Soviet Union in 1989, Hungarians quickly moved toward free elections. In May 1990, elections presented the center-right party Magyar Demokrata Forum (Hungarian Democratic Forum or MDF) with almost a quarter of the vote. The Szabad Demokraták Szövetsége (Alliance of Free Democrats or SZDSZ) came in second with 21.4% and the Magyar Szocialista Párt (Hungarian Socialist Party or MSZP) with less than 11%. MDF formed a ruling coalition with Kereszténydemokrata Néppárt (Christian Democratic Peoples Party or KDNP) and József Antall, party leader of MDF, became prime minister.

The ruling coalition consisted of two factions: the liberal-conservatives and more radical, anticommunist groups. The radical wing was popular with the party members and moved the party significantly to the right. As such, the distance between MDF and MSZP grew, leaving no ground for reconciliation. As stated by Tokén [36], "József Antall's choice between an ideologically homogeneous Christian democratic and, with the inclusion of one or both liberal parties, a broader government coalition sowed seeds for the present lopsided bipolar left-right parliamentary configuration."

Over the next 4 years, József Antall and his coalition set out an ambitious plan to bring free-market reforms to the economy, while maintaining its financial obligations to the West. Privatization of state firms meant restructuring and layoffs. As a result, unemployment grew nearly 10% between 1990 and 1992 [15], mostly among the working classes. Moreover, MDF's commitment to pay debt obligations to the West on schedule rather than rescheduling meant a considerable outflow of capital needed for development. The commitment did encourage \$8 billion of foreign investment between 1990 and 1994, but that paled in comparison to the \$30 billion paid in debt obligation. Although the reforms ultimately provided long-term

growth in Hungary [15], the resulting instability from transition weakened MDF position.

During this period, the ruling coalition provided generous grants to all but 4 Churches¹⁸. They also provided a provision for the return of property that was expropriated from the various churches by the communist regime¹⁹. In 1993, several cases were brought before the constitutional courts claiming that certain religious organization are receiving preferential treatment with respect to education²⁰. Moreover, minority religions and various NPO protested that they were excluded from the opportunity to reclaim expropriated property. The courts ruled that these groups ” . . . were not operating at the relevant time or had suffered no loss remained unentitled . . . ”²¹.

In the 1994 elections, MDF suffered significant erosion of their base due to economic conditions. MDF lost 13% of the vote while MSZP gained 22%. With the largest share of the vote, MSZP formed a ruling coalition. With the loss of Jozsef Antall to a terminal illness in late 1993 and the defeat of the party in 1994, MDF fractured into several smaller parties and remained insignificant thereafter.

The new MSZP government led by Horn Gyula, realized that obligations to return expropriated property, or provide financial compensation for those properties that could not be returned, may provide constitutional conflicts of separation. As such, they promised to arrange an income-tax scheme for the independent funding of churches. Furthermore, it opened the possibility of financial compensation in lieu of property [14]. In 1995, new suits were filed in the courts by minority religions accusing discrimination by the parliament²². Although the verdict was for the parliament, it was a catalyst for a new commission to change the governments rules for dispersing funds to the public²³.

In June 1997, the Vatican signed a bilateral agreement with the Hungarian government

¹⁸ Act IV/1990 s.19.2: The four exceptions are Jehovah's Witnesses, Krishna's, Unitarians, and Scientology which filed a constitutional suit - s70/A

¹⁹ Act XXXXII/1991

²⁰ Decision 4/1993. (II. 12.) AB, ABH 1993. 48,53.

²¹ Decision 4/1993 s.15

²² Supreme Court Pfv. IV. 22.499/1995

²³”only those religious communities that have both been registered for at least five years while also performing some kind of public activity received money [14].”

concerning the religious funding and public activity²⁴. It resembled those implemented in Italy and Spain. Tax payers would be allowed to designate up to 1% of their income-tax burden to the Catholic Church.

Soon after the Act was passed, protests by minority churches and NPOs were filed, alleging that they had suffered property loss at the hands of the past government and should be compensated accordingly. In light of the protest, the parliament sought to extend the tax privilege to all NPOs and public institutions²⁵. Religious communities, fearing a lack of popular support for religious communities, demanded that religious organizations have a separate designation apart from that of the NPO. In 1998, the government relented and passed tax reform that allowed 1% of income-tax burden to be given to a registered religious organization and another 1% to be given to a registered NPO.

Hungary, much like Italy and Spain, has a story of conflict between religious communities and secular socialist parties. As we have seen in both Italy and Spain, pro religious government in power suffer from an internal divide. The result is the rise of a socialist coalition and, once in power, enacts the PL to increase separation between church and state. In Hungary, the twist came from the NPOs that sought restitution from the former communist regime. These organizations, aligning themselves with the disenfranchised religious minorities, opened an opportunity to gain a preferred subsidy from the State. Although the religious communities conflict was over separation of Church and State, the conflict over restitution was just as salient in the process of the Hungarian law.

The lack of trust in the government by the Hungarian electorate should not be surprising considering the political failure of MDF. In a poll taken in 1989, 34% of Hungarian believed that "everyone had a say in the management of the affairs of the country" [7]. By 1994, that had fallen to 23%. Similarly, 34% of Hungarian reported that "Politicians do all they can to get to know the opinions of the people" as true. In 1994, it had dropped to 25%. The Hungarian electorate were skeptical that the government would produce what was important to them. Moreover, Transparency International's perceived corruption index in

²⁴Act CXXIV/1997

²⁵museums, theaters, . . . etc

1996 was 4.86/10. Although considerable better than that of Italy and Spain, still below most of the West.

The 1998 tax reform in Hungary was coined as the "Percentage Law". The NPO that participated its creation soon developed an organization called NIOK to provide logistical support and analysis of the law. Where the Vatican had been the conduit for passing the law in the past, NIOK would be it in the future.

2.3.4 Slovakia

At the fall of the Soviet block in 1989, Czechoslovakian was comprised of three major ethnicities: Czechs, Slovaks and Hungarians, in order of population (largest to smallest). Cooperating with each other, the three groups staged a peaceful transfer of power know as the velvet revolution. In June 1990, the first free elections were held since 1946. The anticommunist parties carried the day, but the tenuous coalition began to dissolve along ethnic lines [24].

The Hungarian minority is situated in the South of the Slovakian State, which was a part of Hungary until the Treaty of Trianon in 1920. At the beginning of 1990, the newly independent Slovaks took the opportunity to settle existing disputes with the Hungarian minority without foreign interference. In February of 1990, the Forum of Hungarian Citizens responded with a list of demands to the Slovakian National Council. They included protection of their language and support for Hungarian curriculum in schools. The Slovaks responded by developing civic groups to promote Slovakian nationalism and demonstrate against pro Hungarian policies [19]. The dispute resulted in a law that ban the use of the Hungarian language in all areas with less than 10% Hungarian population.

Between 1990 and 1992, tensions between Czechs and Slovaks over national identity sparked debate over separation. Although Czech and Slovak public opinion were in favor of a federalized state, which allowed both the Czech and the Slovak nations considerable autonomy, debate in parliament continued. The Hungarian minority in Slovakia preferred a unified state. They saw a strong central authority as a counter weight to Slovakian

dominance of their region [24]. In 1992, Vaclav Klaus and Vladimir Meciar, leader of the Movement for Democratic Slovakia (Hnutie Za Demikraticke Slovenska or HZDS), were elected to the Czech and Slovak National Council, respectively. Both leaders advocated a greater separation of the Czech and Slovak nations. Despite public opinion, the two leaders moved forward and in 1993, the two nations separated in what came to be known as the Velvet Divorce.

With the separation of the Czechs and Slovaks, the nationalist rhetoric of HZDS, no longer had an opponent. To maintain party momentum, Meciar turned his national rhetoric on the Hungarian minority. In 1993, the Matica Slovenska promoted the creation of a law that would establish Slovak as the only State language. Coexistence, a Hungarian civil organization, reacted by accusing them of chauvinism and separatism [24].

In early 1993, elements of Meciar coalition switched to the opposition. In March of 1993, Meciar was given a vote of no confidence and resigned. The opposition formed a new ruling coalition, which contained the Hungarian coalition. They chose Jrzef Moravcik as prime minister. In July of 1994, parliament acted to rescind the 1990 language practices. The gesture won the tacit support of the Hungarian coalition and, more broadly, the support of the international community [24]. The Hungarian victory would be short lived and the Moravcik's government would pay for their goodwill toward the minority in the following election.

In the 1994 elections, HZDS garnered 35% of the vote and formed a government with the National Slovakian Party (Slovenska Narodna Strana or SNS), a far-right nationalist party. Meciar returned to the parliament as prime minister once again. In March of 1995, SNS proposed a bill that restricted the freedom of speech. It was vetoed by Kovac and discarded by the parliament. In May, Meciar called a vote of confidence for the president, which was not constitutional. The parliament gave an vote of no confidence to Kovac and demanded his resignation. Kovac declared it unconstitution, but in June parliament stripped him of his role as head of the army. In November 1995, the parliament approved a law to restrict all languages that were not Slovak, which jeopardized relationships with Hungary and NATO

membership [19].

The threat of a return to an authoritarian regime and a desire to move closer to the European Community galvanized the opposition together. In the 1998 elections a conglomeration of 5 parties, SDK, rivaled HZDS in their share of the popular vote. Along with SDL, SOP, and SMK; they formed a ruling coalition and Mikulas Dzurinda became the prime minister.

Following the elections, the percentage law was drafted. With support from NIOK, they designed a law similar to the Hungarian provision for registered NPO, but it contained no special designation for religious organizations. All registered organizations would have an equal opportunity to receive funds from the tax subsidy. In January 2000, the PL was incorporated into tax law. In the following years, it would be amended to include guarantee of designator anonymity, transparency in transfers and a 1% for corporate earnings.

Unlike the Italy, Spain, and Hungary; the primary conflict was not religious, but ethnic. As such, the special designations given to religious organizations disappeared and an open-access system took its place. Although the law was passed by a large coalition of parties, 8 in all; the political landscape was dominated by nationalism and minority rights. This is confirmed by a survey taken in 1994 by Evans and Whitefield [17]. They found that while the Czechs were primarily concerned with economic liberalism, the Slovaks preferences were dominated by ethnic rights. Since much of the advocacy for minority rights and a nationalism took place in the third sector, it is natural that the subsidy was allocated to that sector and not to religious organizations specifically.

In 2000, Slovakia received a score of 3.5/10 on the perceived corruption index. Given the strong arm tactics of Meciar, such a low score is not surprising. Moreover, Meciar was charged with several counts of corruptions following the establishment of the opposition government. Although all the charges were ultimately dropped, they are an indication of the electorate's perception of corruption. Much as the previous countries, the existence of a bimodal preference distribution, intolerance for others, and a mistrust of the government all predict that Slovakia would adopt the percentage law. Although the circumstance

changed whom the subsidy targeted, the conditions for passing the proposal were there.

2.3.5 An Overview of Eastern Europe

The spread of the Percentage Law to some countries and not to others is also telling of the process of adopting the law. Countries with similar peaceful transition did not adopt the law while others with rather violent transitions did. In this section, I briefly discuss several of the transitioning countries of Central and Eastern Europe and their acceptance or rejection of the PL.

Hungary's neighbor, Romania, did not have a peaceful transition. Civil war punctuated the transition to democracy. Croatia also transitioned to statehood through a war with Serbia. Both countries had significant²⁶ minority population before transition. In Croatia, the civil war caused the minority Serbs to flee the country and the population of the minority fell from 12% to 4%. Romania, which has large communities of Hungarians, Turks, and other Slavic ethnicities, adopted a Slovakian-type PL, while Croatia, with its mostly Croat populous after the war, did not.

The Czech Republic and Slovenia are also an interesting comparison. Both had peaceful transition to democracy and are rather homogeneous ethnically²⁷. The Czechs are among the least religious groups in all of Europe with 59% of the population claiming non-believer²⁸, while in Slovenia, 58% of the populous claims to be Catholic. For these reasons, Czech Republic has no PL while Slovenia passed an Italian-type PL.

Finally, the Baltic states tell us the extent to which the minority population matters. Estonia, Latvia and Lithuania are all relatively non-religious and all had a relatively peaceful transition to democracy. Of these state, Lithuania has the smallest minority populous. Lithuanians make up 85% of the population in Lithuania, but in Estonia and Latvia, their native ethnicity is 61% and 59% of the population, respectively. It is in Lithuania that we find a Slovakian-type PL, but we do not find a PL in either of the other states. It would

²⁶greater than 10% of the populous minorities

²⁷less than 10% ethnic minority

²⁸this includes atheistic and agnostic

seem that when the minority populations obtain a critical size, the threat from nationalism and the need for the law is eliminated.

2.4 Qualitative Comparative Analysis

The transitioning countries of Europe provide us with the circumstances under which the PL is enacted and even the form it takes. In all of the transitioning countries, there are political, ethnic and religious preferences. In table 2.5 there is list of countries and their characteristics. I have included the 8 European countries that passed the law and 8 of the neighboring States that did not. In this case, the neighboring State provide a control to balance the 8 States with the Percentage Law, which are the treatment.

The neighboring States are an adequate control for this study. Most of the countries in Central and Eastern Europe have similar experiences under Soviet regimes, transition to democracy, and conflict between conservative and socialist factions. Moreover, the political institutions of these countries tend to be similar in electoral process and parliamentary procedures.

To analyze which of these factor are the most important in predicting the enactment of the percentage laws, I use a QCA approach. Using software developed by Charles Ragin, Kriss Drass and Sean Davey at the University of Arizona, I run a Fussy-Set Analysis with standard calibration. PL is used as the outcome parameter, while corrupt, catholic, religious, war, small minority, and large minority are used the predictors. Transition is removed due to low variance. A print out of the programs analysis can be found in Appendix II.

The algorithm provides us with two case that explain PL. The first case is when the country is catholic, religious, experienced no violence in transition, and does not have a large minority. These conditions explained 75% of the cases. The second case is when the country is corrupt, religious, experienced violence in transition, a small minority but does not have a large minority. These conditions explained the remaining 25% of the case.

Notice that both a religious populous and the absence of a large majority are common between the two cases. These can be seen as precondition to accepting the law. If we

Table 2.5: QCA Input

State	PL	It	Sl	Corrupt	Catholic	Rel	Trans	War	SM	LM
Albania	-	-	-	1	-	-	1	1	-	-
Bulgaria	-	-	-	1	-	1	1	-	1	-
Croatia	-	-	-	1	1	1	1	1	-	-
Czech Republic	-	-	-	-	1	-	1	-	-	-
Estonia	-	-	-	-	-	-	1	-	-	1
Hungary	1	1	1	1	1	1	1	-	-	-
Italy	1	1	-	1	1	1	-	-	-	-
Latvia	-	-	-	-	1	-	1	-	-	1
Lithuania	1	-	1	1	1	1	1	1	1	-
Poland	1	-	1	1	1	1	1	-	-	-
Romania	1	-	1	1	-	1	1	1	1	-
Serbia	-	-	-	1	-	1	1	1	-	-
Slovakia	1	-	1	-	1	1	1	-	1	-
Slovenia	1	1	-	-	1	1	1	-	-	-
Spain	1	1	-	1	1	1	1	-	1	-
Ukraine	-	-	-	1	-	1	1	-	1	-

PL: Has a form of the percentage law

Italian (It): Has the Italian form of the percentage law

Slovak (Sl): Has the Slovakian form of the percentage law

Corrupt: Transparency International's perceived corruption index is < 5 in 2002, except for Italy, Hungary and Spain, which uses 1996.

Catholic: Dominant Religion is Catholic

Religious (Rel): One religion has support from > 50% of the populous

Transition (Trans): transitioned to democracy

War: suffered a violent transition to democracy

Small Minority (SM): Native ethnicity is < 90% of population

Large Minority (LM): Native ethnicity is < 70% of population

remove these from the two case, the first case shows that a catholic nation that transitioned to democracy peacefully are the major determinate of the PL. This case matches the historical outcomes of Italy, Spain and Hungary, where conflict over religious rights provide the imperative to pass the law. In the second case corruption, war, and a small minority also predict the PL. These factor are similar to the history of Slovakia.

2.5 Discussion and Conclusion

For all the success of the Percentage Law in the transitioning countries, none of the West has adopted these laws. The model may provide the key to understanding their reluctance.

In each of the countries studied, all of them saw transition and corruption before enacting the law. (2.9) shows us that when trust for government is high, demand for a subsidy is low and visa verse. In the same period that these countries enacted the law, the governments of the West have been relatively stable. The more mature institutions of the West meant more trust in the governments. Therefore, the electorate did not demand a law that removes some of the tax revenues from the government and places it in the hands of tax payers.

The development of the PL seems to follow a similar pattern. In all of the founding countries of the Percentage Laws, we find a repressive regime dominating the polity. With the fall of that regime, the opposition enacts the Percentage Law to resolve the conflict created by the previous government. In the instance of Spain, the introduction of the law proceeds a 12 year dominance by the opposition party. It is possible that these parties that enact the law are trying to reduce the vote share of the previous dominant party by removing a dominant preference from the public realm. For example, Italy's DC party gathered most of their votes from the electorate that feared the lose of their public services that were provided by the CCR. By moving the decision out of the public realm and into the private realm while maintaining a coordinating factor, the new government strips the previously dominant party of their platform and voter base .

In general, the percentage law is a single example of the many changes that the transitioning States are experiencing, but the percentage law may provide us with insight into the political feasibility of vouchers or other full subsidies. Vouchers, like the PL, provide a good or service at no cost to the user, in other words a 100% subsidy. If vouchers and PL are effectively the same, we should find vouchers where there is a bimodal distribution of preferences and a lack of trust in the government to provide it publicly. Moreover, ethnic and religious tensions over the type of good or service for which the voucher is issued can indicate why it was passed.

School choice is an extension of vouchers. If we find that school choice is greater in countries with the PL than those without, then school choice, or school vouchers, might be affected by similar forces. The Czech Republic and Hungary provide us with a sample to

test this theory. Both the Czech Republic and Hungary introduced the option of private schools after the transition to democracy, but it was Hungary that shows a greater growth in nonstate schools [32]. In 1995, where Hungary had continued support for nonstate schools, the Czech Republic had abandoned its policy of equal treatment. Moreover, the majority of nonstate schools in Hungary are religious. The anecdotal evidence presented, although not conclusive, seems to fit the pattern of the PL.

The popularity of the Percentage Law stems from its ability to reconcile differences in preferences. Whether it is between nationalistic desires and minority rights, or religious services and secular societies; the Percentage Law plays a role in mediating the conflict that arises from opposing preferences within a common State. It is possible that the Percentage Law is more than a passing tax phenomenon in Central and Eastern Europe, but a tool of reconciliation in a State suffering from internal divisions.

Chapter 3:

Taxes, Crowding Out, and the Percentage Laws

3.1 Introduction

Public participation in civil society has been noted as being a corner stone of democracy and free markets. They are the political parties that promote democratic participation, and they are the business groups that help link opportunity with know-how. The religious and civic organizations that support individuals in their time of need and provide spectacles for the public. Civil society is the village within the State.

The West has been build on the concepts of civil society, but many of the transitioning countries of Central and Eastern Europe had most of their civil society extirpated by the Soviet governments that gained power after the Second World War. As such, the movement toward democracy in some nations has been a rather slow. Funds and expertise from the West have flowed into these countries in an attempt to seed civil society and promote growth. The attempts have had varying effects.

The introduction of the percentage law in Central and Eastern Europe has been hailed as a new means of promoting public participation and providing local financial support for civil society. Those that have participated in the percentage law have noted that the it will never be able to completely fund civil society, but its main purpose is to increase participation. The increase participation is seen as a key ingredient in the development of civil society.

Taxes have long been known to reduce volunteer behavior, both in terms of monetary contributions and volunteer labor. Abrams and Schmitz [1] originally developed the theory of taxation and voluntary behavior. Coined as crowding out, they noted the relationship

between increased taxes and a reduction in charitable giving. Empirical work by Clotfelter [12] supported the hypothesis, but provided a caveat that the crowding out was not complete. Andreoni [2] tested individuals behavior directly in experiments based on the public good games introduced by Isaac and Walker [23]. Andreoni observed crowding out, but as Clotfelter also observed, it was not complete. In certain situations, he observed taxation creating a priming effect to the contribution.

With the evidences against standard taxation as a means of promoting civil participation, could the PL be an institutional innovations that reduces the crowding out effects of taxes? It is possible that the extension of the choice set beyond public decision make could promote voluntary participation, but the law has only been around for 10 years and data is not as readily available for most transitioning countries. Moreover, the confounds of democratization may make the empirical work of isolating the effects of the law impossible. For these reason, I use experiments to compare the effects of a standard tax and the percentage-law tax on the propensity to voluntarily contribute. In sections 1, I introduce a model of both a standard tax and the percentage law within the framework of a multiple public good. In section 2, I design the experiment around the model and define the treatments. In section 3, the results are introduced and compared to other experiments. In sections 4, I discuss the implications of our results.

3.1.1 Model

Consider an environment where individuals choose between investing their wealth in a private market of goods or in one of two organizations. One organization effects the entire populous while the other only effects a subset of the populous. The services of these organizations behave as public goods, return less to the individual than the private market, but more socially. Assume that these decisions are after taxation for public production.

Each individual is constrained by his initial wealth. The amount that she can spend on the private market and the services of the organizations must be less then her initial wealth. Let E be the initial wealth of the individual. x , a , b are the amount of the endowment that is

spent of the private market, the global organization and the local organizations, respectively. Since the decisions are constrained such that $x + a + b = E$, then $x = E - a - b$. Let all individuals belong to the set I and the local organization effects only the members of group m . The utility of individual i can be stated as (3.1).

$$\pi_i = E - a_i - b_i + \alpha_a \sum_{j \in I} a_j + \alpha_b \sum_{j \in m} b_j \quad (3.1)$$

where α_a and α_b are the marginal per capita return for each organization.

The Nash equilibrium of the equation is to contribute nothing to either organization and therefore, investing all the endowment in the private market. The Pareto equilibrium is investing everything into the organizations that produces the greatest public wealth. This model is fundamentally the same as Blackwell and McKee's [5] model.

To study the percentage law, we must first compare it to a standard tax system, which funds government grants. Assume all the government grants are given to the global organization. Let the tax be a fixed percentage of the endowment that is equal to t . Adding this to (3.1) we find (3.2).

$$\pi_i = E - a_i - b_i - t + \alpha_a \sum_{j \in I} (a_j + t) + \alpha_b \sum_{j \in m} b_j \quad (3.2)$$

The addition of a tax does not change the Nash equilibrium or the Pareto equilibrium. Therefore, any changes in decision must be due to the behavioral effects and not to strategy changes.

The percentages law effectively allow tax payers to allocate tax revenues to the organizations as they see fit. As such, the tax payer must choose the distribution of the tax. Let γ be the distribution of the tax, where $0 < \gamma < 1$. Then the amount that an individual gives to the global organization is $a + t * \gamma$ and the local is $b + t * (1 - \gamma)$. Incorporating into (3.2):

$$\pi_i = E - a_i - b_i - t + \alpha_a \sum_{j \in I} (a_j + \gamma_i t) + \alpha_b \sum_{j \in m} (b_j + (1 - \gamma_i) t) \quad (3.3)$$

Once again the Nash equilibrium of a and b do not change and are equal to zero. At Nash, gamma is equal to 1 if alpha of a is greater than alpha of b. It is zero otherwise. The Pareto equilibrium remains unchanged. Strategically, (3.1), (3.2), and (3.3) are equivalent.

3.2 Experiment Design

3.2.1 Model

The allocation of tax revenues and the resulting choice under these constraints are the central aspects of the experiment. The design reflects the stages of decision making and the choices at each stage. Starting with the design of the original public-goods game developed by Isaac and Walker [23], we extend the public account to a choice between two organizations that produce public good. One organization, Org A, returns benefit to all subjects in the experiment and behaves like a pure public good. The other organization, Org 1 or Org 2, returns benefit to a subset of subjects and behaves similar to a club good¹. The design is an 8 subject equivalent to that of the Blackwell and McKee's 12 subject design. A version of this design has been introduced by Fellner and Lunsar [18].

Subjects are given an endowment (e\$20) at the beginning of each round. From their initial account, they can distribute the endowment into two accounts: public and private. For each e\$ placed into the private account, the subject receives e\$1 in return at the end of the round. For each e\$ placed into the public account, subject have the option of giving the money to two organizations that produce public good. Any money that remains in the initial account or public account at the end of the round returns nothing to the subject, or anyone else.

There are two organizations that the subjects can contribute: Org A and a numbered

¹See [8] for an overview

Org. For each of the e\$ allocated to the account of Org A, the amount is multiplied by either 1.6 or 3.2, depending on treatment, and distributed equally amount all subjects in the experiment. Therefore, each e\$ given to the account of Org A has a marginal per capita return (MPCR) of either 0.2 or 0.4. The average per capita return (APCR) for Org A is equal to its MPCR.

There are two numbered Orgs: Org 1 and Org 2. Each numbered Org has 4 members and each subject is a member of only one of the numbered Orgs. For each e\$ given to the numbered Org, the amount is multiplied by 1.6 and divided equally amount the members of the group. Therefore, the MPCR for members of the group is always 0.4, but the APCR is only 0.2². Subjects are not allowed to contribute to the numbered Org of which they are not a member. Therefore, the subject can distribute from the public account to Org A or the numbered Org of which they are a member.

3.2.2 Treatments

The experiment is a 3 x 2 design. Three tax mechanisms are used: strictly voluntary contribution (VC), standard tax (ST) and percentage law (PL). Under the VC, subject have no tax and can voluntarily given to all either Org. The VC treatment is a replication of Blackwell and McKee's experiments with 2 groups instead of 3. In the ST treatment, a portion of the subject's endowment is directly placed into Org A account. The subject can distribute the remaining amount as in the VC treatment. In the PL treatment, a portion of the endowment is placed into the public account. Subjects can distribute this amount to either Org A or the number Org, but not into their private account. The rest of the endowment can be distributed as in the VC treatment.

I vary the multiplier for Org A such that the MPCR of Org A and the numbered Org are equal and the APCRs are equal. When the multiplier is 3.2, the MPCR is 0.4, which is equal to the MPCR of the numbered Org. When the multiplier is 1.6, the APCR is 0.2, which is equal to the APCR the numbered Org. The varying of the multiplier is to reflect

²apcr encompasses all subjects, not just the members of the group

the changes in behavior observed by Blackwell and McKee.

The 3 x 2 design with 2 replications gives us a total of 12 sessions. The endowment and number of subjects is held constant. The tax rate is held constant between the two tax types. In the table 3.1, there is a review of the parameters.

3.2.3 Design

George Mason University students, graduate and undergraduate, are recruited through the ICES recruiter. 8 subjects are randomly seated at computers and asked to read and sign a consent form. Subjects then read instructions on the computer. During the instructions, 4 quizzes are given. The first 3 test the subjects understanding of the return from each of the three accounts and who benefits from the accounts. The 4th quiz tests their understanding of the tax rate³, if in a tax treatment (ST or PL). Quizzes must be answered correctly to continue. Once all subjects are done reading the instructions, the experiment begins.

If subjects are participating in the ST or PL treatment, the tax rate (Portion Given) and the taxed amount (Amount Given) are displayed beneath the endowment. In the ST treatment, the taxed amount is subtracted from the initial account and directly placed into Org A account. In the PL treatment, the amount taxed is place into the public account. All treatment have a tax rate of 20%, an endowment of e\$20 and a taxed amount of e\$4. Therefore, in the ST treatment, the endowment box displays 20, the initial account displays 16 and the Org A account displays 4. In the PL treatment, the endowment and initial account are the same, but the public account displays 4 and the Org A account displays 0. If it is a none tax treatment, both the tax rate and taxed amount are not shown and the initial account is equal to the endowment.

Subjects distribute their endowment from account to account using arrows (see figure 3.1). Once they have completed their decision, they can submit by pressing the submit button. A confirmation pop-up window confirms the outcome of their decision and warns them if any e\$ will be lost. If the subject confirms, they move to the next round. If not, they

³Instructions and interface use the language "portion of income given" and not tax rate to avoid potential tax biases

Table 3.1: Table of Parameters

Treatment	Subjects	Groups	Endowment	Tax Rate	Amount	Type	MPCR	APCR
							Org A	Org A
							Org #	Org #
1	8	2	20	0%	0	VC	0.4	0.4
2	8	2	20	0%	0	VC	0.2	0.2
3	8	2	20	20%	4	ST	0.4	0.4
4	8	2	20	20%	4	ST	0.2	0.2
5	8	2	20	20%	4	ST	0.4	0.4
6	8	2	20	20%	4	ST	0.2	0.2

can change their decisions. Each subject is allotted 2 minutes to complete their decision. If they fail to complete their decision within the allotted time, they lose all the endowment. Once all the subjects have submitted their decisions, the outcomes is displayed and each subject is warned that the next round is about to begin with a pop-up box and the next round begins. Subjects are able to review their decisions and the outcomes in a table at the bottom of the screen. The round and time are displayed at the top right hand corner.

There are 30 round in each session. At the end of the session, the subjects are show the total amount earned in e\$ and US\$. The exchange rate is e\$50 to US\$1. Subjects are paid after the experiment and released one at a time.

3.3 Results

Using the parametric model introduced by Blackwell and McKee, we regress the data on 3 observations: amount given to Org A, amount given to the numbered Org and the total voluntarily contributed to either Org. We introduce 2 dummy variable to account for the ST and PL treatment. Use random effects to control for individual preferences for giving, we get the following model:

$$C_{ir} = \alpha + \beta_1 totA_{i,r-1} + \beta_2 totNum_{i,r-1} + \beta_3 round_{ir} + \beta_4 mpcr_{ir} + \beta_5 ST_{ir} + \beta_6 PL_{ir} + u_i + e_{ir} \quad (3.4)$$

Where totA is the lagged total amount given to the account of Org A and totNum is the lagged total amount given to the numbered Org of which i is a member. mpcr is the MPCR of Org A and round is equal to r. ST and PL are dummy variables for the treatments. C is for one of the 3 decision metrics.

Using the model, we use the amount given to Org A, including tax; amount given to the numbered Org, including tax; and the total amount given to either Org A or the numbered Org, excluding tax; as the depend variable in the model above. The results are in the table below (table 3.2). A random-effects modified Durbin-Watson [4] shows insignificant auto

The screenshot displays an experiment software interface with a yellow background. At the top left, a 'Citizen' logo is visible. In the top right corner, there are two input fields: 'Round' with the value '1' and 'Time' with the value '0:26'. The main area features a decision tree starting from an 'Account' box with the value '48.00'. From this account, two paths emerge: one to a 'Private Account' box with '21.00' and another to a 'Public Account' box with '15.00'. The 'Private Account' path leads to a 'Check' dialog box. The 'Public Account' path leads to a 'Submit' button. Below the 'Public Account' box, there are three input fields: 'Endowment' (100.00), 'Portion Given' (2.00%), and 'Amount Given' (2.00). To the right of the 'Public Account' box, there are two 'Organization' boxes: 'Organization A' with '11.00' and 'Organization 1' with '5.00'. The 'Check' dialog box contains the following text: 'You have chosen: Put \$21.00 in your Private Account, Give \$11.00 to organization A, Give \$5.00 to organization 1. You will lose \$63.00'. It has 'Accept' and 'Reject' buttons. At the bottom right, there is a 'History' table with the following columns: Round, Endowment, Tax Rate, Taxes, Private, Benefit, Org A, Org 1, Total, Dollars. The table is currently empty.

Figure 3.1: Screen Shot of Experiment Software

correlation and therefore it is ignored.

As was found in both [5] and [18], the coefficient for the round is negative. This reflects the general learning process of subjects as their decisions change from their prior to the Nash equilibrium. The signs of both lagged variables are also consistent with past findings. In the public good that is accessible to all subjects, Org A, the total amount invested into the same good is positively correlated with increased investment in the following round, while the total investment into the numbered Org is negatively correlated with investment in Org A in the following round. The same is found for the numbered Org, the total invested in a numbered Org is positively correlated with the investment into the same good in the following round and the total investment into Org A is negatively correlated with investment. This reflects individuals' perceptions of cooperation and the substitution effects as one public good outperforms another. The mpcr of Org A is positively correlated with increased investment in Org A and negatively correlated with investment in the numbered Orgs. Once again, this reflects the substitution effects due to marginal returns.

The effect of the treatment shows that crowding-out is present in both tax systems. In the ST treatment, the tax increases the amount invested by the individual to Org A by only 0.18 and to the numbered Org by 0.16. Although this increases the total amount invested, it actually is a reduction in the amount voluntarily given. Subjects involuntarily gave e\$4 to Org A. Therefore, although there was a total increase of e\$0.16, there is a decrease in voluntary giving of 3.66 ($4 - 0.18 - 0.16$). The decrease is confirmed when the total net voluntary contributions are regressed in our model and the ST coefficient is -3.57. The increase in investment to Org A is driven completely by the tax with some substitution effects increasing investment in the numbered Org. The reduction in contributions is less than the amount of the tax, which was noted by Andreoni [2], but the crowding out is almost complete. The standard tax, in net, increased investment into the public goods by almost nothing for Org A and little for the numbered Org as well.

In the PL treatment, the tax increased total investment more than the ST treatment, but still relatively small. The percentage-law tax increases investment to the numbered

Table 3.2: Table of Regressions

	org a	org #	total contributions
	(1)	(2)	(3)
PL	.160 (.172)	.533 (.157)***	-3.094 (.220)***
ST	.176 (.197)	.156 (.180)	-3.567 (.252)***
mper of a	-.317 (.870)	-4.477 (.793)***	-4.307 (1.112)***
total a (lagged)	.120 (.004)***	-.002 (.004)	.115 (.005)***
total b (lagged)	-.015 (.010)	.162 (.009)***	.143 (.012)***
round	-.007 (.008)	-.019 (.007)***	-.029 (.010)***
cons	.435 (.478)	2.427 (.344)***	2.857 (.599)***
e(N)	2879	2879	2879

Stata random-effects regression: xtreg . . . , i(subject)

Org by e\$0.53 and e\$0.16 to Org A. The total increase is e\$0.69, but e\$4 were involuntarily contributed. Therefore, subjects reduced their contributions by \$3.31 due to the tax. The regression of net voluntary contributions shows that this is the case. The PL coefficient is -3.09, which is less than that of ST.

Although neither of the dummies for the treatments in the voluntary contribution regression are significant, they match with the sum of the individual Org coefficients, which are significant, minus the taxed amount. For the experimental design, this check seems to signify that the amount that voluntary contributions is reduced under PL is less than that of the ST, but not by much.

3.4 Conclusion and Discussion

Whether the cost of implementing and maintaining either tax system is beyond the scope of this paper. Therefore, we can not make any judgments on the efficiency of the two tax systems over no tax system. We can compare the two systems and determine the possible

advantages of each. Both the Percentage Law and the standard tax seem to increase the accounts of all organizations, even when the tax revenue are only given to one organization. A standard tax, which can be compared to government grants, seems to slightly increase the total amount in the accounts of the organizations, but for the most part exhibits almost complete crowding out. The percentage law, on the other hand, exhibits a distribution that favors the numbered Org and displays a greater increase in the amount given to the organizations. Despite the differences between the two tax systems, they both have rather high amounts of crowding out and are relatively as effective as the other in this experiment.

The popularity of the percentage law is most likely not based on its reduction in crowding out. Behaviorally, voluntary contributions are greater under the percentage law than a standard tax, but poor overall. The percentage laws had a less equitable distributions. As such, concerns over equality between organizations may not be a driving force behind its popularity. Although there is a small advantage for the organizations with the percentage law, the total amount of crowding out is equally high in both taxed. Increasing participation by increasing voluntary contributions is most likely not the reason for the PL's popularity.

Chapter 4: The Percentage Law and the NGO Experience

4.1 Introduction

In the previous chapter an experimental study suggested that the Percentage Law (PL) has rather high crowding-out of voluntary contributions. Although the laboratory offers control of the environmental variables that also influence behavior, it lacks the dynamics of individuals changing the institutions in which they operate [31]. As such, institutional adaptation, which develops in response to the law, may provide a set of rule such that contributions are actually increased.

Changes in policy provide an incentive for individuals to innovate in order to take advantage of the policy. These innovations may create the environment in which the transaction costs of contributing fall. If this is true, the negative effects on contributions from the law could be overshadowed by the increases in contributions due to a reduction in transaction costs.

For example, if the PL provides an incentive for not-for-profit organizations (NPO) to advertize, then the search costs of donors decrease. The reduction in search costs means a greater return for the donors because they are more likely to find the NPO that best fits their preferences. As the donors value for contributions increases, donors increase the amount that they are willing to contribute. If the amount of increase from the advertizing is greater than the reduction from the crowding out, then the PL has a net increase in contributions. Therefore, the behavior in isolation of institutional innovation is negative, but when adaption is considered, it is positive.

Although the tax payer is directly affected by PL, the costs and benefits are dispersed

throughout population. NPO, on the other hand, are nexuses for the benefit. As such, we should expect the NPO to be the innovators and the tax payers and government reacting to their innovations. Therefore to understand how institutional change affects the net contributions, observing NPO behavior is a good starting point.

Understanding how NPO react to the PL and their relative success provides us with a picture on the institutional arrangements that proves the PL does increase contributions. The purpose of this paper is to explore the NPOs reaction to the PL. In section 1, I discuss a ethnographic methodology used to explore and classify the activities of NPO who participated in the PL in Romania. In section 2, I discuss the results of the research and their theoretical implication. In section 3, I provide concluding remarks of the research.

4.2 Methodology

4.2.1 Data

To explore the impact of the PL at the ground level, the tacit knowledge of those operating within the influence of the law must to be exploited. Tacit knowledge is the fine details that is not know to individual's outside the industry. For example, most people know that when iron glows it is hot, but a seasoned blacksmith can estimate the actual temperature from the color and surface of iron. Because the temperature is important to the process of working iron, the blacksmith has learned to recognize the signs that determine temperature. For the rest of us, the relationship between the color and the temperature of iron is not important to our daily lives. We benefit from specializing in the information that is pertinent to our role in the economy.

Tacit knowledge is not always obvious to those who have it. Most individuals employ their tacit knowledge without being aware of it [29]. Therefore, it is difficult for a researcher to find particular information if neither the researcher nor those who may have the knowledge, know what is pertinent to the study. Moreover, holders of tacit knowledge my not want to report the information accurately because of shame or it conflicts with their moral

values.

Ethnography provides a method for accessing this knowledge without directly asking. Unlike surveys, ethnographic interviews use nonverbal cues, open-ended questions, and context to develop a narrative of the interviewee's experience. Through comparing and contrasting a set of interviews, the elements that are similar in the set emerge from the narratives through a process of triangulation. The end result is a set of categories that are common to the set of individual interview.

There are 3 major stakeholders of the PL: the government, tax payers, and NPO. NPO are uniquely situated to provide information on all three of these groups. NPO directly interact with their members, who are most likely to designate to the NPO. The members are the volunteers and donors needed for the NPO to operate. Any problems or concerns about the PL are passed along to the NPO. NPO also play a major role as advocates for its members [35]. Moreover, NPO must lobby for their interests as a sector as well. This advocacy places the NPO in contact with politicians and bureaucrats.

In this paper, I use a semi-structured, ethnographic interview with leaders of NPO to develop my understanding of the PL in practice. I interview these leaders at their places of operation and observe their facilities. I ask 12 open-ended questions to help them develop their experience participating in the PLs as well as their opinions concerning the law (see appendix III). The tacit knowledge that they hold as the crossroads of all three stakeholders should provide us with the most complete illustration of the PL in practice.

4.2.2 Sample

As in all empirical research, a perfectly random sample allow generalization of correlation across all population. Therefore, the selection process should be as unbiased as possible. If the selection process is not random, any selection bias is confounded in the correlations. The outcome of the research is subsequently limited to the biased sample and not generalized to all.

Ethnography is no different. The sampling process must be as random as possible to

ensure generalization. Unlike research with observed data, ethnography requires consent and participation by an individual. Participation in interview with sensitive subjects may require a relationship or introduction to establish trust. Therefore, random sampling may not be practical. An alternative to random sampling is opportunistic and network sampling [27].

Opportunistic sampling in Ethnography is interviewing all individuals who meet the criteria of the study. Although the process is prone to bias, preselected criteria reduces selection effects of the researcher. Network sampling using introduction by non-researchers and prior participants as the selection process. Each branch of the network is biased by the introduction of those in the branch, but if mapped carefully, the network biases can be accounted for in the data. This reduces effect of the bias on the analysis.

To explore the PL in practice generalized across all States, the researcher should sample an equal amount from each country with the PL. With unlimited resources this type of sampling provides the most robust results. Unfortunately, scarcity of resources means a limitation to cross-country sampling. Case study framework limits the scope of the sampling, but at the cost of biasing results to the institutions of the case. Although it is not generalizable across all countries, it may be generalized to all States with similar institutions and demographics.

Given the constraints of resources and consent, the sampling process used by this paper is limited to the case of Romania. Furthermore, due to the concentration of NPO, I limit the study to Bucharest and Cluj. Both these cities, due to their population and proximity to government, provided a large population of NPO. Within these limits, a combination of the opportunistic and network sampling is used.

For the opportunistic selection, my preselected criteria is simple: any executive of a registered NPO. Anyone that would introduce me to this individual, I would accept. There are 3 individuals that play such a role during the study. The network sampling process yielded two branches and one subbranch. In figure 4.1, there is a tree of the introduction. All NPO executives have been replaced by the shorthand ORG# and all individual that

facilitated introductions with P# for participant privacy.

4.2.3 Analysis

There are several qualitative techniques that are used to triangulate the important concepts from the narratives. Due to the relatively small number of interviews, this study uses a ground-theory approach as advocated by Corbin and Strauss [13]. As such, I start with the priors that NPO produce public goods and optimize according to the Niskanen [30] model of bureaucracies. Tax payers are utility optimizers and optimize the production of the NPO as an impure public good. I also assume positive transaction costs can exist, but treat them as zero unless reported. Government policy is considered exogenous, unless reported otherwise.

The open coding is marked in the summary of the interviews in appendix IV. The open coding phase yielded 64 codes over 9 participants. 29 of the initial codes were in more than one narrative of the participants. A list of these initial codes can be found in appendix III.

In the axial coding phase, I use a Boolean coding system to combine the 64 codes. The Boolean categories are marked positive if the statement agrees with the category, negative if the statement disagrees with the category and don't care if the statement is neutral. The axial phase yielded 19 categories with a median fit ¹ of 44.4%. All codes with only one observation at the end of the axial coding phase are discarded. 82 observations remained after the phase, which shows that 27 of the observations were redundant. A summary of the code and participant relationships to the categories and the relative fit for each is displayed in table 4.1.

4.3 Results

The category that was most commented on in interviews was (1), from where did they receive financial support. It is not surprising given that it was directly primed by question number 4 (appendix III). Two-thirds of the NPO reported that funding came mostly from

¹Fit as defined by Strauss and Corbin

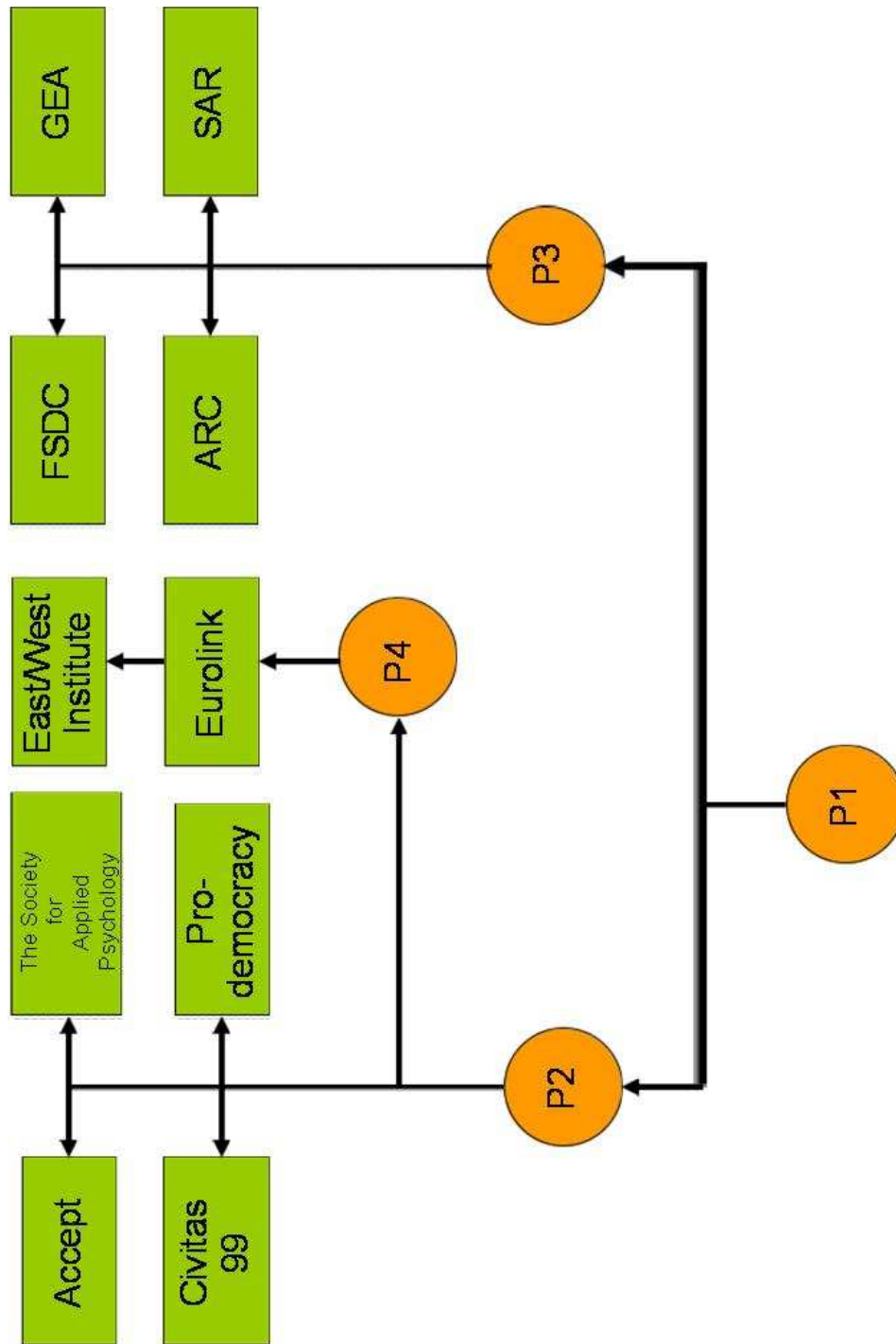


Figure 4.1: Interview Referral Graph

foreign sources. Funding source match the responses for (16), non-government entities can regulate NPO. All NPO who commented that it was possible to be regulated by non-government entities also received most of their funding from foreign sources, while all NPO who commented that it was not possible received the majority of their funding from the a local source, whether it be government or donations.

The second category with the most comments was (10), importance of government regulation. 3 out of the 8 NPO who reported, commented that government should have more regulation on the PL and NPO. Of those that reported that more regulation is needed, they also replied (8), markets should determine which NPO operate, and (13), NPO must be well know to benefit from PL, but they were not the only positive reports on either (8) or (13).

The third most reported category (2), high knowledge of the law, was directly primed by question 6. 6 out of the 7 NPO who reported, displayed accurate knowledge of the PL, while only one was misinformed. There were no systematic connections other categories.

The fourth most reported was category (3), PL is a insignificant portion of the budget, which was primed by question 8. 6 out of the 7 NPO who reported, said that money received from the PL was to little to effect their finances. There were no systematic connections to other categories.

The firth most reported category (13) was not primed by any question and had no negative responses by any of the NPO. A total of 7 had made some kind of reference to the fact that only large and well establish organizations could benefit or that advertising was the only way to increase their access to money from the PL. As Org 2 noted through an interpreter, "If you do not have money then you can't advertise. If you can't advertise, then you won't receive any money from the percentage law. It is a vicious cycle."

The sixth most reported category is (4), external or internal campaign. Interviewees reported two types of campaigns, those that advertised to a public as a whole and those the advertised exclusively to their member. Although the participation in a campaign was partially primed by question 7, the mention of campaign type was from the interviewees.

Interestingly, all of the interviews that reported (7), a net loss from the PL, also had an external campaign. Similarly, the only NPO that reported a net gain, also reported an internal campaign. The connection between these two categories seem to indicate that those who advertised to the public as a whole received a loss from the campaign, while those who only advertised to their members receive a positive benefit from the campaign. Org 7 admitted to me, "An advertising campaign can be valuable over the long run, but for now it is not." Most of those that had external advertising campaigns were going to reduce their future campaigns, most likely to members only.

The next category, if commented on, was positive. Category (8), markets should determine NPO, was partially primed by question 11 and often exhibited conviction when commenting. All those that report (19), government and NPO too connected, also reported (8). This is not surprising given that those who prefer market system would be the most sensitive to government encroachment. Those that report (8) were confident that competitions between NPO would remove those who produce service not desired by the public or produce less efficiently than the others. As Org 8 noted, "There is a limited number of [NPO] that can operate in the economy. There needs to be a shake out of the unwanted."

Category (14), is it feasible to increase the PL, was unanimously negative from all those who reported. They gave two general reasons: the government would never give up the money or to increase the PL the government would have to reduce public services which would not be popular. In all cases, interviewees seem to express skepticism in the percentage law, even when they said that it was good for Romania as a whole. Category (14) was not connected to any other category.

Category (11), NPO are more efficient than the government, was partially primed by question 10. 4 out of the 6 that commented said that NPO were better at providing services to the public than government. As the umbrella organization, Org 3, reported "[NPO] are more innovative than government and they are able to create more services."

Category (7), NPO suffered a net loss from participation in the PL, was remarked on by 5 interviewees of which only 1 said that they had made a profit. It seems many did

not find active participation a benefit to the organization. The umbrella organization Org 3 reported that all the many NPO campaigns cost more than it returned and create a net loss for the organization. He did mention one exception. SMURD, a NPO that provides ambulance services, developed a large media campaign and captured a large percent of the money made available for NPO through the PL. He reported that they had started an even larger advertising campaign in metro stations throughout Bucharest.

All the other categories received less than half the NPO mention them. One that had some interest was the concern over the difficulty of designating, category (17). Only mentioned by 4 NPO, they expressed concern that the government had made it difficult for individual to designate through the PL by creating overly complicated forms and rules. One organization even set up a booth to help tax payers that wanted to designate to the organization. They mentioned that tax returns were filed through the workplace where workers were pressured to designate to a particular NPO. Others mentioned extra forms which had to be mailed to separate location for those who are self employed. In general, they expressed that if the cost of designating to the NPO they desire is too costly, they will not designate.

Some of the NPO interviewed suggested that the PL increase the participation in the third sector by increasing the opportunity of lower income tax payer to donate, since they would not donate normally. In a transaction costless world, this would be true, but as the interviews show, there are positive transactions cost. If we assume that the tax payers are myopic and government and NPO are substitutes, then when the marginal value of designating the determined amount to an NPO minus the transaction cost of designating is greater than the marginal value of giving to the government, they the tax payer prefers to designate. We can express this in (1).

Where x is the amount designated and c is the cost of designating.

If we assume that c , $\frac{\delta U}{\delta g_{npo}}$, and $\frac{\delta U}{\delta x_{gov}}$ are fixed, then we can solve for x .

When x is small, the tax payer prefers not to donate. If this is the case, then as the tax burden of the tax payer increase, the willingness to donate also increase. An indication of

Table 4.2: Education and Designation

Level of education, social status	Designated1%	Did not designate 1%	Total
<i>Educational background</i>			
Did not complete primary school	30.7	69.3	100.0
Completed primary school	33.4	66.6	100.0
Vocational training	42.4	57.6	100.0
Secondary school	52.2	47.8	100.0
HE college, university	72.5	27.5	100.0
<i>Occupational status</i>			
Self-employed	43.0	57.0	100.0
Employed, white collar with college or university degree	77.2	22.8	100.0
Employed, white collar with no college or university degree	62.6	37.4	100.0
Blue collar worker	40.7	59.3	100.0

Kuti 2007, pg. 34, NIOK [<http://www.onepercent.hu/Dokumentumok/KUTI2007web.pdf>]

this effect is collaborated by statistics of the PL from Hungary. According to NIOK², the percent of tax payers that donate is directly increasing in the amount of education (table 4.2). Since education is correlated with income, it is possible that the lower-income tax payers are rationally not contributing due to the transaction costs. This problem could be eliminated by increasing the percent that can be designated, which the interviews suggest is not possible, or streamline the process of designating, which reduces *c*. The interviewees who spoke of the problems with designating do not believe that it will change in the future.

Finally, interviewees that report (6), government has transparency or corruption problems, mentioned that they often don't even know if they are receiving the money that individual had designated. Several organizations reported that the money from the designations was just transferred into their accounts with no formal statement. The frustration with the government came through in an anecdote from a minority-rights organization about the designation from a wealthy member which was not transferred, "I called the ministry of finance in the district from where he donated. They told me to call the ministry in the area where [we] are located. They told me to call the other ministry. There is no transparency!"

²See NIOK website: <http://www.onepercent.hu/research.htm>

4.4 Conclusion

The purpose of this study was to examine the practical implementation of the PL and determine if it either provided a local means for supporting the third sector or promoted participation in the PL. As most of the interviewees reported, the PL has had little to no effect on the financial outcomes of the percentage law. It would seem from the reports that only the very large and well know NPO have benefited from the implementation of the law. It would seem that the percent required to actually support the third sector in Romania is much larger than the current amount and as several of the interviews have revealed, it isn't likely to increase anytime in the future.

As several interviewees said, the PL is for promoting NPO more than for supporting them, category (18). They remarked that it gave them the incentive to advertise and became well known, category (13). But the reports on campaigns seem to contradict these statements. Most organizations that campaigned to the public as a whole lost money. Even though they expressed long run possibilities, most were going to reduce their expenditures for the following year. If we assume Niskanen's model to apply to NPO, then they should move from a negative sum strategy of external campaigning and move to a positive sum strategy of internal campaigning. If this is the case, the incentive to advertise to a broader base than the member of the NPO does not exist if the NPO is sufficiently impatient. This seems to be the case considering the reported reduction in external campaigning. Only those that are already know and sufficiently large have the incentive to campaign to the public.

Finally, reports that the percentage law increase participation amount the lower-income populous fail to see the effects of transaction costs. Any egalitarian effects from the law are dispersed by the effects from the difficulty of designating. Therefore, the upper-income groups still dominate the contributions to NPO, just as they do when there is no subsidy [34].

The theory that the PL increases participation and provides a local source of funds does not seem to be true in practice. The subsidy seem to direct tax payers to only the large and

established NPO. Small and medium size NPO are then caught in a "vicious cycle" where they are limited to their own membership. It also maintains a skewed distribution of higher donation from the more wealth due to transaction costs. If the goal of the PL was to create a diverse civil society and increase participation among the populous, governments would be better off without the subsidy than with it.

Chapter 5: Conclusion

Subsidies for charitable giving can be used to help develop civil society; the Percentage Law is no different. Although the extent to which it stimulates development is not clear. The research presented in this dissertation suggests that there may be marginal benefits in the development of civil society. Evidence from a multiple public good experiment shows less crowding out under the Percentage Law than a standard tax or government grant system. If increased participation, in terms of voluntary contributions, is the goal of the subsidy, then the Percentage Law may provide a small advantage to a standard tax and grant system.

If the goal of the subsidy is to create a local source of revenue for civil society, experiments show that has a small advantage over a standard tax. Interviews with participating organizations suggest that the due to search costs and advertizing, only large, well-known organizations actually benefit from the percentage law. The experiment also shows that the distribution between the two organizations that produce public goods is less equitable. This predicts that only a small concentration of NPO can take advantage of the Percentage Law.

The Percentage Paw could have other uses than supporting civil society. The history of the Percentage Law shows that conflict is the main reason the law is enacted. If the full subsidy is being used to mitigate political conflict, then the law could be employed to settling disputes over allocation of government funds. As such, the law can be used to increase stability in States where the preferences of two or more groups are diametrically opposing. It is the resolution of this type of conflict that holds the true benefit of the Percentage Laws.

Appendix I

Optimal Subsidy

Starting with the model presented in section 2.1

$$u_i = \sum_{j=1}^n f(|x_j - x_i|)U_i(C_j(p(1-s))) + f(|x_m - x_i|)U_i(R - s \sum_{j=1}^n C_j(p(1-s)))$$

To find the preferred subsidy of the tax payer, we can optimize the utility function with respect to the subsidy. The subsidy that maximizes the utility of the tax payer is the preferred subsidy. Therefore, by taking the First Order Condition and solving for s, we can find the preferred subsidy.

$$\frac{\partial u_i}{\partial s} \sum_{j=1}^n f(|x_j - x_i|) \frac{\partial U_i C_j(p(1-s))}{\partial s} \frac{\partial C_j(p(1-s))}{\partial s} (-p) + f(|x_m - x_i|) \frac{\partial U_i}{\partial s}$$

Solving for s we find

$$s_i^* = \mu + \frac{1}{n} \sum_{j=1}^n \frac{f(|x_j - x_i|)}{f(|x_m - x_i|)} \cdot \frac{\frac{\partial U_i(c_j)}{\partial x_i}}{\frac{\partial U_i}{\partial x_i}(R - s_i^* \sum c_j)}$$

Appendix II: fsQCA Print out

File: C:/Program Files/fsQCA/widget/ch1_SdiffL.csv

Model: $pl = f(\text{corrupt}, \text{catholic}, \text{religious}, \text{war}, \text{s_minority}, \text{l_minority})$

Rows: 64

Algorithm: Quine-McCluskey

True: 1

0 Matrix: 0

Don't Care: -

— TRUTH TABLE SOLUTION —

Assumptions:

raw unique

coverage coverage consistency

catholic*religious* war* l_minority 0.750000 0.750000 1.000000

corrupt*religious*war*s_minority* l_minority 0.250000 0.250000 1.000000

solution coverage: 1.000000

solution consistency: 1.000000

Appendix III: Fieldwork

Interview Questions:

1. What does your NPO do?
2. Who benefits from your NPO?
3. How did your NPO start?
4. Where do you receive your funding?
5. How would you describe your NPO?
6. What is the percentage law?
7. What did you do to access the law?
8. How has the percentage law affected your funding?
9. What is your opinion of the percentage law?
10. How are NPO different from government?
11. Who should determine what NPO should operate?
12. Who should determine what NPO should do?

Initial Coding Description

1. NPO is not main stream
2. NPO servers the minority
3. High foreign support
4. Romania is social intolarent
5. NPO is small
6. Advocates should not take money from gov
7. Not enough transparency in the PL
8. Too much government intrusion
9. Insignificant income from PL
10. NPO campaigned for PL
11. Too small to take advantage of PL

12. PL can't support entire NPO
13. NPO efficient to an extent
14. It is costly to designate
15. PL promotes NPO
16. NPO more specialized than gov
17. NPO more accountable than gov
18. Participation should not be restricted
19. NPO benefits the majority
20. High local support
21. Low Knowledge of PL
22. Advertizing important to benefiting from PL
23. Specialization possible, but not without money
24. Competition determines which NPO should operate
25. Not enough government control
26. High knowledge of PL
27. Attempted to lower cost of designating
28. Medical NPO receive most of PL
29. Net loss to NPO
30. Increased PL not good
31. Promotes citizen particitation
32. NPO more innovative
33. Market decides who receives money in PL
34. Gov., NPO, and firms are equal
35. NPO is a umbrella organization
36. PL passed a part of a political game
37. Internal campaign for PL (members only)
38. Gov. budget constraints make increase in PL impossible
39. Gov. won't give up contol of money to incease PL

40. Gov. is becoming more friendly toward NPO
 41. Gov. should not regulate PL
 42. Media is not a check on NPO
 43. NPO must have public utility status for gov. money: not good
 44. NPOs are partison
 45. Lack of IT is the blame for lack of transparency
 46. NPO community should monitor PL, not the gov
 47. PL good, but poorly implemented
 48. NPO are not valuable without gov
 49. Unions and political groups should be restricted from PL
 50. PL increase the incentive to become know
 51. PL is meant to change the public frame of civil society
 52. NPO is supported by gov
 53. The problem is NPOs not known
 54. PL can't support entire NPO unless firms are included
 55. Citizens see NPO as tax avoidance
 56. No political will to increase PL
 57. Anonymity for donors important
 58. NPO overregulated
 59. No trademark protection for NPO
 60. Umbrella org. can't provide governance
 61. PL helps large, well know NPO
 62. Banks better than NPO for economic services
 63. Current regulation is fine
 64. Public utility status is good for the third sector
- Category Description
1. NPO is funded by foreign source
 2. NPO is informed about the PL

3. PL is an insignificant portion of the NGO budget
4. NPO conducted an External Campaign (vs. an Internal Campaign)
5. NPO believes that political advocates should not receive government funding
6. Government has corruption or transparency problems
7. NPO had a net loss from participating in the PL
8. Market should determines which NPO operate
9. NPO is small size (vs large)
10. There is too much government regulation
11. NPO are more efficient than government
12. NPO benefits the majority (vs. the minority)
13. You must be well-know to benefit from the PL
14. It is possible to increase the percentage law
15. The NPO is an umbrella organization
16. Non-government entities are not able to regulate the third sector
17. There are transaction costs in designating
18. The PL promotes NPO and increase participation
19. The government and the third sector are cooperating
20. No Relevance

Appendix IV: Interview Notes

Interviewee: Florin

Organization: ACCEPT

Date: June 20th, 2006

Florin is an administrator at ACCEPT and he maintains the finances of the organization. I was introduced to him by Bogdon at Florin office. After a small discussion with Bogdon in Romanian, he agreed to speak with me. The interview was held on the balcony of a community room with Bogdon sitting behind Florin next to the balconies entrance.

1. ACCEPT is a gay and lesbian organization. They provide legal services as well as public awareness for the gay and lesbian community. Florin noted the general change in Romania society since the start of ACCEPT. A poll in 1998 showed that 86% of Romanians did not want Gays in their community while in 2004 only 43% responded the same.
2. Minorities, not just gay and lesbians, are the recipients of ACCEPTs services.
3. Officially ACCEPT started in 1996 as a minority support NPO. Florin notes that it really started with 1994 seminar series from advocacy organization in the US and UK. In 2000, the Romania government repealed the laws that prohibiting homosexuality. After 2000, ACCEPT became an official organization for the advocacy of gay and lesbian rights.
4. The major source of funding for ACCEPT is foreign NGO. They receive no money from the government. Florin says that things are changing and he notes the police protection of the gay and lesbian parade. He says it is unethically for ACCEPT to take money from the government because they are there to advocate change. This is not possible if there you are taking money from the government.

5. ACCEPT operates with 30-40 volunteers and it has 5-7 staff members.
6. Florin is well informed about the 2% law. He notes that it started with a 1% law in 2005 and it was increased to 2% in 2006. He criticizes the first year of implementation by saying it was not transparent and the ministers are not accountable. He notes that the law was passed in April 2005 and the deadline for paperwork was May. Only 100 of the 400,000 budget come from the 1% law transfers.
7. ACCEPT had a campaign for the last two years with little success. There are plans for a campaign next year, but it will be much smaller than before. Florin notes that the law and system are too unstable to plan a larger campaign.
 - (a) Florin doubts that the government will transfer all the funds designated to ACCEPT. Not one of the ministries has sent a statement about the transfers to ACCEPT. The money was just transferred into the accounts.
 - (b) He tells an anecdote about a well-off member who submitted his paperwork, but ACCEPT never received the money. Florin called the ministry of finance in his district and they told him to call the ministry of finance from the donors district. He called the other district and they told him that they had transferred all the money to the ministry of finance in the district of ACCEPT.
8. Florin does not believe it is possible to support ACCEPT solely from the 2% law. Florin believes an expansion in the 2% law can be good, but he does not think it is possible if public services are to be maintained.
 - (a) Florin notes that the largest problem with the 2% law is the procedure. The Fiscal code is still new and the obligations of the ministries are not well defined and enforced.
 - (b) There are too many transaction costs that lead those who would transfer funds to neglect it. The transaction costs are noted as cost of obtaining form, cost of mailing form, time spent in ministry of finance and lack of information.

9. Florin believes the 2% law is good for Romania because it promotes NGO and NGO can personalize services.
10. It is possible for NGO to specialize services more than the government.
11. NGO are accountable to donors. NGO create markets for public goods.
12. NGO already need to have a fiscal registration. The government made a list of qualified NGO. There should be not additional regulation.

Florin, Bogdon and I have a small conversation before leaving where Florin notes that people will stop using the system because of impatience. So society needs to take care. While walking to the next interview, Bogdon warns me that Florin may have been trying to please me, rather than tell the truth.

No interview referrals were given.

Interviewee: Dorin Bitfoi

Organization: The Society for Applied Psychology

Email: liviu_bitfoi@yahoo.com

Date: June 20th, 2006

Dorin is the founder of the Society for Applied Psychology. Dorin is also an academic at one of the local universities. Bogdon makes the introduction at the beginning of a weekly meeting and he agrees to an interview without hesitation. The interview is held in a bar around the corner from the meeting house. After a general conversation in Romanian among members, the atmosphere quiets and the interview begins. Bogdon sits next to us and he translates words that Dorin can not understand.

1. The Society for Applied Psychology (SAP) is an organization dedicated to analyzing and interpreting cultural phenomena. Clinical psychology is the core of their

methodology and they tend to analyze film, art and other culture manifestation. The objectives of the organization are not professional; they are more cultural, social and intellectual. Although the organization is not professional, Dorin notes the advantages for professionals involved in clinical research. The organization seeks to express psychology in language and spread the concept of psychological analysis. Dorin admits the organization is an experiment in civil society and a work in process.

2. The services of SAP are targeted at individuals who are interested in debate and discussion of psychology. Dorin would not consider them the majority, but notes how the majority will benefit from his organization.
3. The organization was founded in 2003 and it became official in 2005. Dorin is the founder along with some other members of the organization.
4. All of the funding for the organization is from member dues and donations.
5. No relevant information.
6. Dorin is familiar with the law, but not all the details. He had asked the members to donate to the society, but little was received.
7. He plans on asking member to designate their 2% to SAP, but he believe it will have little help. Dorin mentions a vicious cycle with 2% law. One can not advertise without money and one can not access the money from the 2% law without advertising. If the organization is small, it will remain small.
8. 2% law can not support the organization because it is too small to access it. He refers back to the vicious cycle.
9. The law is good, but what are the means to attract citizens 2%: publicity, website. It is limited.
10. It is not possible without financial power.
11. Competition between NGO will remove those who are useless.

12. Yes, there is no government control and there needs to be a change.

Interviewee: Octavian

Organization: FSDC

Date: June 21th, 2006

Octavian is the manager of FSDC (). He has connections to CADI and he is friends with Horia Terpes. I met him at the office of FSDC and the interview took place in the meeting room. Several interruptions by employees stopped the interview, but it was fairly fluent.

1. FSDC is an umbrella organization, which assists other nonprofit organizations (NPO) in starting, operating and expanding their organization.
 - (a) They help administer the FARI programs in Romania and it provides access to international recourse for local NPO. They work with USAID and the EU to develop civil society in Bucharest. They work with international organizations compile statistics on philanthropy, NPO and programs. It is involved in creating a database of NPO with help from John Hopkins.
 - (b) It provides technical support, legal advocacy and strategic planning for developing NPO. They publish a news letter and create pamphlets to help NPO to inform organizations on opportunities and application processes. They provide legal support for NPO and they interact with the ministry of Justice and the ministry of Finance in order to resolve problems for NPO. They publish documents on strategic planning and Octavian boasts of a process that can implement an NPO within 3 months of creation.
 - (c) They also monitor NPO and report of the performance of NGO. They are part of the USAID watchdog program and they publish a donors guide magazine. They compiled the Romanian CSDF report for Romania.

2. They serve other NGO.
3. They started in 1994 with support of the EU. They expanded in 1996 to create a resource center for NPO.
4. Sources of income are mainly from international NGO and some local business support. They also gain funding through consulting services to local and international NGO. The major international NGO donors include the following:
 - (a) CSDF
 - (b) USAID (through grant program)
 - (c) World Bank (through MOD)
 - (d) EU and US Embassies
5. Nothing interesting.
6. FSDC was part of a consortium to implement the 2% law. The consortium consisted of FSDC, ARC, the American Chamber of Commerce and other Foreign Donors.
 - (a) There were plans to train the ministry of finance, local ministries and offices on the 2% law, but it was rejected by donors. Normally, the ministry of finance gives order to the local ministries and offices.
 - (b) Octavian notes that it was not possible to pass the law in 2001 because it was not fashionable for politicians. In 2003, NPO started an initiative to pressure politicians. In 2004, it became fashionable to be identified with civil society and therefore the initiative was passed. The key was making civil society popular. Octavian proudly admitted that "it was from the political game," that the initiative was passed.
7. No personal campaign.

- (a) They conducted a campaign to inform the public through poster, flier, Radio and TV, in order of money spent. Most of the campaign was funded through USAID. Most of the campaign materials, including Radio and TV spots, can be found on website: www. .ro. It was a national campaign for awareness.
 - (b) Local campaigns were responsible for helping individual to submit the forms and documents to the local ministries. Many of the NPO set up station to help fill out and submit forms.
 - (c) They provide a list of the NPO that are eligible to receive the redirected funds. In the first year, 20,000 NPO were listed and they receive some money. Medical NPO receive the bulk of the redirected funds, but only 10
 - (d) Many NPO campaigns for the 1% law cost more than the provided. It led to many net losses (in funding). Medical NPO spent the most on advertising.
8. Increasing the amount that citizen can redirect not necessarily good. The 2% law is not necessary for funding to NPO. The law was never meant to support an NPO completely.
 9. 1% law is good for Romania because it establishes a link between NPO and citizens. It is a way to decentralized contributions. It is also a source of funding that is free from conditions.
 10. NPO more innovative than the government and they are able to create more services.
 11. No more regulation. The market will decide donations; a civil society market will be created.
 12. NPO are equal to private and public companies. The ability to add more funds and quality in up to the NPO. More access to citizens, public authority and private firms will help.

After the meeting, Octavian invites me to a conference with local NPO. It was a discussion on the value of NPO in the development of the economy.

Interviewee: Irina

Organization: Civitas 99

Date: June 21th, 2006

Irina is the president of Civitas 99 as well as a student in political science. She is a friend of Bogdon and they are connected through the organization. The interview was held at a caf in the center of Bucharest. The caf is busy, but most people are outside.

1. Civitas 99 is a student organization that links students of political science with practicing professionals. The organization consists of 20 voting members and an extended membership without voting rights. They provide student and professional mentoring programs for their extend members. They publish as journal for student papers and organize debates. They often act as a mediator between the university and students seeking access to university facilities. They help students develop research projects by providing resources and finding funding. They also organize conferences for the presentation of research projects.
 - (a) The 20 voting members are not static and they have a process for becoming a voting member.
2. University, political-science students.
3. It was founded in 1999, hence Civitas 99. It was originally organized by a group of political science students.
4. The university supplies meeting space and other resources. Member volunteer services. Corporate sponsorship and private contributions provide funding for conferences. Grants from the EU have also provided funds.
5. Only students of the University of Bucharest know the organization. It is a work in progress becoming known beyond the University.

- (a) The student and professional network is divided into groups
 - i. International Relations
 - ii. Political Markets
 - iii. Post Communism
 - iv. Security

- 6. Irena was aware of the 2% law and she noted that it was developed by NGO devoted to democratic development. No significant portion of the budget was due to the 2% law. She mentions that SMURD was the largest recipient of the 2% law.

- 7. They used a campaign of mailing reminders to members and speaking to people professionals in the network. External campaign was not viable due to cost. They targeted mainly students.

- 8. They cant support themselves strictly from the 2% law. Irena mentions that none of the NPO can. Expanding the 2% law is not possible due to budget constraints of the government.
 - (a) Government is not willing to give up control because of fear of opposition. "There is poor cooperation between government and civil society," Irena said. Civil society was oriented to the right at the beginning of the post communist period.
 - (b) She mentions that there are improvements. Chamber of Deputies new policy to offer space for NPO for free. Improved cooperation a sign of transparency.

- 9. The 2% law is good for large organizations as a source of funds. It is a sign of good will by government. It helps people become more informed about the services that NPO offer. She notes that it is not very useful to nonmembers.

- 10. Irina answered, "Sure." Policy groups can provide important expertise. If they can check policy then they can make policy. Therefore, these groups can get more funding and they become less bureaucratic. They will be more publicly oriented.

11. No one should regulate the NPO, but the NPO themselves. They are legal entities and they should be responsible to the law.
12. Free entry and let market forces work. Irina notes that the media has not historically checked organizations because they are often linked to political parties.

Interviewee: Sever

Organization: Eurolink; House of Europe in Romania

Date: June 23th, 2006

Sever is the president of Eurolink. We meet at his office, but we quickly leave to a restaurant for the interview. He doesn't understand why Isebella is not with me. I explain there must have been a misunderstanding of the meeting. I interview him in an Italian restaurant west of piata universitate.

1. Eurolink is a national organization that is sponsored by international organizations, mainly EU. They provide training and lobbying services to promote social progress. They have been involved in activities from training teachers how to teach history and promoting open society to lobbying for improved competition.
2. There have served civil servants, local entrepreneurs, business elites and minority groups.
3. It was founded in March 1997 by Sever and others.
4. The major source of funding is EU NGO. They have also won grants from USAID and private firms.
 - (a) Sever notes that they have never received money from the government. He mentions that the NPO must have a public utility status in order to receive money from the government, but the status has an unclear definition and arbitrary. NPO given this status are often linked to the government.

5. Sever notes that the impact of his NPO has great effect and their events are large and visible. He says the operating budget is 50,000 euro.
 - (a) Sever comments on the honesty and transparency of NPO. NPO are partisan and they are linked to the government. Remata Veber replaced the elected president of Solas because of her political ties. There was no press scrutiny because the press is opportunistic. NPO are not modest. They often allocate funds to administration rather than public projects.
6. 2% law was unusable. Money from program was not released to Eurolink. There is a complete lack of transparency and timely delivery. The lack of IT in the nation is partially to blame.
7. Campaigned via their website, distributed leaflets at events, letters with a footnote about donation opportunity and announcements at events. Not very successful.
8. 2% law is good for large NPO with visible causes. Breast cancer and public medical services, such as SMURD, were successful with their campaigns.
9. It is good, but it needs to be monitored by NPO community, not the government. It is a part of a general strategy. Overall the concept is good, but it was poorly implemented.
10. Not necessarily. Without government, it is impossible. It is controversial.
11. There is no judicial control over NPO. There is no control and therefore there is no difference between a firm and a NPO. Sponsoring law for more governance is difficult.
 - (a) 2% law needs stronger regulatory law. OCD codes are needed in Romania.
12. Currently, unions, governmental bodies and political groups are part of the NPO. The conflict of interests can cause problems. There should be restrictions against such problems. There needs to be a debate.

After the interview, finished our lunch and left by taxi. In the taxi he gave me a contact in Bucharest and one in Prague. He also asked if I were interested in meeting the head economist at the US Embassy. I expressed my interest and I got out at piata Romania.

Interviewee: Constinten Marza

Organization: Prodemocracy

Date: June 26th, 2006

Constinten is a spokesman for Prodemocracy. I was introduced to Constinten by Bogdon and we set up an interview for the beginning of the week of the following week. At the interview, Constinten invited an intern from the Ukraine to observe the interview. We had the interview on the balcony of the Prodemocracy offices while Constinten smoked.

1. Started by observing elections (national, local and some party elections). They have projects regarding
 - (a) Political party financing reform
 - (b) Lobbied and provided expertise for electoral legislation reform
 - (c) Civic, legal and political education as part on the national high-school curriculum
 - (d) Lobbied for freedom of information and political transparency.

Projects are to promote MP and citizen links. Proportional list system disconnects the citizens from the MP. He notes the existence of steam engine candidates that pull up the list, even though the other candidates are not good. Therefore, some MP dont have to campaign in there local districts.

2. They serve all of Romania because they are watching the political process.
3. They were founded in 1989 in Brasov. In 1990, it moved to Bucharest. Originally, it consisted of 2 groups who were brought together to form ProDemocracy by NDI (national democracy institution).

4. Most support comes from foreign NGO.
5. Notes on organization
 - (a) 31 branches called clubs, autonomous but number adhere to standards.
 - (b) They have 1,000 members and a much larger number of volunteers.
 - (c) They have a general assembly and a board consisting of a president and advices.
 - (d) They have a center for coordination in Bucharest (it is also a regional center) and 7 other regional resource centers (a total of 8 centers).
 - (e) Highest notoriety of NGO in Romania by study. Election reform and observance are the most visible of the projects by ProDemocracy.
 - (f) 25 employees and many other temporary employees during elections.
 - (g) \$400,000 budget on average.
6. The 2% law is known. 2003 law is passed 2004 1%, 2005 2%. They collected 60,000,000 lei or over 2000 euro from the last campaign. It was less than 0.5% of budget.
7. Not enough funds to advertise. Used internal network for advertising and placed an announcement on website. Not enough funds for large campaign. Pre-prepared form for the tax payer.
 - (a) SMURD and ProDemocracy, SMURD has a more visible NGO and they received sizable funds for the 2% law. Organizations like Save the children got more.
 - (b) No plans to expand their campaign, but they regard it as an important source of revenue.
8. The 2% can never support all the programs, maybe the administration cost (fixed costs). If expanded, it could run more projects, but it is very unlikely it will ever happen. It is possible, but what to do with the money?

9. 2% law is good thing. Tax payers need to understand that the money redirected would go to the government if not redirected.
10. 2% law will not change the landscape of the sector, but it will help the more visible NPO. FARI will end in a couple of years and domestic donors must be found. Fund raising must be developed in Romania. Some large companies have their own foundation and will only fund their own foundations.
11. Yes because he is a liberal and he thinks that government should stay out of society. NGO have an agenda and therefore, they will not find social needs and fulfill them.
12. Should there be regulation? No, but there should be some clarifications in legislation and the status of a public utility. Transparency should be considered, but it is the citizens that should decide; so no more regulation on NGO.

Note: He has a study on the demographics of individuals who are most likely to participate in the 2% law.

Notes of the system: No problems getting funds released. It is incompetence rather than maliciousness that causes delay in the release of the funds. Other problems are the identities of donors are not given and no regulations talks about it. The system is overly complicated. A declaration of revenue is needed to submit the 2% redirection. It is not needed because the ministries of finance have a database with this information. It is an unneeded extra step.

After the interview, we exchange email addresses and he asks to read the final paper.

Interviewee: Nicu

Organization: ARC

Email: nicu@arcromania.ro

Date: June 29th, 2006

Nicu is an employee of ARC. He is a student of anthropology who does work for ARC. ARC is located in Cluj. I meet Nicu at the office of Cluj, which is located in the old part of Cluj in a humble building. In a meeting room adjacent to a courtyard. The interview is recorded.

1. ARC is a NPO that promote and supports other NPO. They provide NPO with training, lobbying and funding search services. Their recent activities have mostly been the promotion of the 2% law as well as providing resources for donors.

(a) Conducted an awareness campaign

- i. Annual event for the first day of 2% law.
- ii. 700 posters and 200,000 leaflets were made about the 2% law.
- iii. Events in Bucharest and 6 other cities.
- iv. 155 TV spots on 7 nation wide TV stations.
- v. No radio spots were used, but they are planned for next years campaign.
- vi. Businesses participated by giving leaflets with pay checks and the employees were asked to use the 2% law.

(b) Resources for donors

- i. Toll-free phone number for help with filling out tax forms to redirect to NPO.
- ii. Database of NPO that meet a minimal transparency standard. 387 meet the standard and 68 were excluded for not meeting standard. Those included had profiles of campaigns online.
- iii. 8 magazines for donors were published.
- iv. Businesses were not able to redirect income tax.
- v. Forms and instructions available on website.

(c) Research effect of 2% law

- i. Regional study of NPO with included interviews with leadership.
- ii. Statistics on the uses of the toll-free phone number.

iii. New study is being conducted on what type of campaign is the most effective.

(d) Notes on law

i. Individuals who wish to participate must have a fiscal report from the ministry of finance. There is some lobbying to remove the fiscal report and replace it with a simple ID.

ii. The law states that no one but the individual can submit the form.

iii. So far, the ministries have been late on distributing funds. The funds should be released at the end of December, but they have been releasing redirected funds in March.

2. Romania at large is the users of ARCs services.

3. ARC was started in 2002 by Dona Pot to support and sustain fundraising for NPO for the benefit of the community.

4. Main source of funding are grants from foreign governments and NGO. In the future they would like to be independent and find support from businesses.

5. Nothing interesting

6. Participating architects of the 2% law.

7. No personal campaign.

8. The 2% law is not enough to support NPO. There is a need for other fundraising methods. The 2% law is just one of these methods for finding resources.

(a) It is impossible to expand the 2% law.

9. It is extremely good because it provides incentive for NPO to become known.

10. It is possible for the NPO to create diversity and competition. Government is trying to subcontract services. NPO provide extra services that the government cant.

11. There needs to be more transparency, but it should be regulated by individuals and not the government.
12. The 2% law is a change of mental frame. Allows the community to support and interact with the NPO directly.

Interviewee: Dragos

Organization: GEA

Date: July 4th, 2006

Dragos is the manager of GEA. I meet him at his office, which is just north of piata Victoria. The interview took place there.

1. GEA is a bipartisan think tank. They provide specialized services in analysis and recommendations, but they are "not a consulting firm."
2. Currently, they serve mainly the business community and other NGO, but they would like to do more public research for the public good. He notes that businesses should be the major consumers, but confidentiality of projects is a barrier to becoming a public good for all businesses.
3. See website
4. No more than 50% of the funding comes from government entities.
 - (a) Currently, the Romanian government accounts for about 10% of the funding.
 - i. Dragos notes that he would like none of the funding to be from the Romania government. He also mentions that he would rather do pro bono work for the government then accept funding from them in order to maintain independent.
 - (b) The rest of the 50% is provided foreign government grants. The major part of the grants is from the British embassy, but other EU governments are also contributors.

- (c) Dragos mentions that he would like to be part of the FARI program, not because he desires to be part of it, but the funding would allow GEA to remain independent.
 - (d) Other funds come from industry associations and private firms. Some of the projects have been with the textile association, coffee association and local Bucharest business associations.
 - i. Dragos notes that the project for a business association never received the promised funds.
 - ii. He notes that he would like to have a separate consulting branch of the organization for businesses.
 - iii. He would also like to start a funding board to facilitate contributions to GEA.
5. Nothing valuable.
6. Dragos was well aware of the 1% law. GEA received about 130 euro from the 1% law, which accounts for almost nothing of their budget.
7. GEA designed a campaign for the 1% law as a means for supporting a student paper competition. Unfortunately, none of the money was used for that purpose.
 - (a) They campaigned mainly to internal network and club sponsors. The cost-benefit of advertising for support from the 1% law was not positive.
 - (b) It is possible that a campaign will be valuable over time, but not immediately.
 - (c) Dragos notes that it is a major problem that the donators are not known.
8. No, Dragos has "strong doubts" that the 2% law can completely support GEA. If the 2% law is expanded to firms as well as citizens, it is possible.
 - (a) Dragos mentions that there is a difference between think tanks and charities. Charities appeal to the public, while think tanks appeal to the government and

commercial sectors. He notes, "Our role is in the governance process of Romania."

- (b) If individuals with high educations and links to business and government are targeted, then the 2% law can provide benefits.
 - (c) Civil society is seen as tax avoidance and not valuable. Civil society is "losing an opportunity."
 - (d) Increase the 2% law to 5% or more is not possible because NGO are too passive. They needed to be more organized.
 - (e) There is little debate between think tanks. The lack of debate makes their advice and value seem suspect.
9. It depends on ownership and choice. If NPO are transparent and donors have anonymity, then it is a good.
10. In social and research fields, there is not doubt they can. More decentralization is better.
11. NPO are already regulated and possible over regulated.
- (a) Some regulation is needed for trade marking names of NPO. Currently no NPO can have center in name unless they existed before the law was introduced. Names can be important.
 - (b) The status of "public utility" granted by the government is a problem. In order to obtain status, you must apply and secure support of a ministry. If you are a good NPO, then you do not need a special status.
 - (c) Theoretically, umbrella organizations can provide some governance, but in practice, it is impossible. Due to rivalries, evaluations from others will not be trusted. Only if there are standards in evaluations can it be possible.
12. There is not need for government to be a part of this process.

After interview, Dragos asked me if it was possible to get some English economic books for the NPOs library. He also asked if either I or someone I know would be interested in doing institutional analysis for GEA as part of a joint project.

Interviewee: Manual Rauta

Organization: SAR

Date: July 4th, 2006

Manual is a spokes person for SAR. The interview was in his small office about some street construction.

1. SAR is a think tank that is involved with analyzing policy and recommending reforms. In 1998 they analyzed fiscal policy and in 2000, they did the same with EU integration. They have provided government criticism by publishing names of corrupt politicians and their connections to Securit, which caused 60 candidates to withdraw for elections
2. Citizens and other NGO are the main stake holders.
 - (a) 2004 coordinator for press releases and law reform.*
3. SAR was formed in 1996 by former dissidents and intellectuals.
4. Grants from foreign NGO the major part of the budget.
 - (a) No money from the government. Manual notes that it is impossible to be independent if you are accepting money from the government. Therefore, according to the mission of the think tank, no money can be taken from the government
5. Operating budget is \$250,000 with 8 full time employees. There are also many volunteer professionals participating in analysis.
6. Manual was informed about the 1% law. They receive between \$100 and \$200, which is not a significant part of the budget.

- (a) Manual notes that no statement was sent to SAR about the amount redirected.
It was simple wired to their account.
- 7. They campaigned for 2004 on their website, which listed projects of SAR and had links to the needed paperwork. They did nothing the following year. Next year there are no plans to campaign; there is not enough time.
- 8. Romania is like southern Italy in that it lacks institutions and need more development in Civil Society. Currently, organizations can not cover their expenses with the 2% law. Only large and visible organizations can receive any substantial amounts. Corporate donations are a more feasible means of funding.
- 9. Yes, it is good because it provides an incentive for NPO to educate the public about who they are and what they do. It is not an efficient means of financing their activities.
- 10. In education and training services, NPO are more efficient than government. NPO that support the environment can be good, but there are problems.
 - (a) Banks are better than NPO for economics.
- 11. The regulation is fine as it exists now.
 - (a) Public-utility status is a good policy. Government needs to externalize services and the public-utility status is a means to that end.
 - (b) The problem came from a 2004 scandal.
- 12. There is limited capacity for NPO and therefore, there needs to be a "shake out" of the unwanted NPO. Transparency is not a problem.

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Curriculum Vitae

William Gavin Ekins graduated from the University of Arizona with a Bachelors of Science in Industrial Engineering in 2002. Continuing research led him to complete a Masters of Science in Systems Engineering at the University of Arizona in 2003.