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RESEARCH

# Reciprocity and the State

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This paper outlines how norms of reciprocity play a role in building strong and effective states. This considers the state as a natural extension of norms that have evolved in families and communities. It surveys the main ideas in a range of different branches of the social sciences and discusses how they apply in two concrete policy settings: collection of taxes and the design of social security. It emphasises the value of considering policy reforms in terms of an evolving reciprocal social contract between the state and the citizen.

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**Keywords:** reciprocity; state effectiveness; cultural evolution

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## 1. Introduction

Reciprocal obligation lies at the heart of state-citizen relations. This paper argues that recognising the importance of reciprocity in this relationship matters for what the state does and how it does it. While the COVID-19 pandemic has served as a reminder of this, as governments have asked citizens to cooperate in fighting the pandemic, the need for effective public action has wider implications. This paper will explore the reciprocal relationship between the state and citizens as part of a dynamic evolutionary process. Many of the core ideas discussed in this paper were initially developed in [1].

The paper takes a somewhat different analytical approach to that which is standard in political economy. The standard economic approach to government intervention uses the fictitious benchmark of what policy a benevolent social planner would optimally choose on behalf of their citizens. The citizens owe nothing to the planner, who is deemed to sit above and remote from the social and political processes that are needed to govern groups of individuals living interdependent lives. Although they may give useful advice about *what* the state might do to improve the lives of its citizens, they are not particularly helpful in giving guidance on *how* to do it. They are akin to an architect putting forward their architectural designs but without thinking about building materials, scaffolding, or construction methods. We would not have the wonderful rich cityscapes and townscapes that we enjoy every day unless we paid attention to the role of engineers and builders as well as the architects. Similarly, building strong reciprocal relations is a key part of the construction process for state intervention, and incorporating this into thinking about political economy is important.<sup>1</sup>

An additional feature of the approach suggested here is to see reciprocity as part of the bedrock of norms that underpin the governance of modern societies. They are part of the informal institutional structure, which sits alongside formal institutions that define the operation of markets, governments, and social relations. Reciprocity is a norm that governs social interactions and interacts with formal rules. It evolves and adapts as institutions change, influencing as well as being influenced by government intervention. This means that policy, institutions, and norms are part of a co-evolutionary process. Models of cultural evolution that emerged outside of economics generate insights that are increasingly being incorporated into economic models. This approach emphasizes the importance of social learning processes leading to adaptation over time alongside strategic and purposive design of institutions and policies. Together, they provide a way of understanding how societies evolve.

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<sup>1</sup> This concept of what political economy is about can be found in the writings of John Neville Keynes, who published *The Scope and Method of Political Economy* in 1891 [2]. On page 34, he identifies three branches of economics: positive science (what is), normative or regulative science (what ought to be), and the art of political economy, which he refers to as “formulation of precepts”. He remarks:

“when we pass ... to problems of taxation, or problems that concern the relations of the State with trade and industry, or to the general discussion of communistic and socialistic schemes – it is far from being the case that economic considerations hold the field exclusively. Account must be taken of the ethical, social, and political considerations that lie outside the sphere of political economy regarded as a science” (p. 55).

There are two important dimensions of reciprocity that are drawn on in this paper. The first is the ideal of a formal contractual obligation, where each side's obligations are detailed in a formal, written agreement. For example, employment contracts operate in a framework of reciprocity shaped by understandings of what an employee should do, such as hours of work, while an employer has to pay for contracted hours.

The second dimension is reciprocity in the form of tacit understanding. Most relations between family members can be viewed in this way. So even though there is no law that says a child should help an ageing parent when he/she becomes too frail to manage, the standard expectation—for both the parent and child—is that your adult children will take on such responsibilities, whether during lockdowns like those we have recently faced or over the ordinary course of life. These obligations are governed by informal norms of reciprocity, not by formal contracts.

This paper takes a political economy approach in order to enrich our understanding of how states raise and disburse revenues in a web of reciprocal obligations. The paper will discuss elements of an approach that can enhance our understanding of the nature and drivers of public action. It will argue that a better appreciation of the importance of reciprocity is needed to appreciate the history of public intervention and how we expect it to evolve in future. The key idea is that the state is not just a means for coercing individuals to pursue the common good, but also that the state should seek to inculcate feelings of reciprocity between the state and the citizen, ultimately enhancing the function of the state, such as in the collecting of taxes.

While all of the above may appear quite abstract, the ideas discussed here are of practical relevance in meeting policy challenges. During the COVID crisis, the common good of society has become paramount, with citizens willingly sacrificing aspects of their social and economic lives for the general wellbeing of all. The willingness of citizens to comply with this is enhanced by an expectation that the state will support citizens through measures such as the furlough program or provide support for those who self-isolate after receiving a positive COVID test. At the heart of this lies the idea of reciprocal obligation.

## 2. Foundations of Reciprocity

Reciprocity in human societies has three complementary elements: biological, cultural, and formal (or legal). It also has scope across different contexts in society, being important in families, in local communities, and in states, with the latter being our main focus here. But the key idea is that we are drawn to organizing our lives based on reciprocal obligations because of thousands of years of human experience, which has shown that reciprocity has a form of “fitness” advantage for populations who make use of it.<sup>2</sup> This has embedded ideas of reciprocity in our natures and in our institutions. We learn this as part of our upbringing, but we may also have it in our DNA, as Trivers [3] argued is the case for bird populations. The reasoning is functionalist: we are reciprocal in nature because it brings material (and possibly psychic) benefits. That gives species and modes of social organization that are built on reciprocity a competitive advantage, one which is particularly evident when there is competition for resources, or a quest for survival. Indeed, this knowledge or instinct that we can rely on our reciprocal nature often leads to us constructing institutional arrangements that take advantage of it.<sup>3</sup>

This paper is built on the following core ideas about the way that reciprocity shapes our social and political lives. First, reciprocity is a basic human instinct, hardwired into human nature. It is reinforced by the uploaded “mental software” that we acquire through experience, especially during our formative years.<sup>4</sup> Family structures and social arrangements interact to reinforce reciprocity; we seek to punish those who harm us and to reward those who help us. Literary narratives in many cultures also reinforce this, with “revenge” narratives for those who have behaved badly and success for those deemed virtuous. Notions of fairness are often rooted in the idea of reciprocal obligation, with someone who has not contributed getting a reward being regarded as unfair, while those who have striven for a reward getting their “just desserts”. Such notions are also apparent in the normative codes that have dominated Western thinking, foremost among them the golden rule: doing unto others as you would have them do unto you is an attempt to inculcate reciprocal ideas. Reciprocity can then become part of our emotional response to acts of kindness or aggression, not just to material interactions.

Just where and how we gain these instincts is extremely complex and has doubtless changed over human history, as we have been exposed to wider influences. The family is an important nexus of influence. For example, Bales and Parsons [7] put it as follows:

If ... the essentials of human personality were determined biologically, independent of social systems, there would be no need for families ... It is because the human is not “born” but must be “made” through the socialization process that in the first instance families are necessary. They are “factories” which produce human personalities.... We therefore suggest that the basic and irreducible functions of the family are two: first the primary socialization of children so that they can truly become members of the society into which they have been born; second, the stabilization of the adult personalities of the society. (pp. 16–17)

<sup>2</sup> In biological settings, reproductive success is an individual's production of offspring per breeding event or lifetime. In cultural settings, it refers to how norms or cultural memes reproduce.

<sup>3</sup> Sobel [4] provides a very useful overview of ideas of reciprocity that can be brought into how preferences are formed.

<sup>4</sup> There is now a large literature in evolutionary psychology that discusses these ideas; see, for example, Barkow et al. [5] and Henrich [6].

But clearly there is much else at work: the role of schools, religious teaching, watching soap operas, reading novels, and studying philosophy have all contributed to the formation of ways of thinking that colour our perceptions of our obligations to others. These all contribute to the socialization processes that shape our value systems. Although this operates in a context-specific way, reciprocity is common across human societies, reflecting the specific costs and benefits that it brings. We learn to live with each other so as to avoid missing out on opportunities or to avoid the consequences of disorder, while learning to work together to protect each other. As an evolutionary principle, communities and societies that have failed to realize the benefits of reciprocity are likely to be at a significant disadvantage and subject to collapse, to take over, and/or to domination by those that have.

Why people choose to behave reciprocally, and whether it is instinctive or rational, is an open question. While it is clear that people make choices about whether to conform to a norm, they may not have much control over how they *feel* about their behavior, even if they try to rationalize their actions. If reciprocal behavior does have a significant instinctive component reflecting socialization, it will trigger automatic responses, such as feeling angry when we are cheated or pleased when we can return a favour.

Even though some instinctive feelings that have a long-standing cultural (and even genetic) basis could be important, exactly where the domain of reciprocity lies is likely to be much more variable. So people may feel stronger instincts toward those who are part of their “in-group”. This may also partly be instinctive, but it can also be shaped as we choose who to regard as part of our “community of fate”, as Levi [8] put it, and this defines the social group to whom our ties are weak or strong. While some elements of reciprocity may extend to all citizens as in notions of cosmopolitan justice, it is likely that we more often have stronger feelings towards those to whom we have more immediate connections.

The way we perceive the web of obligations that underpin reciprocity are perhaps more open to development and to change than the instinct itself. Formal institutional and policy arrangements can influence this, with political communities created and engineered in ways that enhance notions of reciprocity. For example, when I pay my taxes in a community that funds public services, it creates a direct interest in the way that this group works together. I will be much unhappier if a person in that community fails to pay their taxes than I would be if a stranger living in a different political community fails to do so. So by drawing formal boundaries or shaping political geography, we will tend to hone our reciprocal instinct in specific ways. There can also be persistent cultural differences. For example, the way that we approach social care will be affected by how far a society has established traditions of family support.

One other key element of reciprocity is whether obligations are spelled out explicitly or whether they form part of implicit understandings. This depends in part on how the agreements that underpin reciprocal obligation operate. Even if arrangements are codified, this does not imply that such codification creates legally binding arrangements. Many written contracts are incomplete. For example, they may not anticipate all eventualities and their exact meaning is open to interpretation by courts and other legal professionals. Moreover, if one side of the reciprocal arrangement is the government, then its sovereign power over the law may provide limits on how binding these arrangements are into the future, with the government—whether a new one or not—almost unfettered. We have seen this time and again with pensions, where governments find it convenient to change arrangements over tax reliefs and the timing of benefits at will (e.g., by changing the retirement age) even if the expectations of citizens were based on the existing covenants staying in place. Policymakers need to be aware of the perceptions of political risk that such actions can encourage (see [9] for a discussion along these lines). The narrative that accompanies reforms is important when, for example, shocks to the system necessitate management across different generations in a way that is perceived as fair.

Throughout history, reciprocal arrangements have rested on a range of informal punishments for transgression, such as withdrawing future cooperation or ostracism. This is also relevant when reciprocal arrangements are forged in relationships between the citizen and the state, with sanctions here including voting governments out of office or popular protest. How far such sanctions are invoked when the transgressions are against a publicly announced policy, such as one that formed part of a government’s election manifesto, is unknown. But by writing down arrangements that are to be followed in circumstances where governments transgress, it seems likely that this creates a focal point for those who are unhappy, whether in the near or distant future.

Another variable in reciprocity is whether the payoffs are material or psychic. In the case of a pension, for instance, there is clearly a material cost to any individual who is not paid what they are entitled to. However, there may also be a psychological reaction. Thus, an individual may feel betrayed by policy changes that were unanticipated, thereby resulting in a psychic cost over and above its material consequences.

Also relevant is whether the benefits of reciprocity are private or widespread. When it comes to reciprocity and the state, this is important because individuals may have views about the *principles* of any policy that they expect governments to adhere to, such as whether a policy disadvantages the poor, rather than just judging the policy in terms of its effect on their own pocketbook. Such norms of fairness are therefore also important in making and adjudicating upon government policy.

### 3. Antecedents

There are many antecedents to the issues discussed here. Ideas about reciprocity and the state were widely discussed by political philosophers (albeit stressing different elements, particularly in relation to the idea of a social contract).<sup>5</sup> Hobbes [11], influenced by the English Civil War and the events leading up to it, discussed how a state could ensure

<sup>5</sup> See Lessnoff [10] for background discussion.

social order, stressing the need for compliance by citizens but overseen by a powerful, authoritative state, or a “Leviathan”, who imposes the benefits of security for the people, both internally and externally. He refers to the social contract as the “mutual transferring of right”, noting how individuals may choose to cede their personal liberty for the greater good. This is similar in spirit to Locke [12], who stressed the conditional compliance of citizens with the state in exchange for social order. In a similar vein, Rousseau [13] emphasised the importance of consent by the governed. All of these accounts of the social contract have in common a view that reciprocity between the governing and the governed is key in establishing an effective state, underscoring limits to what can be achieved with top-down control.

Among political scientists, related ideas were developed in a modern context by Levi [14] who studied the rise of the tax state and the way that it rested on quasi-voluntary compliance. In a later work, she extends this thinking to the conditional consent that is needed for effective military recruitment [15]. Here, Levi emphasizes the emergence of supporting value systems to support reciprocity, focusing on the form of patriotic ideals (i.e., linking the success of the nation whether in sports, conflicts, or foreign policy dealings) to feelings of obligation. These contributions link also to the idea of what gives state institutions legitimacy: that bond of trust between the state and the citizen that allows states to gain compliance. This is particularly relevant to establishing law and order, and Tyler [16] discusses how this works from a psychological perspective.

Within economics, there is now a large body of experimental work stressing the centrality of reciprocity. Experimental research reviewed in Dohmen et al. [17] and Fehr and Gächter [18] provides evidence of how strong reciprocal motives are in experiments, such as leading people to punish transgressors of fairness norms even when it is costly for them to do so.

Boyd and Richerson [19] and Cavalli-Sforza and Feldman [20] have studied the dynamics of culture, emphasising the importance of studying the process of social learning in cultural transmission. Behaviours can transmit from one person or group to another by a range of means, such as by imitation or by consciously reasoning how best to solve a problem through considering the behaviour of others. Learning can take place in a range of social settings such as families, schools, or communities. Such ideas have been explored in economics research by, for example, Bisin and Verdier [21] and Tabellini [22]. A number of contributions have stressed how reciprocal behaviour and strategies are transmitted (see, for example, [23–25]). More recent approaches have tried to put together the study of culture with accounts of how institutions and policies change. Bisin and Verdier [26] and Persson and Tabellini [27] develop general frameworks for looking at this, while Besley and Persson [28, 29] respectively discuss their application to the emergence of democratic states and how the emergence of environmentalist values can be influenced by policy change. So, for example, when governments start to introduce policies like carbon taxes, this can facilitate cultural change by making becoming an environmentalist relatively more attractive.

Finally, the debates about what institutional features are needed to build effective states are also relevant. As highlighted by Acemoglu and Robinson [30] and Besley and Persson [31], institutional cohesiveness distributes the benefits of the state more widely and consolidates democratic values. Over the course of history, beginning with *Magna Carta* in the case of England, creating constraints that force those with political power to face checks and balances has been an important project. Such arrangements try to ensure that those who hold public office use their power to pursue the broader public interest by empowering legislatures and judges to check their use of this power. This can limit corruption as well as the pursuit of policies with narrow benefits for specific groups that are close to the government. Such institutional features are a key part of what we now call democracy, and without such institutional support, the state may be less able to deliver the benefits that its citizens expect.<sup>6</sup>

#### 4. The Core Argument

The basic thesis of this paper is that, when it comes to building states that can make the lives of its citizens better, it is essential to consider how we adapt our institutional frameworks to accommodate norms of reciprocity and the scope of reciprocity within them. This constitutes a two-way dynamic process of institutional and cultural co-evolution.

The scaffolding that results in effective government comprises a mixture of formal institutions and informal social norms. These norms have two functions. First, they provide ways of coordinating beliefs and so affect behaviour in social situations. Once a norm is established, it can become a focal point. A good recent example is wearing a face-covering to protect against the transmission of COVID-19. The idea of a focal equilibrium<sup>7</sup> has been developed in game theoretic models to show that certain strategies are stable when players follow particular norms (see, for example, [33]), while such models have also been studied by psychologists (see [34]). Second, norms may also be internalized in preferences, thereby influencing the way in which we value certain actions and choices. On this view, citizens actually prefer to conform to the norm due to the psychic benefits that norm-following brings, reflecting an individual's tastes and values. Such internalization can be important in public life, where values like selfless public service and the setting aside of self-interest in the public sphere are norms that contribute towards establishing a civic culture and are crucial to prevent individuals in authority from acting corruptly. Further, choosing to vote or to participate in political activities are also elements that underpin norm-driven “civic cultures” [35]. In many instances, formal institutions provide only

<sup>6</sup> See Acemoglu and Robinson [32] for a discussion of how culture and institutions interact to create more effective states.

<sup>7</sup> A focal equilibrium refers to a situation where individuals have a shared belief about how they will behave in a given social situation.

limited control over such behaviour. Consequently, it is norms that are crucial in constraining self-interested behaviour and in encouraging altruistic behaviour.<sup>8</sup>

Reciprocity is a fundamental part of such norm structures and lies at the heart of a functioning state. A stylized account of its role is as follows. The state is run by political and bureaucratic elites, those who have been placed (or have placed themselves) in positions of influence to direct the operations of the state. The way this has been done has changed considerably over human history. Power was historically associated with rule by predominantly male leaders who could command most support from critical groups to legitimise their leadership. However, here, securing their authority over the state frequently involved violence, such as silencing potential rivals—often brutally. Narratives based on heredity and divine rights to rule were therefore encouraged by successful elites to economise on violence and to create a form of legitimacy for such rulers, stabilising the state. But frequently this proved fragile, although leaders who understood their own frailties could respond to this by being careful to show benevolence as well as ruthlessness. However, almost no polity based on such narrow means of selection has survived throughout the course of history without having to eventually resort to violence and repression as the basis of its power.

There is nothing to stop leaders who rule on this basis from tapping into reciprocity, especially when they are seeking to raise tax revenues. The supporting mantra is that taxes have mutual benefits beyond constructing palaces or deposits in Swiss bank accounts.<sup>9</sup> Yet they face an uphill struggle to convince the citizenry that the state will deliver as the basis of building such reciprocity. And with capricious leaders, it may therefore be difficult to build strong ties of obligation.

Two key institutions have emerged to remedy this: constraints on executive power and the selection of leaders in open competition, especially elections. Executive constraints refer to the checks and balances that leaders face. These not only restrict the abuse of the state for patronage and corruption, but also foster greater cohesiveness between groups as they acquire the power to overrule or amend policy proposals. This also provides reassurances to citizens that public programs with universal benefits such as social insurance and widely valued public goods will be a priority. Indeed, the most basic public good of all, the rule of law, requires at its most fundamental level a system in which leaders and citizens alike are treated as equals before the law.

The replacement and selection of leaders can also be important, first as a sanction for those who have not delivered and second to try to identify those leaders who are supportive of the kinds of policies desired by the citizenry. Citizens will look for competence but also for leaders whose value systems contribute to effective state action. When selection processes are transparent and open, there is greater scope for citizens to find such leaders.

Reciprocity kicks in when states deliver collective goods for citizens and, in exchange, when citizens offer their support, whether by paying taxes, volunteering for military duty, or obeying the law. However, their willingness to do so in the long-term is contingent on state behaviour. Institutions that guide the government along rails that pursue the public interest reinforce norms of faith in the government. They provide reassurances to citizens that tax revenues will support common interest public spending, rather than being abused in pursuit of the leaders' interests.

Establishing a norm of reciprocity follows a dynamic trial and error process. Citizens observe how the state behaves and form a view of the likelihood that the state will indeed reciprocate should they comply. There may be pivotal moments in history that demonstrate this, such as during national conflicts or pandemics. These can either reinforce or set back the quest to create a state based on norms of reciprocity depending on how national leaders (and senior public officials) behave. In addition, there are moments when strategic and far-sighted initiatives can be implemented in the form of policy or institutional change, which lay the groundwork for reciprocity in the long-term. Such processes may not be smooth and are rarely linear. Moments in history create rare but important opportunities for discontinuous change, as with the decision to found the NHS after World War II. The narrative of shared sacrifices during the war reinforced the need for a health service that was universal (i.e., open to all and free at the point of use).

Not every country has found itself on a path towards strong norms of reciprocity in the behaviour of citizens and political/bureaucratic elites. That is because mutually reinforcing forces that can drive a virtuous circle can work in reverse. Citizens observing elites that use the state as a personal fiefdom undermines the people's trust and elicits negative feelings of reciprocity. This can weaken the capacity of the state to function effectively, which can become self-enforcing. In turn, this can lead to the breakdown and even failure of a state even when there is a history of reciprocity. However, this is less likely to be the case after a long established tradition has emerged that makes a polity more robust to small shocks. The greater and more sustained the experience of the citizens with effective governance, the less likely upheaval is in the face of small shocks. This explains why states with strong reciprocal norms do not change very much over time. That said, vigilance is always needed to ensure that the path remains clear, while there can be episodes on occasion, such as the poll tax riots in the UK, which shock the system and have persistent effects in changing the functioning of the state (see [38]).

So far, these ideas have been discussed at a high level of abstraction. The next step is to examine two applications where these ideas are relevant: the power to tax and the design of social insurance.

<sup>8</sup> See Weingast [36] for a discussion of how the rule of law can emerge from a model with repeated interactions.

<sup>9</sup> Brennan and Buchanan [37] emphasised how a Leviathan rule will still have an incentive to spend on public goods.

## 5. Two Applications

### 5.1. *The power to tax*

The study of taxation is an interesting context in which to explore the importance of reciprocity. The stylized view of taxation among many economists is that it relies principally on the coercive power of the state, with compliance enforced by detection and fines. This is shown in the classic economic model of Allingham and Sandm [39]. While it depends on the tax base being considered as well as the tax rate, there is an extensive body of evidence that taxation leads to disincentives, with citizens seeking to avoid paying the due amounts in full or otherwise trying to reduce their tax bill. This may be done through legitimate ways, such as reducing earnings, but also through more strategic measures, such as reorganising tax affairs to reduce tax payments through avoidance measures. Such disincentives have an impact on the size of the feasible state, because beyond some point revenues reach a maximum, the top of the so-called *Laffer Curve*. On this standard account, the limits of taxation are viewed as being set by disincentives and by enforcement power.

This approach more or less separates the revenue raising side of the state from the spending side of the state. But this bipartite approach misses some important issues. First, there is the possibility of reciprocity being built into the system, such as when paying taxes directly entitles individuals to future benefits from the state. This form of reciprocity in the system will attenuate disincentive effects of taxation compared to the standard approach and, as discussed in the next section, is particularly relevant for a range of social insurance programs. In this case, the basis of the relationship is entirely material, founded on a transactional relationship between the state and the citizen—a more elevated version of “you scratch my back, I’ll scratch yours”. There is, however, a second reason for reciprocity’s importance, one which does not rest on material consequences. This is based on arguments that have been put forward by Levi [14], Feld and Frey [40], and Besley [1] and is grounded in the social contractarian ideal of reciprocal relations between the state and citizen.<sup>10</sup> On this account, citizens are willing to comply as long as they believe that the state will generate future benefits in general—for society as a whole. The focus is not purely on themselves as individuals. Thus, the approach is neither material nor individualistic. In theory, this too could attenuate disincentives, with citizens becoming willing contributors of tax revenues in the belief that it will benefit them and, more crucially, society, now and in the future. Moreover, if this notion of reciprocity is developed, the state may be able to economise on enforcement costs when it levies higher rates of taxation in order to fund ambitious spending programs that advance the collective common interests of society [31]. Levi [14] refers to this vision of reciprocity as “quasi-voluntary compliance”, while public finance economists have referred to it as fostering “tax morale”.<sup>11</sup>

Some evidence for this idea can be found in the World Values Survey/European Values Survey, which asks respondents: “Is it justifiable to cheat on your taxes if you have a chance?” The questions can be answered on a 10-point scale. In 6 waves, it has been asked across 94 countries and answered around 300,000 times. The key finding is that around 63% of the population do not think that cheating is justifiable. As shown in Besley [1], those who believe that cheating on their taxes is justified have higher incomes and tend to be younger and less educated. Those individuals who say that they lack confidence in their governments also tend to believe that cheating on taxes is fine.

When we look at patterns across countries, however, there are striking cross-country differences. This suggests that national cultures and institutional factors may shape the answers to such questions. Also striking is that when one looks at cohorts of individuals over time, there is strong intracountry persistence in answers to these questions, thus intimating that the cultural and institutional factors that shape answers are pervasive and persistent. This is congruent with the idea that there can be inter-generational transmission of values.

Overall, these findings are suggestive that there are reciprocal norms that sustain high levels of taxation and that the narrow economic point of view—that people are essentially only focused on the best deal that they can get for themselves—need not monopolize the conversation on what drives state-citizen relations. Fiscal sociologists, since the seminal essay of Schumpeter [44], which founded the field, have stressed that fiscal history is inseparable from the history of government in general. And thinking of this as a central feature of a reciprocal social contract makes sense of why this belief is justified.

One corollary of this view is that we may need to soften the distinction between tax avoidance and tax evasion. Even when failing to pay taxes is not formally illegal, it may violate norms. The kind of disapproval and media attention that comes when wealthy celebrities push the boundaries to reduce their tax compliance conveys the power for norm-driven forces in driving taxation. Just because it is labelled as avoidance does not make it *socially* acceptable.

### 5.2. *Social insurance*

Social insurance has always been a core way in which states have created reciprocity between citizens and the state. It is both a source of material reciprocity and part of a wider social contract. Further, it absorbs into the domain of the state one of the more fundamental forms of reciprocity, taking control over the life cycle, something which historically has rested in the bosom of the family. Prior to becoming an important state activity, it was also a place where social capital was built between non-related individuals and families, such as the Friendly Societies in the UK or the Miner’s Brotherhood in Germany. These community organisations were built on mutuality, with a clear link between contribution and benefit, and hence are prime examples of reciprocity. While the state now dominates such activities, vastly expanding the sharing of such risk, their roots lie in the privately organised social action of the 18th and 19th centuries.

<sup>10</sup> For related discussion, see also Kleven [41].

<sup>11</sup> See, for example, Luttmer and Singhal [42] and Torgler [43].

There are many models of social insurance, but they all share two features. First, risk sharing is better than individual savings to cope with the idiosyncratic timing of risks, such as sickness or unemployment. Second, it is an efficient way of pooling longevity and infirmity risk over the life cycle.

Two names crucial to the foundation of social insurance are Germany's Bismarck and Britain's Beveridge. As the first Chancellor of a united Germany, Bismarck saw the provision of social insurance as a means of reducing social unrest and arresting the spread of socialism. A key legacy of Bismarck's system in Germany is the emphasis on localism and contributory finance, which was part of the vision from the start. The idea of contributory finance meant tying qualification for benefits to a personal history of paying into the system.

Beveridge, a technocrat hailing from the British upper class, reflected the patrician Liberal tradition, in contrast to Bismarck's background as a feudal landowner. Yet, he, too, advocated for a system based on contributions in exchange for benefits. This reliance on the contributory principle appeals directly to reciprocal norms. It is the universality of the contributory principle's appeal—taken up by a liberal like Beveridge and a conservative like Bismarck—that explains its widespread support and explains why it was a foundational part of the welfare state in both Germany and the UK.

History notwithstanding, the UK has incrementally moved away from a contributions-based system, even though it continues to maintain a somewhat artificial distinction between income tax and national insurance contributions in the tax system. The former raised about £193bn in 2019/20 and the latter almost as much at £143bn. Even though the latter is levied on both employers and employees, there is a “first-principles” economic argument as well as reasonable evidence to support the claim that it is a tax on workers, regardless of who pays it. Hence, in the end, even if the national insurance scheme is framed as a contributory-system, it functions in much the same way as the formal income tax.

Despite the fact that much of the population is likely to view the two elements collectively, as a simple “income tax”, there are some distinctions in the operations of these two systems. First, there is an upper earnings limit for core national insurance contributions, with employees paying a lower percentage of the upper bounds of their income.<sup>12</sup> National insurance contributions also only apply to labour earnings rather than all sources of income and cease to be paid after the retirement age is reached. The UK system therefore retains some vestiges of the original contributory funding model.

When it comes to benefits, there is almost no connection between national insurance contributions and benefits, while the elements that made up Beveridge's original proposal for the welfare state have been largely dismantled. The UK now has nothing resembling an unemployment *insurance* program, preferring a system based on constructing a floor on consumption, using benefits. Attempts to increase that linkage through the state earnings related pension (SERPS) have generally been modest and short-lived. And the link between national insurance contributions and any form of public spending is largely mythical, even though political rhetoric may occasionally try to link taxation to benefits, such as when Gordon Brown tried to link the payment of national insurance to NHS funding.

The IFS's Mirrlees Review [45] recommended merging income tax and national insurance contributions in favour of a comprehensive income tax system with all elements of the contributory principle.<sup>13</sup> Atkinson [46] questioned this proposal, largely on the basis that the disincentives to earn may be different when citizens perceive a benefit from paying certain taxes. The arguments developed here suggest a more wide-ranging version of this argument, reminiscent of what Barr [47] and Hills [48] have complementarily argued. The psychological link between benefits and taxes can be much more than a calculation based on personal benefits and costs, but instead can be portrayed as citizens' participation in a system that protects those who face risks or suffer misfortune. Net contributors and net beneficiaries even out over the life cycle to a significant extent. And even where they do not, universality in providing insurance to its citizens can be an appealing way to understand the value of taxation in a way that links strongly to the evidence on quasi-voluntary compliance with taxation.

But it is crucial to understand that this model is partially in tension with the view that sees redistribution as one of the primary motivations for state action and further conflicts with the view that spending programs should, as a matter of principle, be targeted at those in need. A comprehensive social insurance scheme would also support income replacement for higher income individuals, something that the UK chooses not to do. Of course, the exact structure for income replacement is open to debate. Some have advocated combining social insurance contributions up to high levels of earnings, perhaps on all earnings, together with a cap on benefits, as a way of freeing resources for redistributive purposes (see, for example, [49]). These issues were also germane to the design of the recent furlough scheme, introduced to sustain income levels when the economy was suspended, which paid 80% of an individual's wages but limited this at a maximum of £2500 per month as an important cost containment measure. This further reinforced the limited *insurance* role of the state for those who pay considerable taxes. Attempts to reduce the deductibility of pension contributions of higher earners is a further case in point. Argued from a perspective of outcome equality, this does have a certain logic.<sup>14</sup> However, advocating for it fails to appreciate the historical origins of the state and the importance of universality principles in sustaining quasi-voluntary compliance. A social contractarian perspective building on principles of reciprocity at the heart of the state would tend to support a larger, but perhaps more universal, set of programs, thus justifying the slightly higher tax rates—particularly on higher earners—necessary to sustain them.

<sup>12</sup> In a break with this, there is now an additional 2% contribution above the limit that was introduced by Gordon Brown in 2002.

<sup>13</sup> For the sake of transparency, note that I was a member of the Mirrlees review panel that made that recommendation.

<sup>14</sup> This is quite separate from the well-known argument that there should be tax breaks for saving for efficiency reasons due to a desire not to distort intertemporal decision-making.

As we emerge from the Covid-19 pandemic and assess the implications for the way that we rebuild state structures, the question of whether we need a universal form of insurance, properly funded and more comprehensive, should be firmly on the policy agenda. The temptation to more narrowly target available resources rather than stress universal programs looms large when the public finances need to be repaired. Furthermore, given how dependent the UK has become from a small group of relatively well-off taxpayers to fund the state, the political reality of ensuring that all higher earners fully comply with the tax regimes should not be underestimated, whether the concern is with their evasion or their avoidance. Moreover, history is on the side of those who have realised that this is an essential part of creating a sustainable funding model for the state.

## 6. Concluding Comments

This paper has focused on the importance of reciprocity in building and maintaining effective states. Creating and fostering a reciprocal relationship between the state and citizen is a natural way to leverage the reciprocity that has evolved in families, kinship groups, and small-scale communities. The modern nation state has been built on a notion of citizenship associated with membership of a political community that brings benefits and obligations. Such a method of construction is a human contrivance that has evolved through a process of social learning, along with some elements of strategic design. Policymakers who understand this can view their role not only in terms of implementing policies but also as guardians of reciprocal norms that have collective benefits. We have developed two examples where these ideas are particularly powerful: paying taxes and the design of social insurance. However, there are many more policy contexts where these ideas are relevant.<sup>15</sup>

This perspective on state effectiveness as “doing good or ill” in relation to specific forms of intervention is a conception that has colored much debate in political economy. Whether the state maximizes some conception of the public good, such as “Maximum Utility” might even be construed as a pernicious way of framing debates about state intervention, as Collier [51] argues. This approach too easily encourages us to think about the relationship between the state and the citizen being one-sided and, by taking such a distributive perspective, can actually increase the salience of divisions within society between those contributors who fund the state and those who receive from the state. Instead, the two-sided view based on reciprocity emphasizes the importance of universality and mutual obligation. Authors such as Barr [47] and Hills [48] have rightly stressed that thinking about the state as “us and them” is misleading as an empirical matter when viewed over the life cycle. It is also conceptually limiting when it gives insufficient weight to the norms that underpin the creation of successful states as argued in Shafik [52].

A rich conception of reciprocity also gets away from a narrow self-interested and material conception of what matters. The values that support cohesive states recognize that the rich, poor, and middle class derive mutual benefits from working together to form a successful polity aware of each other’s needs. The model is built around the primacy of common interests supported by relational political equalities and is often manifest in universal programs funded by broad-based taxation.<sup>16</sup> The recent rise of populism, whether from left or right, is frequently about fomenting division. It is rightly seen as a threat to the social contract and antithetical to basic liberal principles. Politicians that stress the use of the state as a redistributive tool often fail to appreciate the delicate balancing act that building a successful state requires. Stressing universal obligations, values, and programs is a core part of the political economy of successful states.

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<sup>15</sup> For example, Korn et al. [50] consider the process of vaccination against COVID-19 as social contract.

<sup>16</sup> See Besley, Beramendi, and Levi [53] for discussion of an approach to political equality rooted in conceptions of relational equality.

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