TAX MORALE AS A SOCIAL NORM

PhD(c) Ada Marinescu[5]

Abstract:
We will show in this paper that social norms have an influence on shaping tax morality. The classical models of tax behavior explain tax evasion based on a rational utility model. This theory does not account the high rate of tax compliance. Individuals also pay taxes due to a sense of moral duty. Homo oeconomicus, the individual concerned with his utility maximization is replaced with homo sociologicus, who lives in society and is influenced by the other participants to the social process. An individual usually imitates the behavior of others from the group. There are social preferences, social identities, social groups and social norms. According to experiments, people are actually conditional cooperators, not free riders. People cooperate as long as the other people from the group are also cooperating.

Tax morale is influenced by several variables such as the perception of tax-payers on the degree of fiscal evasion, age, religiosity, employability, education, social class, trust in the government, trust in the legal system, national pride, pro-democratic attitude, financial satisfaction, personal income, church attendance, direct democracy. If we refer to tax morale as a social norm, individuals can be persuaded to pay taxes due to social pressure. We will refer to the importance of the social dimension when it comes to tax compliance. In accordance with experimental results, we propose the idea that individuals are actually conditional cooperators, they will pay taxes as long as other members of the social group do the same.

Key words: tax morale, tax evasion, social norm, conditional cooperation

JEL classification codes: A13, D01, H26

Introduction

We will analyze in this paper the deviant fiscal behavior from the perspective of tax morale. Tax mentality or tax morality defines the attitude towards taxation. We will analyze in this paper how attitudes of people, attitudes related to social norms, affect the shaping of tax mentality and tax morality. As people are social beings, the influence of the social norms in determining the attitude towards paying taxes cannot be left aside. People tend to be influenced by the society where they live – if the society treats people with respect and not as potential cheaters, then the individuals will tend to act in the same manner, manifesting tax-compliant attitudes. But if people live in a society which treats them as potential tax-evaders, then they will respond accordingly. There are many other factors that shape tax morale – tax authority, the tax system, perception and experiences with deterrence factors, awareness of tax issues and trust in government. The influence of social norms in the formation of tax morale becomes manifest when individuals change behavior due to the changes in the group behavior.

We want to outline in this paper that tax compliance seems to be dependent on tax morale. The attitude of an individual towards tax evasion is also a function of social norms. Cultural or social norms have an important effect on tax compliance and the goal of this paper is to outline the role played by social norms.

Classical models of tax compliance usually take into account only deterrence and explain compliance based on a rational utility model. Yet, it seems that the high rate of tax compliance is inconsistent with the utility maximization model. So, other factors should be taken into account to explain compliance, because compliance is actually much bigger than traditional utility models would predict. Sociological research shows that the notion of utility cannot be reduced to self-interest, but includes as well ethical values and concern for social duty.

The theory of rational choice cannot account for tax evasion, because its consequences would be much more tax evasion than it really happens. According to the classical model of tax evasion, the

[5] *The School of Advanced Studies of Romanian Academy, Department of Economics, Sociology and Law, e-mail: marinescu_ada@yahoo.com*

individual is considered to act as maximizing automata, which is always choosing more for less and applying the principle of cost-benefit analysis in his choices.

The economic actor is seen as acting in applying the postulate of rationality, and he is performing optimization analyses - utility maximization or the minimization of cost. According to the rational choice theory, the individual will choose in every situation what best satisfies his interests.

From the prospect of the rational choice theory, ethics or morality is not important. If from the result of the calculus the conclusion is that it is more profitable for the individual to choose to involve in illicit activities, he will evade taxes. By comparing the action, that is the adopting of a deviant behavior and the result – the risk of being sanctioned or fined, the actor will choose that action with the best possible result cost-benefit. This calculus is merely an automatic action, in which prime not ethical considerations, but maximal benefits.

Deterrence is related to the expected utility model, which shows that individuals pay taxes due to the coercion from the state – tax audits and fine. According to this model, individuals pay their taxes to the limit that they satisfy the utility as compared to the fine they might get as a result of noncompliance. But this expected utility model is unable to explain the high rate of tax compliance. This compliance might be explained by tax morale. Individuals pay taxes due to a sense of moral duty, a feeling which cannot be integrally accounted by the model of utility maximization.

Homo oeconomicus or homo sociologicus

Homo oeconomicus is the perfect rational being, he acts on a market with perfect competition and he has access to all possible information. His action is motivated by the maximization of personal utility and he will try in every possible situation to get maximum gain with minimum efforts, and he is capable of performing extremely sophisticated calculus, like a robot.

If for homo oeconomicus the society has practically no importance, for homo sociologicus the society with its norms and rules is very important. The behavior of an individual is influenced by the norms which dominate in society.

In our case the fiscal behavior is influenced by the internalization of norms within a process of socialization. In this situation the individual finds himself between the restriction of social norms and his desires – a low tax level and a better standard of living. He is caught between social norms and his desires.

There is a distinction between external norms, represented by traditions, customs and values which are particular to a certain society and internal norms, which have been internalized by the individual and form his moral system.

In every society there are certain moral and cultural standards and norms and the individual internalizes these norms, which become the pattern of correct behavior.

Some authors (Kirkhler, 2013, p. 79) claim there is a specific category of taxpayers, social taxpayers, whose behavior is influenced by social norms. These social taxpayers are motivated by the group where they act. If many individuals from the social group do not comply with tax regulations and find out ways to evade, these tax payers will act accordingly. If the majority of the group does not approve with illicit and fraud behavior, then the individual will follow the pattern behavior expressed by the group. For these social taxpayers the role of social norms is decisive.

At the individual level, rules define standards of behavior which have been internalized. At the level of society, rules express the behavior of a social group based on standards which are shared in common. These kinds of rules a society has in common become cultural norms and they are expressed in the legislation of the country. Tax morality and the consciousness of duty and of respecting norms are shaped in a process of adopting these cultural norms which define and are prevalent in a certain society.

The institution of society and also the norms prevailing in society are important in the process of cooperation and abiding by the norms. Once these norms are accepted by the individual and they are internalized, then the cooperation of the individual is easier to be obtained. Acceptance of a fiscal morale is thus due to the process of compliance and internalization of norms created in a society. The establishment of trust and cooperation is a long and difficult process, but in the long run it is worth that the state tries to gain the acceptance from citizens.

If individuals are satisfied with the actual social order, then they will comply voluntary and a correct and fair social and fiscal behavior will benefit all individuals, society and the individual in case. But for this it is important to create appropriate social norms and institutions capable of shaping civic consciousness and responsibility.

Compliance actually means cooperation, a permanent review of the relationship citizens, government, institutions, in order to reduce social distance and establishment of trust between citizen and political administration (Bergman, 2002, p. 290).

Social thinking and social norms

Usually people use mental shortcuts and mental models in order to filter and interpret information and are often influenced in how they think or act by other people, and this is usually called thinking socially.

Recent research in the economic science is showing that people make decisions based on social expectations. In the process of decision-making insights from behavioral science and psychology show that people do not take decisions based on a perfect calculus of costs and benefits. People form preferences and this process is influenced by social institutions which shape the manner in which the individual perceives reality.

Man is a social being, whose behavior is influenced by the others in the social group. We can talk in this respect about social preferences, social identities, social groups and social norms. Usually the individual imitates the behavior of the others from the group and we are interested in what the others individuals think and say about us.

Many people dispose social preferences for fairness and reciprocity and possess also a cooperative spirit. But these characteristics can be exploited both in a positive and negative manner, because there are different types of societies – societies which display correct behaviors and societies where corruption is the dominant.

Experiments show that people behave like conditional cooperators that are willing to cooperate as long as other people are cooperating. The results of different public goods games show that majority of people adopted the pattern of behavior of cooperation, not that of free riders. The much bigger proportion of cooperators proves that the standard economy theory is misleading when it is depicting people like selfish beings choosing the behavior of free-riders whether it is convenient for them, and not caring about morality.

The principle of thinking socially has several implications for policy. Human sociality is a major factor influencing behavior, and institutions and interventions can be designed to support cooperative behavior. A key consequence of sociality for development is that groups and even entire societies can get stuck in collective patterns of behavior such as corruption.

Are we free riders or conditional cooperators?

A very important assumption in the neoclassical theory is that people are naturally free riders and they prefer to take advantage of public goods, but not pay for them. In this case, the assurance of public goods is problematic and is a difficult task. But experimental economics shows that people are not actually free riders, but conditional cooperators. As long as other people cooperate, people will tend to do the same and not to choose the selfish behavior.

Experiments demonstrate that people have the tendency to reward others who cooperate and to punish people who do not cooperate. These kinds of behaviors are explained by two different reasons, one is related to instrumental reciprocity and the other is intrinsic reciprocity.

Instrumental reciprocity means to respond to an attitude of kindness with kindness with the purpose of maintaining a relationship.

For the study of intrinsic reciprocity, economists have used the ultimatum game. In this game two players are given a certain amount of money, for example the sum of 10 dollars. The proposer is instructed to offer a certain amount of money (from 1 to 10 dollars) to the other player. If the responder accepts the offer, then the money is shared in accordance with the offer. But if the responder refuses this offer, then each player gets nothing. The norm of self-interest suggests that the most rational offer for the proposer would be to offer 1 dollar and remain with the rest, and the second player should accept, because 1 dollar is still better than getting nothing.

In experiments only a minority of people behave in this manner. On average the offers from the proposers are often between one-third to one-half from the total amount, while low offers are usually rejected by respondents. These finding apply irrespective of the amount at stake.

Another experimental game used is called the public goods game. This game begins with each player having to choose with how much from his endowment to contribute to a public fund. Contributions are then multiplied so that the public good payoff is maximized when players contribute their entire endowments. The game was first established so that it was no way for players to be able to punish low contributors. In the first round of this game, half of the participants contributed to the public fund. But in time as an effect of not all people contributing to the public fund, cooperation stopped. After 10 periods, the result was a very low level of cooperation. Things changed only when researchers introduced opportunities for players to award punishment points, which is the laboratory equivalent of being able to eliminate a free rider from the group.

These experiments show that people are actually conditional cooperators who prefer to cooperate only insofar as other people are also cooperating.

A study about behavior has been conducted with subjects from eight countries, with the subjects implied in the public goods game (Martinsson, Pham-Khanhand Villegas-Palacio, 2013, p.150). The results of the study contradict the assumption from standard economics according to which everyone is a free rider, showing the actual distribution of free riders towards conditional cooperators.

It is true that the proportion of cooperators differs according to the country, but in no country free riders represent a dominant share of the population. The final conclusion is that the traditional model of behavior exhibited in neoclassical theories is not supported in any real society (Henrich and others, 2005).

As shown by these experiments, cooperation depends a lot on the expectation of the individual about the cooperation of others. If people have the chance to choose, they would choose an environment where cooperation dominates and they would punish people who are free riding and exclude them from the group (Fehr and Williams, 2014).

The main conclusion drawn from experiments is that most people prefer conditional cooperation not free-riding. In a public goods game experiment when people do not have the possibility to punish free riding the cooperation reaches quickly a low level. But when the behaviors of cooperation are again rewarded and especially the introduction of punishment will quickly increase cooperation.

Relation between social norms and fiscal morality

Intrinsic motivations may depend on social interactions, which create a role for norms in tax compliance. The importance of norms is highlighted, for example, in Posner (2000) when he notes that:

"A widespread view among tax scholars holds that law enforcement does not explain why people pay taxes. The penalty for ordinary tax convictions is small; the probability of detection is trivial; so the expected sanction is small. Yet large numbers of Americans pay their taxes. This pattern contradicts the standard economic model of law enforcement, which holds that people violate a law if the benefit exceeds the expected sanction. Some scholars therefore conclude that the explanation for the tendency to pay taxes must be that people are obeying a norm — presumably a norm of tax payment or a more general norm of law-abiding behavior." (Posner Eric, 2000, page 1782).

Is there any fiscal morality? Research shows that there are significant differences among countries when it comes to fiscal evasion and tax morale. For instance, studies about tax compliance in the United States and Spain show that people in US have a much higher compliance to norms and bigger tax morale. So our question would be whether we can measure tax morale.

As stated in the literature, individuals pay taxes for two reasons. One reason is the detterence and the reaction of individuals is described by the expected utility model. The second reason is the sense of obligation of the individual towads the state, which is embboddied in the tax morale. (Frei, Bruno, 2003, p. 392).

We will start with a definition of tax morale. Tax morale was defined as the intrinsic motivation to pay taxes, the willingness to pay taxes by the individuals. Contrary to tax evasion, tax morale does not measure individual's behavior, but individuals' attitude. It can be seen as the moral obligation to pay taxes, the belief in contributing to the society by paying taxes. On the other hand, it also catches the moral regret or guilt over cheating on taxes (Torgler, Benno, 2003, p. 2).

Generally, fiscal morality is related to the attitude towards the issues of complying with fiscal regulations. Some authors refer to tax morality as internalized obligation to pay tax liabilities or as intrinsic motivation of an individual to pay tax obligations and others connect with the concept of civic duty in the sense that people are not motivated only to maximize their own welfare, but also by feelings of responsibility and solidarity to the state and nation.

The results of comparative studies show that tax morale differences can be explained by differences in the system of tax administration, and also by the attitudes of governments in the countries. According to cultural studies, we can measure the cultural traits of a certain country. There are databases which present measures of the values across a certain country and how these different values are shaping and affecting tax morale.

There are many econometric models which study the relation between fiscal evasion and several exogenous variables: the level of taxes and taxation from a country, morality of tax-payers, degree of development of that country. Other econometric models show the relation between fiscal evasion and fiscal morale and analyze several variables responsible for shaping tax morality: the perception of tax-payers on the degree of fiscal evasion, age, religiosity, employability, education, social class, trust in the government, trust in the legal system, national pride, pro-democratic attitude, financial satisfaction, personal income, church attendance, direct democracy.

The conclusions of these studies show that: tax morale increases with age; tax morale is lower in case of self-employed and unemployed; tax morale is lower for upper-class individuals; financial satisfaction leads to increase of tax morale; trust in government and legal system increase tax morale; national pride increases tax morale; a pro-democratic attitude leads to higher tax morale; education increases tax morale; religiosity increases tax morale.

Frey and Torgler find using data for Western and Eastern European countries that taxpayers are strongly influenced by their perceptions of the behavior of other taxpayers. If taxpayers believe tax evasion to be common, tax morale decreases. Alternatively, if they believe others to be honest, tax morale increases. We would hypothesize that the higher the percentage of taxpayers someone perceives to cheat on taxes, the lower his/her tax morale will be (Frey, B. S. and B. Torgler, 2007, p. 136).

In a study performed by Strumpel (Strümpel, B., 1969, p. 13-32), he analyzed the tax morale of European tax payers. In the study he performed a comparison between different systems of taxation and also the level of tax morale in European countries. The findings of the study were that tax morale in Germany was lower than in UK. Strumpel explained these differences from the point of view of the government attitude towards citizens. In UK the government tended to treat tax payers with more respect, while the German system was based on excessive control and coercion, treating people as potential tax-cheaters and evaders.

There are many factors to identify which influence tax morale. Tax morale refers to the principles or values that people have in respect of their taxes. Econometric studies have shown that tax morale is very likely to be influenced by a wide range of individual and social variables, such as trust in the government, the nature of the fiscal exchange, perceptions of fairness, trust in the institutions of government, the nature of the fiscal exchange between taxpayers and government, and a range of individual characteristics (age, gender, married, employment) (Alm, James, Torgler, Benno, 2006, p. 228).

We will study how tax compliance is influenced by ethical considerations and also by social interactions and relations. According to this kind of theories, individuals can be convinced to be tax compliant due to social pressure. All studies, either econometric or experimental, tend to prove that there is an important social dimension when it comes to tax compliance.

It is worth to study the decision of fiscal evasion or tax incompliance from the prospect of being a social norm. How can we model tax-compliance as a social norm, imposed by the social group to which the individual belongs? Are there countries or societies which are more prone to fiscal evasion than others?

This ‘‘social norm’’ of tax compliance can be distinguished by the feature that it is process-oriented, unlike the outcome-orientation of individual rationality (Alm, James, Torgler, Benno, 2011, p. 636).

For example, Bosco and Mittone (1997) take altruistic approaches, stressing that taxpayers are not only interested in their own welfare but are also concerned about the general welfare, so that their decision to evade is constrained by the knowledge that their evasion will reduce the amount of resources available for social welfare.

Polinsky and Shavell, who present a survey of the economic theory of public enforcement of law, draw attention to the issue of social norms. Social norms are seen as an alternative to law enforcement when modeling the behavior of individuals. The effects of non-compliance with social norms has both internal effects as sanctions (such as feeling of guilt or remorse) as well as external sanctions, exclusions from the group and gossip (Polinsky, Mitchell, Shavell, Steven, 2000, pp. 45-76).

A social norm therefore represents a pattern of behavior that is judged in a similar way by others and that therefore is sustained in part by social approval or disapproval. Consequently, if others behave according to some socially accepted mode of behavior, then the individual will behave appropriately; if others do not so behave, then the individual will respond in kind (Frey and Torgler, 2007).

Erard and Feinstein (1994) incorporate shame and guilt directly into the taxpayer’s utility, by hypothesizing that a taxpayer feels guilty when he underreports and escapes detection yet conversely also feels ashamed when he underreports and gets caught. (Erard, B. and J. S. Feinstein: 1994, p. 70–89).

In this section we want to analyze how the decision whether or not to evade is affected by the tax parameters and opportunities to evade and how their impact changes when tax compliance assumes the characteristics of a social norm. Tax compliance can be seen as a code of behavior in the community of taxpayers, although it is difficult to picture how it may emerge and remain as a norm. There are many factors to be taken into account when studying the emergence of tax compliance as a social norm. Taxpayers care about how many other individuals evade tax, and for this there could be many reasons, because they care about their reputation within the community or because they are concerned that each member in the community pays a fair contribution to tax revenues.

Conclusion

Tax morale is influenced by many variables and one of the most important influences comes from the social group. Social norms represent the traits of a certain social group which define attitudes and beliefs. As experimental studies show, people behave in most cases like conditional cooperators, not as free-riders. Individuals will comply with fiscal regulations as long as other people from the group pay taxes. The fiscal morale is strongly influenced by the perception people have about the others` attitude.

Frey and Torgler (2004) provide the most direct evidence on the relevance of conditional cooperation for tax morale. They use data from the European Values Survey and conduct a multivariate analysis across 30 countries (with at least 1000 individuals per country). In their study they find a positive correlation between people’s tax morale (measured by a question whether cheating on tax is justified if you have the chance) and people’s perception how many others cheat on taxes.

People behave like conditional tax-payers, they pay their taxes insofar they perceive the other tax-payers as being honest and paying taxes.

According to these studies, people are influenced in the decision to evade by the perception of the others` attitude. For this reason we consider it is important to study tax morale as a social norm. The process of implementing tax morality within a social group depends on preferences displayed by the group, but in principle people behave like conditional cooperators and exclusion of free-riders serves to improve cooperation in the group. In case clear regulations for excluding free-riding function, it is more likely to implement a large-scale cooperation on tax compliance. At the same time, tax morale is influenced by a wide range of factors, and all these factors should be taken into account in the process. Therefore, human nature has a social side which makes that the influence of the others is very important, tax morale becoming thus a social norm.

The social group plays an important role when it comes to define what it is right and wrong from the social and moral point of view. The process of shaping fair moral and fiscal norms is an ongoing process, and in this process the abidance by the laws is influenced by the ability to ensure a fair environment for people to act. People are social beings and social norms play an important role in the process of tax compliance.

Traditional economic theories tend to consider individuals as innate free-riders, who will choose in every situation the behavior which is most convenient for them, not including in their calculus any moral standards. Experimental results show that people are actually conditional cooperators, that is they will cooperate and abide by moral and fiscal regulations only as long as other people from social group behave in the same manner. The importance of social norms and also the importance of influence from the other people from the group should be taken into account when trying to change and influence the level of tax morale from within a certain social group.

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