



# All's fair in taxation: A framing experiment with local politicians <sup>☆</sup>



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## ABSTRACT

Tax and benefit systems commonly assign premiums to (socially) preferable states. For instance, having a child usually warrants a (cost-reducing) premium compared to remaining childless. These premiums may equivalently be achieved as positive benefits for the preferable state, or as taxes for the non-preferred state. However, perceptions of fair treatment of the rich and poor may differ with the frame. This paper contributes to the understanding of framing effects in tax and benefit system design by providing an empirical test with actual political decision-makers exposed to system-relevant considerations. Using a survey-experiment, we find participants ( $N = 608$ ) to grant higher premiums for having children to low income families in a benefit frame, but to high income families in a tax frame. A similar framing effect occurs in a second scenario based on real competencies of our respondents. In both scenarios the effect is moderated by the political ideology of participants' parties. Its occurrence among policy-makers raises concerns about imbalanced tax and benefit schedules being designed unintentionally despite (or because of) attention to social fairness.

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## 1. Introduction

In discussions on tax and benefit system design, the notion of fairness plays an important role for citizens and politicians. Yet, what many intuitively perceive as fair or unfair may not pass closer scrutiny. In an in-class (thought-) experiment Schelling (1981) argues that it is possible to construct two systems which, in order to both be judged as fair, produce very different - if not contradictory - results. Briefly summarized, Schelling (1981) argues that the perception of what constitutes fair treatment of the rich and poor in creating premiums for certain (socially) desirable behaviours may be dependent on the

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frame used in posing that question. More precisely, the baseline dimension upon which either a tax is levied or a subsidy granted plays a key role in evaluating fair treatment across income levels. This notion that people's feelings towards economically vital instruments such as taxes and benefits are susceptible to the way they are presented has been described by Daniel Kahneman (2011, p.369) as his "favorite example of a framing effect".

While (risky-choice) framing effects in taxation have received ample attention in the literature on tax compliance (see e.g. Cullis, Jones, & Lewis, 2006; Cullis, Jones, & Savoia, 2012; Hasseldine & Hite, 2003; Torgler, 2002, 2003), behavioural influences on tax and benefit system design remain understudied. Previous empirical tests of the influence of framing on 'fair' taxation preferences are few and find mixed results (LeBoeuf & Shafir, 2003; McCaffery & Baron, 2004, 2006; Reimers, 2009; Traub, 1999). This paper presents a survey-experiment carried out among Flemish local politicians with actual authority over financial incentives in their municipalities. It contributes to the evaluation of framing effects in taxation by (i) broadening the empirical base to political actors involved in the design of tax and benefit schedules, (ii) expanding the testing of this type of baseline framing effects from the commonly used scenario of child benefits as proposed by Schelling (1981) to another decision area in which the participants of the survey-experiment have authority, namely municipal taxes, and (iii) identifying the political ideology of participants (measured by the average self-placement of their party on a left-right scale) as a moderating factor of the framing effect. Overall, our findings provide a clear confirmation of framing effects in the perception of taxes and benefits also among those deciding such issues.

The occurrence of strong framing effects among politicians tasked with designing and implementing fiscal instruments raises concerns about *ex post* unintended tax and benefit schedules. It appears that despite (or potentially even because of) due *ex ante* consideration of social fairness aspects, implemented schedules may disproportionately favour some subjects over others. As our results indicate, the baseline upon which an intervention is planned (i.e. the choice between a benefit for a (socially) desirable state or a tax for the undesired state) can lead to contradictory results with regards to fairness across income levels. However, the size and direction of the effect may be domain dependent. Particularly for the design of new taxes or benefit schemes, it may be insufficient to judge the size of a tax or benefit in relation to income levels. Instead, discussion and deliberation of 'fair' amounts may benefit from the use of multiple instruments and increased focus on the intended differential between recipients of different income or wealth levels *before* determining the treatment of the group representing the baseline.

## 2. Literature and motivation

Redistributive policies usually evoke discussions on *who* should provide the money and *how* it should be allocated, particularly when redistribution is meant to alleviate disadvantages of certain (e.g. income) groups. Schelling (1981) describes how (supposedly) ethical concerns and the principle of equity can guide policy-making. With respect to the question *how* to (re-) allocate money, the wish to provide equitable solutions may impair the economic efficiency of redistribution. For instance, rent control or food stamps may provide appealing options in helping the poor. Yet, if the provision of a welfare programme comes at a higher cost than the recipient's valuation of the benefits, it fails to optimally use the available funds. Instead of, for example, receiving food stamps to subsidise food, the recipient may prefer to invest more in their child's education or other necessities. The point Schelling (1981) makes is that in such circumstances the intended fairness of a policy may in fact make it an unsuitable instrument for dealing with the issue to be solved. A single instrument may be insufficient to solve different redistributive issues. In many cases, the obvious answer may be the provision of cash instead of earmarked coupons to remove the problem of imbalanced valuations of certain benefits, allow optimal allocation by the recipient, and reduce market distortions. It also allows disentangling the issue of food/rent/energy or any other issue targeted by a redistributive programme from the underlying problem of, e.g., poverty.

Even when there is agreement on how to distribute funds, the question remains *who* should provide them, and in what share. Here again, the notion of fairness is typically important. The design of taxation and benefit schedules can often be thought of as a two-step process. First, a baseline is defined as reference point for the intervention. For example, in defining social benefits, the baseline may be: a childless couple for defining child benefit; the net income of a worker for defining the size of a pension; or the certification of a certain status or licence (e.g. safety training, standards, modern equipment) for subsidies. In the second step the differential between the baseline and the group under consideration is determined. For example, how much benefit parents should receive for having a child, what ratio of income should be recognised for determining the size of a pension, what kind of subsidies emission free cars should get, etcetera. In economic terms, the result of such tax and subsidy schemes is the assignment of a financial premium for one condition compared to another. The underlying principle, often supported by widespread public preferences for progressive tax systems (see e.g. Edlund, 2003; Kirchner, 2007),<sup>1</sup> is usually that the premium should decrease for those with ample financial means, and increase for those less well-off.

Schelling (1981) argues that thinking of the collection of funds for redistribution along the lines of a single instrument may have unintended consequences. Looking more closely at child benefit systems as an example, they typically provide a financial benefit to families with children, thus creating an additional incentive for having children. The baseline is a family

<sup>1</sup> Note, however, that public opinion on such issues may itself be subject to cognitive biases and other influences (Mehlkop & Neumann, 2012; Roberts, Hite, & Bradley, 1994).

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