Deception choice and self-selection – The importance of being earnest[☆]

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A R T I C L E   I N F O

A B S T R A C T

We study deception choices, the self-selection of capable and less capable deceivers and deception detection in a tax compliance experiment. We find large systematic differences between whether subjects are perceived as honest or as dishonest. Taxpayers are seemingly aware of these perceptions. The empirical outcomes are in line with a theory suggesting that taxpayers make their tax compliance choices on the basis of these perceptions. Taxpayers who are perceived as honest self-select since they are more likely to underreport. This selection effect is stronger if the fines for underreporting are high.

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1. Introduction

Individuals have a choice whether to lie or to tell the truth. This choice depends on a number of issues. One important aspect is whether individuals assess their look as honest or dishonest and, thereby, how they assess the subjective probability that their deception would be detected. Specific audit mechanisms may be applied in an attempt to detect deception. One important characteristic of audit design is whether there is a face-to-face interview by an inspector. Individuals who choose whether to cheat and deceive take such characteristics of the reporting and audit design into consideration. They assess whether they are perceived as honest or dishonest and compare this perception with those of others when they choose whether to report truthfully or whether to underreport. Accordingly, individuals who think they have a comparatively honest look may adopt a deceptive strategy more frequently. Those individuals who eventually decide to cheat can be expected to be a self-selected group. This self-selection may make it more difficult to detect deceivers.

This paper makes a first attempt to trace self-selection in the laboratory, in the specific context of tax compliance with face-to-face declarations. We conduct a tax compliance experiment and use the data generated in this experiment in a

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lie-catching experiment. We study deception detection if self-selection according to perceptions as honest or dishonest is potentially present. More specifically, we first consider whether individuals are perceived as honest or dishonest and try to measure these differences in perceptions. Second, we trace whether individuals are aware of these perceptions. For this purpose we investigate if the individuals' self-assessed audit probabilities are correlated with other people's assessments of them being honest or not. If individuals base their deception choices on their self-assessed perception of looking honest, this should lead to self-selection. Thirdly, we thus ask whether there is evidence of self-selection in which individuals who look more honest are more likely to lie. In order to identify this effect we use variations between two treatments that provide different monetary incentives for individuals to underreport. From these insights gained, we draw conclusions on the optimal design of the audit mechanism.

Choice problems for which the attempt to deceive involves a material risk and therefore provides an incentive for self-selection are rather common. At customs, there are people who have nothing to report and people who have something to report. The ones who have something to report have to make a compliance decision. They may report the value of their goods truthfully and pay customs. Alternatively, they may claim to be one of the persons who has nothing to report. Such underreporting leads to lower custom duty payments if underreporting remains undetected. Underreporting triggers a fine and leads to higher payments if it is detected.[1]

Similar decisions emerge in other contexts. Inside an organization people may be upfront about what went wrong and may apologize, or they may apply deceptive strategies and try to avoid taking responsibility for mistakes.[2] In a job interview, applicants may report truthfully or they may lie about their competencies and skills.[3] Salesmen may report truthfully, or inflate their expense claims, or shirk on their working hours.[4] And supervisors may misreport the performance of their workers.[5] In each of these cases individuals choose whether to report truthfully, or whether to attempt to deceive their counterparts and thereby self-select. We look at a specific framework, but self-selection in a deception framework is a more general issue. It is also important for laboratory experiments. Treatment effects might in fact be the consequence of the self-selection of the participants along a certain dimension, if the experiment allows for such self-selection.

To study an individual's honest look, its role for deception choices, and self-selection we conduct a lie-catching experiment that is framed in the context of tax compliance with 231 subjects – called 'judges' – who rate videotaped tax declarations of 80 subjects – called 'taxpayers' – leading to 9240 observations. These videotapes were taken from a tax compliance experiment. In this experiment there were taxpayers with two levels of income. Their true income was their private information. All taxpayers had a face-to-face interview with a person who had the role of a 'tax inspector' in a laboratory environment. Taxpayers with a low income reported low income, leading to a zero tax obligation. A taxpayer with a high income had to decide whether to pay taxes truthfully or to claim to have a low income. Such a tax payer knew about the possible monetary upsides and downsides of underreporting, compared to truthful compliance: underreporting was rewarding if he was not caught, and more costly than truthful compliance if he was caught. As will become clear further in this paper, we used two different treatments to identify the role of self-selection. One treatment had high fines for taxpayers who were caught underreporting and a second one had low fines. A high fine should discourage underreporting in general, and it should discourage liars with a dishonest look more effectively than liars with an honest look. For this reason, the sets of individuals who choose to underreport income in the two treatments should be perceived differently with regard to their look. Selection, and hence average perception as honest, should be higher among individuals who choose to underreport in the treatment in which underreporting is discouraged by high fines.

The answers to the research questions outlined above are: First, taxpayers exhibit systematic differences regarding their probability of being correctly classified as tax cheaters or honest low-income reporters. This heterogeneity in perceptions is found for both truthfully reporting low-income taxpayers and for high-income taxpayers who underreport. There are underreporting taxpayers who are consistently classified as dishonest (measured by a high number of judges who classify them as untruthful) and there are underreporting taxpayers who are systematically wrongfully classified as truthful by a majority of judges. And similar heterogeneity exists for honestly reporting low-income taxpayers.[6] Second, taxpayers are aware of these perceptions. They can to some extent correctly assess how honest they are perceived to be by others. Using a 'dishonesty score' which we construct from the data on how individuals were rated by the judges, we find subjects' self-assessed likelihood of being given an audit to be positively correlated with their dishonesty scores as stated by

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[1] This choice between a safe tax payment outcome and a gamble involving a possible fine is at the heart of much of the tax compliance literature (see, e.g., Allingham and Sandmo, 1972 or more advanced models such as Reinganum and Wilde, 1985).

[2] See, e.g., Kellerman (2006) for a discussion of the high stakes for corporate leaders and the optimal choice problem of whether to apologize, deny or remain silent.

[3] Deception in employment interviews has attracted considerable interest among social psychologists. One survey and meta-study is by Barrick et al. (2009).

[4] Such choice problems are the starting point of the literature on efficiency wages (Shapiro and Stiglitz, 1984) or the principal–agent literature on moral hazard.

[5] See, for instance, the experimental evidence by Rosaz and Villeval (2012).

[6] Perhaps surprisingly, the judges do not show systematic differences in their ability to detect liars. Ekman and O'Sullivan (1991) found differences in accuracy for deception detection among occupational groups. However, the issue of whether experienced lie-catchers have higher detection rates remains controversial among psychologists. In particular, experience seemingly loses much impact if the assessment context is changed. We do not contribute much to this controversy, as all our judges are students. We find that the heterogeneity in lie-catching ability among the student judges is low.