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Why do people evade taxes? New experimental evidence from Greece ☆

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A B S T R A C T

This paper uses new experimental survey data to explore the determinants of tax compliance among Greeks, by investigating several hypotheses set by the slippery slope framework. The latter provides a unified research paradigm for analysing tax compliance behaviour integrating economic and psychological factors. Tax honesty is distinguished into two types, voluntary and enforced compliance and these in turn vary depending on the trust individuals have on government and on the power of tax authorities. Results verify that trust increases voluntary compliance, and power increases enforced compliance. A very interesting finding is that power has no influence on voluntary compliance in the high trust conditions, but high power leads to even lower voluntary compliance in low trust conditions. This suggests that in high trust conditions, power of tax authorities is perceived as legitimate, while in low trust conditions, the same power is perceived as coercive and yields negative attitudes. In the post-crisis years, Greece has experienced a deep erosion of trust to the authorities. With the "trust paradigm" deactivated, efforts to improve the effectiveness of tax authorities can at best improve enforced compliance. This might be a last-resort strategy for the short-run, but the long-run bet is regaining trust.

1. Introduction

Greece is in the middle of the most severe fiscal crisis in its recent history. Revenue shortfalls have been a constant feature of the execution of the government budget almost every year of the decade preceding the outbreak of the crisis. Although there is no study precisely quantifying the level of tax evasion, all available indicators suggest that it is high. The importance of personal and business income as a tax revenue base is abnormally low at least for Euroarea standards, while the VAT compliance gap is the highest among 15 European countries (de Mooij and Keen, 2012). Perhaps more surprising is the degree at which the shortcomings in the enforcement of tax laws seem to persist, even after Greece was subjected to an ambitious fiscal adjustment programme by the three international organizations surveilling the Greek economy since May 2010. Even under the threat of default, efforts to improve the performance of the tax system so far had only modest results.

Tax evasion is a phenomenon particularly acute but certainly not confined to Greece. This is why its explanation and deterrence has attracted the interest of researchers for a long time.[1] Starting from the seminal contribution of Allingham and Sandmo (1972), initial attempts set the problem within the general theory of criminal behaviour (Becker, 1968) and frame the decision to evade as a purely economic decision under risk. In this light, combating tax evasion is a matter of fine tuning audit rates, tax rates and fines. The "enforcement" paradigm, however, proved inadequate to explain observed behaviours of taxpayers, as levels of tax compliance and their differences across countries could not be explained simply by the effectiveness of tax authorities in enforcing tax laws. It, therefore, became clear that the decision to comply involves more complex considerations and many actors, namely other taxpayers, the government and the tax authorities. New and emerging paradigms of compliance behaviour put forward the idea that compliance has different motivational orientations and particularly that trust in authorities might be an important determinant of voluntary compliance with the tax system. By focusing on the reciprocity of commitments between authorities and tax payers, such paradigms emphasize that as long as citizens trust that the government will use their money for sensible projects (e.g. the provision of public goods), they will voluntarily pay their share of taxes (Feld and Frey, 2007).

The "slippery slope framework" (Kirchler et al., 2008) is a recent attempt to synthesize different research paradigms on tax compliance behaviour by introducing insights from behavioural economics, that is by using methods and evidence from other social sciences (especially psychology) to analyse group and individual decision making. This framework assumes that tax payments are influenced by the trust in government and the power of authorities. People might pay

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[1] For an excellent review, see Alm (2012).

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their taxes because they want to or because they are forced to do so. Increasing trust in government boosts voluntary compliance, while increasing the power of tax authorities increases enforced compliance. Apparently, the policy implications about appropriate strategies for closing the tax gap are far fetching.

The present paper contributes to the existing literature in several ways. First it tests whether the “slippery slope” paradigm fits Greece, the country with by far the highest shadow economy among OECD countries (Feld and Schneider, 2010). This paradigm has been recently tested for other countries, like Austria, Hungary or Russia (Kogler et al., 2013; Wahl et al., 2010a) with promising results. Second, the paper is the first attempt to use evidence from a specially designed survey to study the issue of tax evasion in Greece from the perspective of fiscal psychology. Third, by employing this paradigm it explores the reasons behind extensive non-compliant tax behaviour in Greece, in an attempt to inform the policy dialogue on this highly topical issue.

Main postulations of the slippery slope framework are indeed verified. Both high trust to government and the power of tax authorities lead to increased tax compliance. Motivational orientations of taxpayers differ in each case. Trust increases voluntary compliance and power enhances enforced compliance. A very interesting finding is that power has no influence on voluntary compliance in the high trust conditions, but high power leads to even lower voluntary compliance in low trust conditions. It seems, therefore, that if citizens trust the government, they perceive effective authorities as strong and powerful, while if they do not trust the government, they perceive the same power as coercive and enforcing. The experimental nature of the survey raises certain concerns about the generalizability of results, yet a main insight gained at a policy level is that although toughening the profile of tax authorities might be a way of increasing enforced compliance, it does so at the expense of voluntary compliance. A more promising way of fostering tax compliance in the medium-term would probably involve forging trust to government, which seems to have plummeted among Greek citizens during the recent fiscal crisis.

The paper is organized as follows. Section 2 briefly reviews the literature on different research paradigms for understanding tax compliance behaviour, giving a special emphasis on the “slippery slope” framework. Section 3 describes the data and methods used, as well as the limitations of the study. Section 4 discusses the main results, Section 5 combines these results with real world evidence to provide some insights for fighting tax evasion in Greece at a policy level, while Section 6 concludes.

2. Relation to the literature

The first theoretical approach to understand the problem of tax evasion (Allingham and Sandmo, 1972) was an extension of the economics of crime model (Becker, 1968) and frames the decision to evade as a choice under risk. According to the models in the Allingham and Sandmo tradition, the only reason an individual will exert honesty is out of fear of detection and punishment. The policy conclusion is clear; compliance depends upon enforcement and the degree of tax compliance will increase if the government is able to increase the frequency of audits and the severity of fines.

These models, however, hardly explain actual levels of tax compliance. If people made their decisions as to whether or not to pay taxes, on the basis of purely economic factors, then most taxpayers would be involved in tax evasion or fraud because of the low probability of detection and the small relative to evasion penalties. As Alm et al. (1992) stress a ‘... purely economic analysis of the evasion gamble implies that most individuals would evade if they are rational because it is unlikely that cheaters will be caught and penalised’. In their survey Andreoni et al. (1998) present a large number of studies to demonstrate that tax compliance exceeds the predictions of the models in the Allingham and Sandmo (1972) vein of analysis. Moreover, the standard theory of tax evasion cannot adequately explain differences in tax evasion across countries. It seems therefore that government enforcement activities are not the only motive for compliance.

More recently, many researchers have sought alternative explanations for tax behaviour, acknowledging that people are motivated not only by self-interest but also by sociological and psychological factors and group notions like social norms, fairness, trust, reciprocity and tax morale (e.g. Dell’Anno, 2009; Cullis et al., 2012; Balestrino, 2010). Newer paradigms of tax compliance behaviour are based on an interdisciplinary framework involving elements not just from economics, but from other social sciences as well, especially psychology. Braithwaite (2003), for example, differentiates between five motivational postures for (non-) compliance ranging from the feeling of a moral obligation to pay one’s fair share to engaging in a “cops-and-robbers” game with the tax authorities.

Alm et al. (2012) provide an informative review of different research paradigms (besides the traditional Allingham and Sandmo one) for analysing tax compliance behaviour. Tax compliance behaviour can alternatively be seen as a social contribution dilemma (Wahl et al., 2010b). The main rationale here is that individuals may choose to voluntarily pay their share, if they perceive that tax money is indeed invested in public welfare and social services. If, on the other hand, they believe that pubic money is not spent efficiently, their own behaviour might indeed be governed just by the enforcement powers of tax authorities. Other models (e.g. Feld and Frey, 2007) view taxpayers’ behaviour as stemming from a “psychological contract” between themselves and the tax authorities. Attention is shifted away from taxpayers acting alone towards the relationship between taxpayers, the government and tax authorities. All are partners in a relationship (either cooperative or antagonistic) and people will behave according to some socially accepted mode of behaviour. In this setting, tax compliance depends on maintaining a good cooperative relationship between authorities and taxpayers that involves reciprocity of commitments and mutual respect, going beyond legal regulations. Yet another approach highlights the fact that taxpayers cannot be perceived as a homogeneous group, and that they rather exhibit great diversity in their behaviour even when they act in the same external environment (Alm, 2012). Such diversity may occur due to different opportunities for cheating, age or simply to individual differences in morality.

The slippery slope framework, proposed by Kirchler (2007) and Kirchler et al. (2008), attempts to synthesize the above approaches taking into account the relationship between taxpayers, the government and the tax authorities, and identifying their interactions as determining factors of taxpayer compliance behaviour. Two dimensions of these interactions are considered of primary importance: (i) trust in government, i.e. the belief that the latter is benevolent and works beneficially for the common good, and (ii) power of tax authorities, i.e. the perception that the latter are capable of detecting and punishing tax crimes. Two types of tax honesty are distinguished: voluntary compliance and enforced compliance. The former depends on the trust that individuals have in the authorities and is influenced by perceptions of fairness and social norms. The latter depends on the power of the tax authorities and is the form of compliance envisaged in the original Allingham and Sandmo model. Tax payments are influenced by the combination of trust and power. In cases where both are at low levels, tax payments are assumed to be low, since tax payers have no motive to comply (other than their personal morality). When trust in authorities increases, so are expected tax payments. Tax payments also increase as tax authorities become more powerful. Tax compliance is assumed to be highest in cases of trustworthy governments which are assisted by a powerful tax authority. The assumptions of the slippery slope framework have been tested in a number of papers using either experiments or surveys of real-world taxpayers with promising results, while very