Fiscal psychology past and present: Contemporary experiments validate historical hypotheses

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Abstract

Fiscal psychology is not a modern discipline. The history of economic thought leaves no doubt as to the fact that many of the notions of fiscal psychology as we know it today were present in the past. There are even cases, though these are not frequent, of economists and social scientists of the past who understood certain psychological aspects of the taxpayer which went out of fashion and of which contemporary fiscal psychology is not aware. Such is the fate of Amilcare Puviani (1854–1907), a marginalist in the tradition of Vilfredo Pareto and an advocate of the study of Italian Public Finance which was in vogue at the end of the 1800s and the early years of the 1900s. We have conducted a number of experiments to verify certain of Puviani’s theories regarding the behaviour of the taxpayer, all of which tested positively. Of particular interest is his concept that a minor tax levied contemporaneously with a heavier tax is better tolerated than if it is levied alone. Another related concept, not yet widely known to contemporary fiscal psychology, is of undoubted interest: a tax when levied under favourable circumstances is more tolerable. Finally, we verified Puviani’s hypothesis that a tax is easier to accept if split into a number of instalments of nominal amounts, and also (but this is applicable only to a certain category of tax payer) that an indirect tax is better supported if it is not specified in the price of the product or service being taxed.

1. When did fiscal psychology come into being?

There are a number of questions that have not received sufficient attention in economic psychology in general and in fiscal psychology in particular. When did fiscal psychology come into being? Has the psychology of the taxpayer been studied prior to modern fiscal psychology? If so, how, by whom? When? What were the findings?

These questions may appear to be banal. At a cursory glance, fiscal psychology would appear to be a modern development, and consequently without any history.

This idea is easily confused; all that is required is a detailed study of the scholars of the past who studied the relationships between the State and the economy. It is a fact that the study of the psychological variables of fiscal behaviour preceded what we commonly define today as fiscal psychology by many years. True, these reflections so distant in time from the present, but no less important for that, were not qualified as psychology and were not labelled as such. Indeed, many of the authors of these reflections were economists.
Take Smith, for example, and his “An Inquiry into the Nature and Causes of the Wealth of Nations” (1776); the Scottish economist dedicated Chapter III of the fifth book of this great work to taxation. He made specific and extensive reference to the taxation of luxury items and laid great importance on the lack of fiscal awareness in the various social classes.

A few years later, Ricardo wrote along much the same lines in “On the Principles of Political Economy and taxation” (1817), remarking on the confusion which reigned in the mind of the taxpayer and the fact that governments certainly did not disdain exploiting these cognitive limitations regarding fiscal issues. In the middle of the 1800s another important economist, Mill (1848, “Principles of Political Economy”, p. 174), was to take up Ricardo’s concepts and develop them further. He concentrated his studies on the reaction of the taxpayer to the various types of taxes and observed that, under the same tax burden outcry and consumption may decrease or even increase with the application of a new tax. The first case usually occurs when a new tax is levied on wealth or consumption (for example on real estate or on alcohol), while an increase in spending may occur when an inheritance tax is applied.

He took a very modern approach to the psychological problem of the greater acceptance of indirect taxes (where the tax burden is ‘concealed’ in the price of the taxed item); he explained that his compatriots could support heavy taxation as long as they were not obliged ‘to look the taxman in the eye’, as this leads to a clear and typical perception of the direct tax.

Cournot (1863, 1877) also took up the subject of how the taxpayer supports the tax burden and his acceptance of governments imposing taxes. This economist, rightly considered a classic pillar of economic thought, was convinced that real fiscal growth has a secular trend. In his view the taxpayer is accustomed to a certain tax burden, and to a degree this numbs him to the distress, but, Cournot warns, this state of mind needs time to consolidate.

Cournot lived and wrote at the time of the marginalist revolution of economic thought. Marginalism had a tormented relationship with psychology; in the early days, the economists of the neoclassic/marginalist paradigm considered psychology a resource to explain economic behaviour. However in the years 1934–1939 Hicks and Allen (1934a, 1934b) and Hicks (1939) reversed this, with a rigid rejection of psychology. Those were the years in which the premises were created for the paradigm of the rational taxpayer, a paradigm that blocked most of the economic thought on the social–psychological component of fiscal behaviour. It was only in the years after World War II, after the studies conducted by Katona and the developments in the field of psychological science that the psychology of the taxpayer came back into vogue. This was the period during which fiscal psychology as we know it today came into being.

Summing up, there can be no question that the history of economic thought has made significant contributions to the study of fiscal psychology. However, there is still an important question to be answered: are there still concepts of interest and novelty to be found in these contributions, or even concepts of importance for modern fiscal psychology? This is not an easy question to answer. An accurate and in-depth study of historical thought is necessary in order to fully comprehend the real reach of these reflections. At a first glance, it would seem that the major part of the results of these contributions has been integrated into modern fiscal psychology; for example, the difference in perception and toleration of direct and indirect taxes which intrigued economists in the past, has been carefully analysed by modern fiscal psychology. It can in fact be said that significant progress in methodology has been made in most of the fiscal subjects dealt with, particularly from an empirical point of view. It follows that very often the interest for psychological studies of taxation before fiscal psychology is purely historical in nature, with regard both to the study of thought and to the indirect study of past forms of taxation and the reconstruction of the history of the reactions of the taxpayer.

There is however at least one very important exception.

2. The historical tradition of fiscal psychology research of Italian Public Finance

The important Italian tradition of research in the field of Public Finance is known to very few outside Italy (and if we are honest, to very few in Italy itself!) and even fewer are aware of its relevance for fiscal psychology. This is to be attributed mainly to the fact that these researchers wrote in Italian, but there is another important barrier. It must be kept in mind that in Italy Public Finance was studied mainly by marginalists of the Paretian school and this line of thought developed and declined (rather rapidly) in the first half of the 1900s, so the study of Italian Public Finance had to face the consequences of the withdrawal of marginalism from psychology just at the time when it could have been at its apex. A few years after Hicks and Allen introduced their theoretical reversal of marginalism in the 1930s, Italian academic economists gradually started to lose interest in the psychological aspects of their subject and so the tradition lost its drive. Having said that, there were several acknowledgements from influential scholars, some at international level, before this interest faded away completely. Particularly worthy of note is James Buchanan, the American economist who won the 1986 Nobel Prize for economics. Just after World War II, he won a Fulbright scholarship to study Italian Public Finance in Italy. It was no coincidence that Buchanan was extremely interested in the psychological aspects of taxation; indeed, he spoke of a ‘fusion’ of psychology and economics applied to fiscality:

Quite apart from the “true” distribution of tax shares and benefit shares, the “perceived” distribution matters. Fiscal perception becomes an important and relevant area for positive analysis. By necessity, “fiscal psychology” merges with fiscal economics. The research potential for positive analysis seems almost unlimited, and relatively little has been done (Buchanan, 1975, p. 390).

Now we will examine the mainstays of these psychological studies, and see which of the teachings have survived.