Empathy, sympathy, and tax compliance

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Abstract

This paper examines the effect of “empathy” and “sympathy” on tax compliance. We run a series of laboratory experiments in which we observe the subjects’ decisions in a series of one-shot Tax Compliance Games presented at once and with no immediate feedback. Importantly, we employ methods to identify subjects’ sympathy, such as the Davis Empathic Concern Scale and questions about frequency of prosocial behaviors; we also use priming in order to promote subjects’ empathy. Our results suggest that the presence of sympathy in most cases encourages more tax compliance. Our results also suggest that priming to elicit empathy also has a positive impact on tax compliance. These results support the inclusion of noneconomic factors in the analysis of tax compliance behavior.

1. Introduction

One intriguing, and largely unexplained, aspect about tax compliance is that most people pay most of their legally due taxes most of the time. Even though there are very strong incentives to evade taxes due to low probabilities of audit and small penalties, taxpayer compliance is typically higher than predicted by the standard Allingham and Sandmo (1972) economic theory of compliance (Alm, McClelland, & Schulze, 1992; Feld & Frey, 2007; Webley, Robben, Elffers & Hessing (1991)). Some researchers have given noneconomic arguments for this compliance behavior. An important factor here is morality. As Eisenhauer (2006) argues, many terms have been used as synonyms for “morality”, including “…ethics, virtue, a conscience, a feeling of guilt over wrongdoing, honesty, altruism, willingness to cooperate, fairness, a sense of duty, and social responsibility”. We consider “morality” to be a set of personal rules that may lead to a feeling of happiness if the individual acts according to these standards of conduct and to a feeling of guilt or embarrassment if the individual acts differently.

As emphasized by Alm and Torgler (2011), it is crucial to consider such ethical dimensions of individuals in order to understand tax compliance. Individuals may have personal moral rules, they may incur psychic costs for not paying taxes and free-riding on the tax payments of others, or they may feel good about themselves for being virtuous and paying taxes. In fact, there is some evidence that morality affects how individuals make decisions generally and tax compliance decisions specifically (Baldry, 1986; Coricelli, Joffily, Montmarquette, & Villeval, 2010; Schwartz & Orleans, 1967). We believe that
morality should be considered when studying tax compliance behavior, especially as a factor that can explain compliance levels that are higher than predicted by standard economic theory.

Of course, morality is a complex issue, and we are not able to cover all of its aspects. Instead, we focus on two moral emotions that have not often been explored in economics, especially in the analysis of tax compliance: sympathy and empathy. “Empathy” is an affective state of “putting yourself in someone else’s shoes”, in which an individual feels the same or a similar emotion as the other person (Batson & Coke, 1981). “Sympathy” is considered an emotional response of sorrow or concern for another’s wellbeing caused by the other’s emotional state, a response that is not identical to the other’s emotion. Many psychologists argue that sympathy and empathy motivate moral behavior and play an important part in morality (Eisenberg, 2000). To our knowledge, there is no evidence on the association of these moral emotions with tax compliance.

We include the concepts of sympathy and empathy in order to examine the effects of morality on tax compliance via an individual’s moral identity. For this, we create a theoretical model including a moral self-perception component that is affected by those two moral emotions, and we analyze theoretically how these influence individual behavior in paying taxes. In order to test the main hypothesis from our theory, we then run a series of laboratory experiments in which we observe the subjects’ decisions in a series of one-shot Tax Compliance Games presented at once and with no immediate feedback. Importantly, we employ methods such as the Davis Empathic Concern Scale and questions about frequency of prosocial behaviors in order to identify subjects’ sympathy. We also use priming in one session in order to promote empathy, in an attempt to examine the impact of moral appeals on tax compliance.

Our results suggest that the presence of sympathy in most cases encourages more tax compliance. Our results also suggest that priming to elicit empathy also has a positive impact on tax compliance. These results support the inclusion of non-economic factors in the analysis of tax compliance behavior.

2. Theoretical framework

The basic theoretical model in nearly all tax compliance analysis begins with the economics-of-crime model of Allingham and Sandmo (1972). An individual taxpayer is assumed to receive an income \( I_i \) that is known to him but not to the tax authority. The taxpayer chooses income to declare \( D_i \), on which he pays taxes at rate \( t \). He does not pay taxes on undeclared income, but he faces a fixed and exogenous probability of audit \( p \), in which case all evaded taxes are detected and fined at rate \( f \), based on the evaded taxes. Defining \( I_{NC} \) (after-tax income if not caught) and \( I_C \) (after-tax income if discovered) as \( I_{NC} = I_i - tD_i \) and \( I_C = I_i - tD_i - f(t(I_i - D_i)) \), the individual is assumed to choose \( D_i \) so as to maximize a von Neumann–Morgenstern expected utility function (where \( E \) is the expectation operator). Or \( EU = (1 - p)U(I_i - tD_i) + pU(I_i - tD_i - f(t(I_i - D_i))) \). Comparative statics analysis is straightforward and (largely) intuitive (Alm, 2012).

This framework has proven enormously useful. Its central result – that compliance depends upon enforcement – is important and insightful. However, this approach (together with its many extensions) also concludes that an individual pays taxes only because of the economic consequences of detection and punishment, and it is clear to many observers that compliance cannot be explained entirely by such purely financial considerations, given the actual levels of audits and fines. Although compliance varies significantly across countries (and across taxes) and is often quite low, compliance seldom falls to a level predicted by the basic Allingham and Sandmo (1972) theory of compliance.

Accordingly, our framework incorporates some notions from this basic economics-of-crime model, but it is also incorporates additional notions that rely on morality. There are many ways of incorporating morality in the tax compliance decision. Gordon (1989) adds an individual’s “honesty characteristic”, which acts as a private psychic cost and which affects evasion negatively. Erard and Feinstein (1994) offer a model with one’s moral sentiments of guilt and shame when evasion is chosen. They find that, when they use their more realistically constrained models, the effects of guilt and shame diminish the extent of tax evasion. Guilt is the most common moral emotion used in research, and in the mathematical formulations of behavior it is often considered a psychic cost, or an emotion that may result from not behaving according to one’s own ideal behavior. According to Akerlof and Kranton (2010), one’s “ideal behavior” may be defined in terms of “exemplary characteristics and behavior associated with a social category”. In this view, individuals in different social categories “should” behave differently.

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1. There are other related and overlapping notions, such as “altruism”, typically interpreted as a concern for others, unconditional upon rewards or punishments. Altruism is often modeled via the inclusion in an individual’s utility function of another agent’s utility or monetary payoff. It should be noted that in our theory (as demonstrated later) an individual does not gain utility from feeling empathy or sympathy and that utility does not depend upon other individuals’ utilities or monetary payoffs. Rather, we assume that an individual’s utility depends on her actual behavior compared to her morally ideal behavior.

2. However, some effort has been done in terms of adding other moral emotions, such as guilt and shame, on theoretical models of tax compliance, as we discuss later. Also, Coricelli et al. (2010) provide an important contribution linking emotions to tax compliance. In their experiment, they measure emotions by skin conductance responses and self-reported questionnaires, and they find that higher emotional arousal (which may be interpreted as feelings of anxiety or guilt based on their study) are positively associated with the probability of evading taxes and the amount evaded. As they state, their “findings also strongly support the importance of tax morale and justify incorporating moral dimensions in the standard models of tax compliance”.

3. In related work, Schwartz and Orleans (1967) and Blumenthal Christian and Simmon (2001) also examine the effect of moral appeals on tax compliance behavior. In each case, they use a field experiment in which a group of taxpayers receive a moral appeal letter before filling their tax returns. Schwartz and Orleans (1967) find that conscience appeals have a greater effect on declared income compared to punishment threats; Blumenthal et al. (2001) find a significant impact for some groups but only a small overall effect. Similarly, McGraw and Scholz (1991) present to a group of taxpayers a video appealing to social responsibility, and find that their moral appeal does not change compliance.
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