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Powerful authorities and trusting citizens: The Slippery Slope Framework and tax compliance in Italy

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ABSTRACT

The Slippery Slope Framework of tax compliance postulates that citizens' compliance depends on the power of the authorities to enforce compliance and/or trust in the authorities and voluntary cooperation. While trust is widely recognized as a strong determinant of cooperation, empirical evidence is less clear on power: severe fines may lead towards compliance or even have the opposite effect. We propose a thorough investigation of the nature of power (coercive versus legitimate) within the theoretical framework of tax compliance to shed light on the ambiguous results and to clarify the complex relation between power and trust. We use structural equation modeling to test the assumptions of the Slippery Slope Framework by taking into account coercive power and legitimate power on a sample of $N = 389$ self-employed Italian taxpayers and entrepreneurs. We found evidence that trust is positively related to voluntary tax compliance. Trust was found to be negatively related to coercive power and positively related to legitimate power. Both coercive power and legitimate power were correlated with enforced compliance. However, the effect of enforced compliance leads to increased evasion. The results evidence the multifaceted nature of power and trust and their relation with tax compliance, and the importance of power and trust in political regulatory strategies.

1. Introduction

The shadow economy and tax non-compliance have increased over the last decades and, thus, gained attention in policy making and research. For example, in Italy the shadow economy and tax evasion have reached an estimated €176 billion in 2010 (http://www.professionefinanza.com/viwe_archivio.php?id=3096. Retrieved 21.05.11). Tax authorities in various countries respond to rising tax crimes with more severe prosecution. In the classic economic approach, frequent and efficient audits and severe fines appear as the most powerful strategies to combat tax crime (Allingham & Sandmo, 1972; Srinivasan, 1973). Assuming that taxpayers behave as rational agents, in the case of tax evasion their decisions to comply depend on the risk of being caught. Despite the straightforward assumptions of the economic theory of crime, it was early recognized that

> *[. . .] a government compliance strategy based only on detection and punishment may well be a reasonable starting point but not a good ending point. Instead what is needed is a multi-faceted approach that emphasizes enforcement, as well as such things as*

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positive rewards from greater tax compliance, the wise use of taxpayer dollars, and the social obligation of paying one's taxes. (Alm, Sanchez, & De Juan, 1995, p. 15).

Kirchler (2007) and Kirchler, Hoelzl, and Wahl (2008) proposed a theoretical concept which integrates the economic assumptions of tax compliance as well as the psychological and sociological determinants. The Slippery Slope Framework starts from the assumption that the interaction climate between the authorities and taxpayers may at the one extreme be antagonistic, and at the other synergistic. Depending on the climate, citizens either need to be enforced to comply or they cooperate voluntarily. Tax compliance is assumed to depend on the power of the authorities and on citizens' trust in the authorities. Audit probability and fines are important to regulate citizens' behavior, but so also are the fairness of the distribution of the tax burden across income groups and participation in public goods, fairness of procedures, and social norms. However, recent empirical evidence shows contradictory results regarding the influence of power and enforced compliance on tax evasion (Wahl, Kastlunger, & Kirchler, 2010). It was argued that to heavy prosecution and coercion leads to increased strategic tax paying behavior. Taxpayers pay if they suspect to be detected but evade as soon as they perceive a possibility of not getting caught. The Slippery Slope Framework differentiates between coercive and legitimate power. From a theoretical point of view power of authorities can be defined as capacity of coercion implementing punishment and prosecution as determinants of tax compliance (theory of crime; Becker, 1968), as well as referring to Tyler (2006) who highlights the importance of legitimate power as correct, legitimized and effective regulation of behavior. This differentiation was discussed by Gangl, Hofmann, Pollai, and Kirchler (2012) who conceptualized the two types of power (coercive and legitimate) in the Slippery Slope Framework referring to French and Raven (1959) and Raven, Schwarzwald, and Koslowsky (1998).

Although, the single relationships between the model variables are well documented, the whole framework misses an explicit empirical model testing. Furthermore, due to inconsistency regarding the impact of power within the model and its relevance for further formalization, the present study investigates the assumptions of the Slippery Slope Framework by a model testing and enriches existing evidence on the framework by differentiating coercive power from legitimate power. In the following sections the Slippery Slope Framework and empirical evidence is presented, followed by a differentiation between coercive and legitimate power. Subsequently, the relevance of Italian taxpayers as a sample of interest is emphasized, and the empirical study is described.

1.1. The Slippery Slope Framework – power and trust

The economic model of tax evasion is based on Becker's theory of crime (1968). Tax paying decisions are pictured as rational decision problems. Taxpayers decide to comply if it does not pay to evade due to the possible audits and fines. This rational view on taxpayers' behavior was praised but also criticized for ignoring factors like fairness and social norms, tax morale, and the relation between taxpayer and tax authorities (Kirchler, 2007). The Slippery Slope Framework starts with economic assumptions on tax compliance and integrates the psychological and sociological perspectives of taxpayers' cooperation. According to the framework, to achieve cooperation within a society, two different paths are possible. The first path stresses the authorities' power to regulate citizens' behavior. Tax compliance is enhanced by external incentives, predominantly by audits and fines. The second path stresses taxpayers' and the authorities' interaction style, mutual trust, and commitment to the society in which they live. Trust is defined as a relational variable providing the base for voluntary cooperation. If trust is high, taxpayers perceive a duty in fulfilling societal needs.

Both approaches promise high tax contributions, either by exerting power or by strengthening trust. Taxpayers' behavior outcomes might be similar – in both cases they pay their share – however, the underlying quality of tax compliance differs. In the first case compliance is enforced; in the second case it is voluntary. Voluntary compliance is desirable as it neither pushes citizens into the roles of opponents of authority nor requires costly measures of control.

Empirical investigation of the assumptions of the Slippery Slope Framework started only recently. A first empirical test by Wahl et al. (2010) adopted an experimental approach using the scenario technique. A fictitious country was presented with tax authorities having high or low power over citizens and citizens trusting or distrusting the authorities. High power and high trust led to higher tax payments and the underlying motives were "commitment" in the case of high trust and "resistance" in the case of high power (Braithwaite, 2003). Further confirmation of the framework was reported by Kirchler and Wahl (2010) and Muehlbacher and Kirchler (2010; see also Kirchler, Muehlbacher, Kastlunger, & Wahl, 2010). Van Dijke and Verboon (2010) investigated the moderating effect of trust on the relation between fairness and voluntary compliance and found that trust is crucial when the authorities focus on fairness to increase voluntary compliance. An econometric formalization of the framework was recently proposed by Prinz, Muehlbacher, and Kirchler (2010), and by Lisi (2011) who extended it in the light of the benchmark macroeconomic model of the labor market.

Although empirical studies confirm the relevance of power and trust, these two dimensions are not independent but in complex interaction. On the one hand, power can fuel trust, while on the other it can also corrupt trust. In an antagonistic climate with the authorities not being trusted, power may be most effective in increasing compliance. However, in a synergistic climate of cooperation, power may either not provide any surplus or even have the opposite than intended effect by crowding out trust (Feld & Frey, 2002a, 2002b). Verboon and van Dijke (2011), however, found severe sanctions to be more effective in enhancing compliance than mild sanctions only when procedural fairness (a key-determinant of trust) was perceived to be high. These ambiguous findings show a need for a theoretical clarification of power and a thorough analysis of the effects of different types of power.