



## Happiness and tax morale: An empirical analysis<sup>☆</sup>

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### ABSTRACT

This paper presents empirical evidence that “tax morale” – taxpayers’ intrinsic motivation to pay taxes – constitutes a new determinant of happiness, even after controlling for several demographic and socioeconomic factors. Using data on Italian households for 2004, we assess the strength of tax morale by relying on single items as well as composite multi-item indices. Our main result that fiscal honesty generates a higher hedonic payoff than cheating is in line with Harbaugh et al. (2007)’s neuroeconomic finding. Further, it sheds light on the well-known “puzzle of compliance”, that is the fact that many individuals pay taxes even when expected penalty and audit probability are extremely low: tax compliance is less puzzling once we show that not only it is materially costly, but also provides sizeable non-pecuniary benefits that make it rewarding in itself.

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## 1. Introduction

It is hardly deniable that investigating morality is important for economics. As Harsanyi (1980) points out, a relevant branch of economic theory such as welfare economics can be seen as an endeavor to understand how to apply certain moral principles (i.e. Pareto-optimality, distributive justice and individual freedom) to economic activities. As to political economy, Tabellini (2008) observes that morality – viewed as conceptions of what is right or wrong, and of how one ought to behave in specific circumstances – is bound to exert a strong influence on voters’ demands and expectations, on citizens’ participation in group activities, on the extent of moral hazard inside public organizations and on the willingness of individuals to provide public goods. His empirical analysis indicates that values consistent with generalized morality are widespread in societies with well-functioning institutions and instrumental variable estimation suggests a causal effect from values to institutional outcomes. However, despite the relevance of personal values and attitudes towards public issues, economists so far have mainly neglected their potential impact on individual happiness (or subjective well-being).<sup>1</sup>

Our paper extends this area of research by making a first attempt to study a new potential determinant of self-reported happiness within developed economies: people’s fiscal morality. Our focus is on an economically relevant form of morality such as individuals’ moral attitude towards taxation – the so called *tax morale*. To our knowledge, the impact of the extent

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<sup>1</sup> Even though we are aware that the two notions are not conceptually identical, we use the terms ‘happiness’ and ‘subjective well-being’ interchangeably.

and variety of tax morale on happiness has never been empirically tested, so far. We do this by addressing the following questions: do people differ in their moral attitude towards taxation? What are the main determinants of their tax morale? Do public-spirited individuals experience different happiness levels, compared to less morally concerned ones? As we will show in the next sections, the dataset we use allows us to operationalize different moral attitudes towards taxation, identify the main variables affecting citizens' moral attitudes and subsequently assess their happiness levels. Our main finding that individuals with higher levels of tax morale are also significantly happier is in line with the well-known neuroeconomic experiment on taxation run by Harbaugh et al. (2007), where even mandatory, tax-like transfers to a charity elicit neural activity in areas related to reward processing.

This paper lies at the crossroads of two lines of research. One is the economics of happiness literature. Fiscal morality is to be added to a growing list of non-pecuniary determinants of happiness such as political participation (Frey and Stutzer, 2000), volunteering (Thoits and Hewitt, 2001), marriage (Stutzer and Frey, 2006), relational goods (Bruni and Stanca, 2008) and religiosity (Clark and Lelkes, 2009). Moreover, a positive and strong correlation between happiness and tax morale allows us to gain further insights on the so called "hedonistic paradox", stating that *homo economicus*, who seeks happiness for himself, will not find it, while the person who helps others will.

The second line of research is the literature on tax compliance and in particular the studies focusing on the relationship between tax morale and tax compliance (see, among others, Andreoni et al., 1998). In the last years, several empirical studies have shown that taxpayers are more honest than classic deterrence models inspired by the economics of crime approach would predict (see, e.g., Allingham and Sandmo, 1972). But why are many people willing to pay taxes even when penalties and audit probability are extremely low? Recent work in the area suggests that individuals' tax morale may provide the "missing link" that makes it possible to bridge the gap between theory and data and finally contribute to solve the so called "puzzle of compliance". The rationale behind the relationship between tax morale and tax compliance is that insofar as citizens are driven by a positive moral attitude towards taxation (i.e. a high degree of tax morale), the level of compliance – other things being equal – will turn out to be higher.

However, even though this argument is intuitively appealing, it is important to note that, on empirical grounds, the current emphasis on tax morale and its supposed relevance for the economics of tax compliance is misplaced unless a positive correlation between tax morale and tax compliance can be established. In his survey, Halla (2010a) observes that in the last years, several studies, by means of both direct and indirect approaches, document a positive relationships between tax morale and tax compliance. The direct approach mainly relies on evidence from laboratory experiments which allow researchers to obtain from a single sample not only behavioral data on tax compliance (from the experiment itself) but also self-reported data on tax morale (from post-experiment questionnaires) as, for instance, in Torgler et al. (2007). A first limitation of this approach is that it needs to be carefully checked whether the answers in the questionnaire are independent from the behavior in the experiment. A second drawback has to do with the artificial nature of the environment in which the data are generated: even though such experiments are typically run by using non-neutral, tax language to make the setting more realistic, it is not possible to rule out that subjects would behave differently when dealing with real tax authorities, rather than with experimenters. Hence, the importance of integrating data from laboratory experiments with evidence from other environments. In an artefactual field experiment, Cummings et al. (2009) were able to provide further support for the hypothesis that tax morale exerts a positive impact on tax compliance.

A different (indirect) approach, by working at a more aggregate level, looks at tax evasion estimates for a large set of countries and years and match them with country-averages of tax morale from international surveys. A series of recent papers report a negative correlation between average levels of tax morale and the size of the shadow economy in Latin America, the U.S. and Europe, and in several transition countries (see the survey by Halla, 2010a). In the last years some papers based on this indirect approach took a step further and directly dealt with the causality issue, addressing then the identification problem and suggesting an instrumental variable approach to disentangle a causal effect (Halla, 2010b; Torgler and Schneider, 2009). They find a statistically significant negative effect of tax morale on the size of the shadow economy. To sum up, despite the fact that each approach has strengths and weaknesses, the methodologies described above send a convergent message about the connection under study.

Even though a significant relationship between tax morale and tax compliance can be established, so far the notion of tax morale has often been treated as a black box, "without discussing or even considering how it might arise or how it might be maintained. It is usually perceived as being part of the meta-preferences of taxpayers and used as the residuum in the analysis capturing unknown influences to tax evasion. The more interesting question then is which factors shape the emergence and maintenance of tax morale" (Feld and Frey, 2002). Our main result – virtuous taxpayers reporting higher happiness levels than less virtuous ones – helps shedding light on the concept of tax morale and contributes to our understanding of why the levels of compliance are generally higher than the standard theory predicts. Insofar as we concentrate on the key relationship between tax compliance and tax morale and morally concerned people experience a high degree of subjective well-being, a relatively high level of compliance turns out to be far less paradoxical than it seems to be at first glance: it can be plausibly argued that an important reason why people comply with their fiscal duties is that they perceive the act of paying taxes as rewarding in itself.

Using a dataset on Italian taxpayers' opinions on civicness and taxation, we carry out an empirical analysis on tax morale and its relationship with happiness that sheds light on a crucial issue within a distinct and relevant area of research such as the economics of tax compliance. As anticipated above, our main finding is that virtuous taxpayers are significantly happier than less virtuous ones, even if a long list demographic and socioeconomic factors is controlled for, and a number of

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