

approach and finds evidence in simulations for a weakly countercyclical underground sector. Finally, *Kari Takala* and *Matti Viren* deal with the underground economy in Finland and ask why respective large sizes of the underground economy, obtained from macro methods, do not show up in administrative inspections. Concerning Finland, the authors find that high estimates of the size of the underground or shadow economy are based on very shaky grounds. Consequently, they call for caution in using such figures for economic policy and legislation.

We hope that this special issue will stimulate further research in this area, with valuable new insights for these relevant topics of economic and fiscal policy.

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Combining Psychology and Economics in the Analysis of Compliance: From Enforcement to Cooperation¹

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Abstract: In tax compliance research, there has been a significant shift in research paradigms, from an emphasis on enforcement to approaches that stress cooperation. In this paper, we trace this shift. We first describe the major “actors” in the tax compliance game and their complex interactions. Second, we examine various perspectives on the compliance decisions of individuals, starting with “economic” factors and then moving to factors based more on “psychology”, like social norms, fairness, and social interactions. Third, we present the “slippery slope framework” as a unifying framework. We conclude with recommendations based on this framework that have been shown to improve compliance.

I. INTRODUCTION

Governments have been collecting taxes for thousands of years. With impressive resourcefulness, politicians and their tax administrators have been taxing their citizens with many creative instruments, and these citizens – often selfishly motivated, recalcitrant, and unwilling both to understand the political rhetoric and to pay their legally due liabilities – typically stop at next to nothing in their efforts to hide their income from the public treasury.

Taxes may be “legal theft”, as Thomas Aquinas (1225–1274) is reported to have said in the Middle Ages. Indeed, Sloterdijk (2010) concludes in “The Grasping Hand” that the current fiscal system has degraded to an ignoble relic of the late absolutist state kleptocracy. As noted by Sloterdijk (2010), the worries of Queen Victoria from long ago now appear almost heart-warming in the current environment. Upon the introduction of an income tax of 5 percent in 1850, she expressed the concern that the measure might have gone “too far”.

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No one likes paying taxes, especially when the authorities collect them coercively. However, is it not sensible for citizens to invest part of their income in public goods like health care, education, cultural institutions, research and innovation, roads and infrastructure, and public security – all of which contribute to the common good of the country? There is scarcely any doubt about the value of all of these public goods that are financed by taxation. However, there is certainly considerable doubt about whether the tax budget is administered frugally and for the general welfare, whether the projects favored by policymakers are also desired by the taxpayers, whether one's own tax burden (and one's own receipt of public goods) is "fair" relative to those of other individuals, and whether it might not be worth withholding one's own contribution while the overwhelming majority of the productive society pays their legally prescribed contribution.

Even if the state is accepted as a paternalistic albeit an authoritarian tax collector, even if taxes seem legally justified, and even if public expenditures are valued, there remains the question of whether one should pay one's legally due tax liabilities. If taxpayers are assumed to be rational, outcome-oriented, self-controlled, selfish, and egoistic individuals who maximize utility without concern for others, we arrive unavoidably at the conclusion that payments are not made voluntarily but are only paid when taxpayers are subject to legal coercion. This view is the point of departure for most of economic analyses of tax behavior. Based on this view, strategies to secure tax honesty have been developed and used by the authorities. However, the success promised in theory by these strategies remains elusive.

Indeed, the decision to pay taxes in compliance with the law is a complex one, and it has become increasingly recognized that taxpayer behavior cannot be explained solely by purely economic considerations. Here research continues to evolve. Even so, one trend seems clear: In the 1970s, the focus was primarily on "economic" factors, especially the deterrent effect of negative sanctions. More recently attempts to explain the behavior of individuals have incorporated a range of alternative perspectives, many of which have as their starting point various factors from "psychology" and which fall under the general name "behavioral economics". As a result, there is currently a much more nuanced view of taxpayers that is gaining ground. This view acknowledges the existence of an intrinsic motivation to cooperate, and it also recognizes that there is a danger in measures that run along the lines of "trust is good, control is better." In addition, the focus on taxpayers has been expanded to include all actors in the system. It is now becoming an accepted consensus that the interactive climate among all actors in a society is decisive for whether individual gain is maximized or cooperation takes place.

This paper surveys these developments. We first describe the major "actors" in the tax compliance game and their complex interactions: taxpayers, elected government officials, appointed tax authorities (or the tax administration), and tax accountants. Second, we examine various perspectives on what determines the compliance decisions of taxpayers. We start with "economic" factors that are based on tax compliance as an individual decision under risk. We then move to factors that emphasize the role of the group and the interactions between the various actors, that recognize differences across taxpayers, and, especially, that are based more on "psychology" than on "economics". Indeed, over the past few decades the view of taxpayers has shifted from one in which an authoritarian government and its tax authority force citizens to pay their taxes under the threat of punishment, to a view in which both elected and appointed

authorities provide the necessary services to enable compliance, and even more recently to a view of authorities and citizens cooperating with one another. Third, we present the "slippery slope framework" as a way of integrating all of these economic and psychological aspects into a unified framework. We conclude with recommendations that can improve compliance, based on this unifying framework.

In the process, we attempt to provide answers to a range of essential questions. Who are the agents that interact with one another? How are decisions taken under risk? What factors beyond purely financial considerations motivate compliance? Under what conditions do individuals cooperate in a social dilemma? What characteristics differentiate taxpayers from one another, in order to understand the various modes of behavior and to promote cooperation? How can a psychological contract between citizens and authorities be conceived? What requirements are needed to promote the intrinsic motivation to cooperate and to stabilize it? How can the interaction climate in a state be described and improved? And what policy implications emerge from answers to these questions?

II. "ACTORS IN THE FIELD"

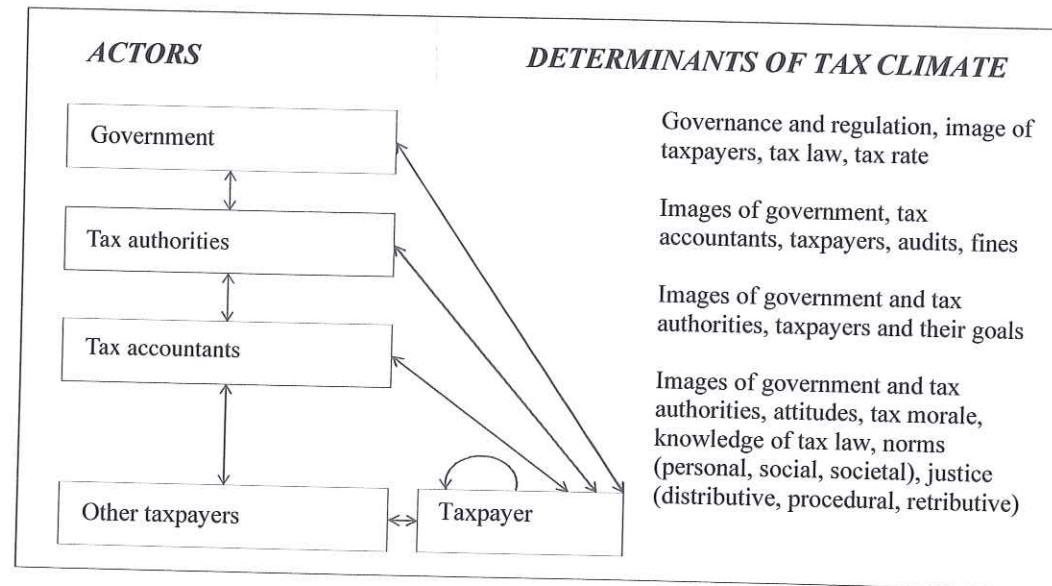
In the arena of tax collection and tax payment, various actors are involved who interact with one another in ways that depend on the climate of interaction. These actors include "taxpayers", elected government officials (or "government"), appointed "tax authorities" (e.g., the tax administration), and "tax accountants". *Figure 1* shows these actors and their paths of interaction. For example, when the politically responsible government officials legislate, their ideas about tax rates and the acceptance of the paying class are relevant. Tax authorities act under a state mandate, and their actions are based on concepts and judgments about the government, tax accountants, and taxpayers. In turn, tax accountants direct their efforts according to their own conceptions of the tax authorities and taxpayers alike. Finally, taxpayers' cooperation depends on their conceptions and judgments about the government, authorities, tax accountants, and the activities of other taxpayers; the behavior of a taxpayer is also dependent on the individual's own values, personal norms, other personality characteristics, and situational factors. Consider each of these actors in more detail.

The authority to tax lies in the hands of the state, or the government. Here, the executive and the legislature draft and enact the relevant laws (with the tax authorities responsible for enforcement of the laws). However, there is the question of how the limitation of the rights and the imposition of duties are reflected upon in the choice of these laws, and also of how clearly and comprehensibly the laws are formulated and communicated. Undoubtedly, legislation in many modern states suffers from an excessive burden of rules and exceptions, and also from language that is almost impossible for the general public to understand. This creates room for the subjective interpretation of duties, and often makes the negotiations over the actual contributions owed into something of a horse trade, while at the same time obfuscating the sense of right and wrong even for the conscientious citizen. Three decades ago, Lewis (1982) calculated that a reading age of about 13 was necessary to understand legal texts in England and the United States, and 17 was the age in Australia. The population on average reaches a reading age of 9. Over the course of the past decades, the complexity of legal texts has if

anything increased. In the U.S., tax law has grown from 200,000 words in 1955 to just over a million in 2000 (Owens and Hamilton 2004).

Thus, the debate is shifting from reformulating the specific, complex rules that often lead to ambiguity, to establishing general principles as guidelines for tax behavior. Instead of a jungle of rules, Braithwaite (2005) suggests that principles of behavior be formulated that clarify what the law actually intends. In contrast to principles of behavior, a body of rules, however dense it might be, offers loopholes for inventive minds to act according to the letter of the law but not according to its spirit, thus minimizing their tax burdens in a fully legal manner (or "tax avoidance").

Figure 1: Structuring the Field: Actors and the Determinants of Tax Climate



A special focus needs to be placed on the *tax authorities*, for they are the ones who maintain direct contact with taxpayers, offer services, implement controls, and impose punishments. Depending on their view of humanity in general and of taxpayers in particular, tax authorities often approach taxpayers either as selfish and non-cooperative maximizers, or as sovereign citizens with a clear understanding of the advantages of taxation for ensuring the general welfare, delegating power to the authorities to ensure both cooperation among citizens and investment of public revenue for the benefit of the community.

As for tax accountants, it is often assumed that the goal of their clients is to exhaust all available means to reduce their tax load. However, Sakurai and Braithwaite (2003) have established that taxpayers actually expect accountants to fill out their tax declarations correctly and that they seek to diminish their concern about controls on the part of the fiscal authorities and mistakes in the tax declaration by paying their taxes properly.

Until now, *taxpayers* have been the center of attention in tax compliance research. As noted earlier, the original perspective on taxpayer behavior was that taxpayers are rational, outcome-oriented, self-controlled, selfish, and egoistic individuals who strive to maximize their own

gains. More recently, it has become recognized that the compliance decision is considerably more complicated. As summarized by Alm (2012), many studies demonstrate that the willingness to pay taxes increases with a greater awareness of tax laws and an improving clarity about the rules. It has also been shown that social norms are strong regulatives of behavior, that citizens generally have a pronounced sense of justice, and that they respond accordingly to the violation of the principles of justice. Further, the motivations for cooperation or evasion vary among taxpayers: a large part of the population acknowledges the necessity and the advantages of taxes, but this sense of community responsibility is clearly not shared by all.

Different strategies are needed to address this "full house" of behaviors (Alm 2012). The "black sheep" cannot be efficiently dealt with only using the sweet "carrot" of incentives, but rather need to be confronted with the "stick" of enforcement, insuring that the readiness of the many to cooperate is not taken advantage of by the selfishness of the few. For others, the stick of enforcement may not be necessary, and indeed may crowd out an intrinsic motivation to pay taxes.

Table 1 summarizes determinants of tax compliance that have been suggested by research. Besides economic factors, psychological factors also undoubtedly affect tax behavior. It is all of these determinants that are discussed in detail next.

III. CHANGING RESEARCH PERSPECTIVES: EVOLVING THEORIES ON WHY PEOPLE PAY TAXES

In this section we trace the evolution of thinking on tax compliance. Our discussion examines several different perspectives on individual decisions, starting from the view that tax evasion can be viewed like any other criminal behavior. We then expand this perspective to incorporate other, more realistic considerations. In the following section, we intergrate these different approaches into a single unified framework.

3.1 As an Individual Decision under Risk

Economists have long pointed to the significance of taxpayers' attitudes toward the state, the government, and taxes in order to explain tax behavior (Veit 1927, Schmolders 1959). However, the real breakthrough in tax research took place when scholars looked at the compliance decision as an individual decision taken under risk. In this framework, a taxpayer decides either to declare taxes honestly, or to choose the risky option of engaging in tax fraud. If no tax audit takes place, an individual choosing to evade has a higher income than an honest counterpart. However, with some probability of audit an individual may be caught, at which point all undeclared taxes are discovered, the undeclared tax debt must be paid, and a fine must also be paid. In this case, the tax offender ultimately has less money at his disposal than if he had made an honest declaration.

This economics-of-crime perspective came originally from Becker (1968), who formulated a general economic theory of criminal behavior. The central insight from his theory is that state-legitimated punishments have a significant deterrent effect, if crimes are discovered and punished. Allingham and Sandmo (1972) first applied this general economic theory to the specific case of tax evasion. Like Becker (1968), their work demonstrated that honesty

Table 1: Economic and Psychological Determinants of Tax Compliance

Perspective	Conclusions from Research
<i>Economic Determinants</i>	
Frequency of Audit	A higher probability encourages compliance, and a subjective probability appears to have more impact on compliance than an objective probability.
Fine	A higher fine has some deterrent effect.
Marginal Tax Rate	A higher marginal tax rate has an ambiguous effect on compliance.
Income	A higher income has an ambiguous effect on compliance.
Opportunity to Avoid or to Evade Taxes	The self employed with ample opportunities to evade are likely to be less compliant than taxpayers with more limited opportunities.
<i>Psychological Determinants</i>	
Complexity of Tax Law	Tax laws are too complicated and compliance is thus difficult, even if desired.
Attitudes	Attitudes are often treated as the source of tax morale.
Personal Norms	Internalized values (i.e., the personal tendency to obey laws) affect compliance.
Social Norms	The norms and values in a social setting affect compliance.
Societal Norms	The norms and values of a society as a whole affect compliance.
Distributive Justice	Compliance is affected by horizontal equity (i.e., an individual's tax burden relative to others with equal income), vertical equity (i.e., an individual's tax burden relative to those with more or less ability to pay), and exchange fairness (i.e., an individual's tax burden relative to the receipt of public goods financed by tax revenues).
Procedural Justice	The fairness of the procedures for making tax-relevant decisions (e.g., having a voice in policy making, transparency, consistency, neutrality, fairness of interaction between authorities and taxpayers) affects compliance.
Retributive Justice	The fairness of the form and severity of the punishment imposed on tax offenders affects compliance.

increases with the audit probability and the level of fines. The impacts on taxpayer compliance of other economic factors like income and marginal tax rates were ambiguous.

Much subsequent work has attempted to determine the effects of these economic variables, using surveys, field data, and laboratory experiments. While the deterrent effects of audits and sanctions have often been shown in lab experiments, even in the artificial laboratory situation – where morality plays a subordinate role – their influence is often less than expected. Other variables also often have mixed effects. Kirchler, Muehlbacher, Kastlunger, and Wahl (2010) summarize the results of these various studies on the effects of audits, fines, marginal tax rates, and income effects. As they discuss, audits and fines seem to have a clear deterrent effect,

albeit only slight, and the audit probability seems to be more salient than the fine rate. The results are inconclusive when it comes to tax rates and income.

These many studies demonstrate that identifying the effects of economic variables on compliance remains a difficult task, even for variables like audit and fine rates where the theory at least is clearcut.

For example, Andreoni, Erard, and Feinstein (1998) conclude in their survey of the compliance literature that audits have little specific deterrent value, and they speculate that this may occur because audits may not turn out as badly as feared or that taxpayers may not find audits to be a negative experience. These considerations suggest that factors beyond narrow economic considerations may well influence individual behavior, factors that begin to incorporate psychology in the individual calculus.

Similarly, audits and fines may not have a long-lasting effect. Guala and Mittone (2005) study tax behavior in laboratory experiments by simulating tax filings over a “60-period taxpaying life span”, and find a strong decrease in taxpayers’ compliance immediately after an audit. This finding, which they called the “bomb crater effect”, has proved quite robust in various experimental studies (e.g., Kastlunger, Kirchler, Mittone, and Pitters 2009, Kirchler, Maciejovsky, and Schwarzenberger 2005). It seems that after audits taxpayers consider themselves safe from another one, so that they think tactically and tend towards risky behavior. Only with repeated rounds do they begin to suspect that audit likelihood is again increasing and return to a more cautious behavior. It may also be the case that those taxpayers who were punished due to incorrect tax declarations may strive to regain the lost money in future filing periods.

These weak results on audit and fine rates may also be due to other factors. Audits and penalties may be perceived by individuals as signaling a lack of trust, thereby contributing to mistrust on the part of the taxpayer and promoting deliberate decision making in which selfish cost considerations dominate behavior. Such decision making can also lead to crowding out the intrinsic motivation to cooperate and undermining the spontaneous willingness to comply. Punishments that are seen as disproportionate and inappropriate may lead to negative attitudes about the authorities in general and taxes in particular. In a study with Austrian taxpayers, Kirchler and Muehlbacher (2008) find that 86 percent of respondents said that they consider a fine to be a fair sanction for tax evasion, while they consider a prison sentence inappropriate. The respondents also said that the ability of the offender to pay would have to be considered for punishments to have a significant deterrent effect.

Overall, the focus of studies on tax behavior as a decision under risk is clearly placed on the individual taxpayer. The perspective of both government and the tax authorities is highly authoritarian, shaped by the presumption that coercive power is necessary to prevent the individual from cheating. However, looking again at *Figure 1*, the interaction dynamics of government, tax authorities, tax accountants, and taxpayers (including the psychological and social aspects of these interactions) are relevant to the compliance decisions of an individual taxpayer, and these dynamics are completely omitted.

More generally, then, this perspective of tax compliance as an individual decision under risk gives the sensible result that compliance depends upon enforcement. Indeed, this approach concludes that an individual pays taxes only because of the fear detection and punishment.

However, it is clear to many observers that compliance cannot be explained entirely by such purely financial considerations, especially those generated by the level of enforcement. If such factors were the only considerations, individuals (especially those whose incomes are not subject to third-party sources of information) should report virtually no income. This type of behavior is seldom if ever seen. This limitation has led researchers to expand the basic model to incorporate other relevant factors, often based on psychology. We now discuss these other factors.

3.2 The "Social Contribution Dilemma"

The image of individuals as purely rational, outcome-oriented, self-controlled, selfish, and egoistic individuals who strive to maximize their own gains is a sobering, even a depressing, one. After all, public goods financed from tax revenues benefit both the individual and the community. Taxpayers often acknowledge that their contributions are used for the community welfare, and they understand that taxes need to be paid. However, they may sometimes doubt that tax revenues are spent efficiently for the public good. They may also suspect that some individuals do not pay taxes.

In short, taxes raise a "social contribution dilemma", in which individual gain runs contrary to the collective good. As discussed by Dawes (1980), this is a situation in which individual interests are opposed to the goals of the community. More precisely, an individual can benefit by acting selfishly; however, if the majority of individuals behave in a similar way, the collective and ultimately the individual are both harmed because the financing of public goods is not secured.

This "free-rider problem" has been extensively investigated in laboratory experiments. Typically, the participants are given startup capital from which they can contribute a freely chosen portion (from everything to nothing at all) to a collective account. The experimental investigator promises to increase the total sum contributed by some multiple (e.g., doubling), and then pay this multiple in equal amounts to all participants. If all players contribute their entire capital, they each receive the doubled amount in return. However, each individual can pay nothing, hoping that the other players will contribute their appropriate amounts. Those who do not cooperate will hold on to their starting capital, and will receive in addition a payment from the community account. If all players are uncooperative, then nothing can be paid from the collective account, and all are left only with the startup capital, which is significantly less than when all cooperate.

Under what conditions do individuals cooperate in these public contribution scenarios?

There is little reason to doubt the promise of the investigator that the collective sum will in fact be multiplied and paid in equal shares to the participants. However, whether the players can be trusted is more in question. If it is possible to make cooperation a binding social norm so that others can be trusted, then the cooperation of the majority is assured. In small groups where the players can communicate with one another, set the rules of the game, and make defection public information, the readiness to cooperate increases.

In fact, parallels between experimental results and tax contributions can be seen from regionally limited areas with direct democracy. For example, the cantons of eastern Switzerland approach the highest level of the scale of tax honesty and the lowest in terms of an underground

economy (Frey 1994, Feld and Matsusaka 2003). Also, Rothstein (2000) writes about an encounter with a Russian tax official who argued that most Russians do not want to pay taxes because, although they cherish the public goods financed by taxes, they believe that the government has high corruption and that there are lax social norms for others to cooperate. Two conditions for cooperation by Russians seem necessary: taxpayers need to trust that other taxpayers are paying their share, and tax authorities have to ensure that the money is invested in public welfare (rather than filling the pockets of government bureaucrats). In other words, *interpersonal* trust leading to binding social norms and *institutional* trust leading to faith in the appropriate use of taxes are of paramount importance for ensuring cooperation.

Despite these insights, social dilemma research still largely assumes that the individual is rational and selfish, striving to maximize his own gains, even though taxpayer interactions with other taxpayers via the group are now recognized. However, other types of interactions are not considered, and the behavior of the other actors is largely kept behind the veil. Looking again at *Figure 1*, the government, the authorities, and tax accountants are left out of the analysis. Also, much of the social dilemma research continues to view all individuals as the same, just as in the standard economic model of behavior. The next strand of research focuses largely on this latter omission.

3.3 Differences across Taxpayers

It has become increasingly clear that taxpayers cannot all be lumped together as a single homogeneous group. As emphasized by Alm (2012), people exhibit a remarkable diversity in their behavior. There are individuals who always cheat and those who always comply, some who behave as if they view the compliance decision entirely as a decision made under risk, others who seem to misperceive the "true" probability of audit, individuals who respond in different ways to changes in their tax burden, some who are at times cooperative and at other times free-riders, and many who seem to be influenced by the social context in which decisions are made. People have developed different personal values, they sometimes prove generous when there are calls for donations for the socially disadvantaged or those affected by catastrophes, and they often have a decided sense of community. These differences must be recognized in explaining behavior.

For example, that individuals differ in their "morality" was shown by Pruckner and Sausgruber (2008) in a natural field experiment on honesty in newspaper purchasing. In Austria, newspapers are often sold by an honor system, where customers are theoretically required to pay but can also pay less than the requested amount or nothing at all. Newspapers are placed in plastic bags attached to street lanterns outfitted with a cashbox, and customers are asked to deposit the appropriate amount in the cashbox. Pruckner and Sausgruber (2008) found that approximately one-third of the observed customers paid at least part of the price, whereas two-thirds did not pay anything at all. However, they also found that cooperation (e.g., payment) increased significantly when a message was placed on the plastic bag appealing to internalized norms of honesty by thanking customers for being honest; a statement that stealing is illegal had no effect.

Also, opportunity makes the thief, and individuals differ in these opportunities. The self-employed in particular are considered to be a high-risk group. While employees of firms usually

have their taxes directly deducted from their salary by their employer and thus hardly have an opportunity to cheat, the self-employed are required to pay on their own various taxes like the individual income tax, the value-added tax, social insurance contributions, and the like. Who would not take advantage of the opportunity to cheat, especially given the often low risk of detection and punishment?

Relatedly, those who must make an explicit and conscious decision to make payments may see their taxes as a loss, and there is much evidence that individuals react to the perception of a loss by taking risks in the hope of making up that loss, as originally suggested by Kahneman and Tversky (1979). Kirchler, Maciejovsky, and Weber (2005) have shown that "out-of-pocket" payments are seen by many as a loss and that the tendency to evade payment of taxes on these payments is large. This behavior is especially likely when tax prepayments during a work year are less than the tax amount actually due and a payment in arrears is required. When the prepayments are higher than the actual tax contribution required and a refund can be expected, the willingness to take risks changes to an aversion to risk, and tax honesty increases.

Even so, the general view that all self-employed are unwilling to pay their taxes is false (Kirchler, Maciejovsky, and Weber 2005). This perception might apply to the self-employed in their young years, but their tendency towards tax evasion lessens with increasing work experience. The tendency for older self-employed individuals to be more honest than younger ones may be attributed to a change in values across the generations. It may also be attributed to different "mental accounting" of young versus old self-employed.

The work of Braithwaite (2009) also shows that taxpayers differ strongly in terms of their motivation to comply with tax law. She distinguishes five motivational postures. She terms two positive motivational postures "commitment" and "capitulation", both of which combine views that express a responsibility to behave in the interest of society and to cooperate. Her remaining three postures express a negative motivation. "Resistant taxpayers" doubt the good intentions of the tax authorities and the government, and they fight for their rights and against their tax burden. "Disengaged taxpayers" are characterized by a similar attitude, but they have already abandoned the struggle for their own rights and see no point in cooperating with the authorities. "Game players" are individuals who do not respect the law as such, but see it as something that can be used cleverly to one's own advantage via, say, gray areas in legislation that can be used to lower individual tax burden without scruple.

For the most part, Braithwaite (2009) attributes a positive basic attitude to the majority of taxpayers: many feel morally committed to contribute to society. Because she believes that positive motivational postures dominate in society, she argues that they should not be destroyed by harsh controls and severe sanctions. She thus argues for a differential approach to regulation on the part of the authorities, in which taxpayers should be treated according to their motivation and in which violations of the law should be sanctioned accordingly. Taxpayers should not be seen as supplicants before the government and the tax authorities, but rather as clients seeking services. Only when individuals repeatedly violate the law should the government and the tax authorities resort to "an iron fist in a velvet glove".

The differential approach of Braithwaite (2009) therefore focuses on distinctions among taxpayers. Age, gender, personal values, motivational tendencies, situational differences, and the opportunity to cheat all emerge as important factors in explaining compliance. Taxpayers

are not seen as an anonymous mass with a single dominating motivation for behavior, but rather are distinguished – or segmented – into various types, all of which require different approaches on the part of tax authorities. Referring again to *Figure 1*, in this tradition the authority of the tax authorities is not questioned, but even so a service orientation of the tax authorities is demanded and differential approaches to taxpayers are imperative. There is no single dominant, successful strategy of ensuring compliance. Rather, measures are required that respond to taxpayers' individual characteristics and situational circumstances.

3.4 The "Psychological Contract" and Social Interactions

A related and more recent research approach recognizes that individuals react to negative stimuli such as controls and sanctions, but that they also have what might be termed a "social norm" of behavior that affects their decisions (Elster 1989). This perspective places social interactions at the center of attempts to explain behavior.

Although difficult to define precisely, a social norm can be distinguished by the feature that it is process-oriented, unlike the outcome-orientation of individual rationality. A social norm therefore represents a pattern of behavior that is judged in a similar way by others and that is sustained in part by social approval or disapproval. Consequently, if others behave according to some socially accepted mode of behavior, then the individual will behave appropriately; if others do not so behave, then the individual will respond in kind. The presence of a social norm is also consistent with a range of other approaches, including those that rely upon social customs, intrinsic motivation, tax morale, appeals to patriotism or conscience, or feelings of altruism, morality, guilt, and alienation. This factor suggests that an individual will comply as long as he or she believes that compliance is the social norm (however defined); conversely, if non-compliance becomes pervasive, then the social norm of compliance disappears. More broadly, a social norm suggests that the nature of one's social interactions with others affects one's own compliance decision.

For example, the notion of a social norm of compliance is closely related to the "intrinsic motivation" to cooperate and also to "tax morale". Schmolders (1960) describes "intrinsic motivation" as the "attitude of a group or the whole population of taxpayers regarding the question of accomplishment or neglect of their tax duties". In turn, he defines "tax morale" as something that is "anchored in citizens' tax mentality and in their consciousness to be citizens, which is the base of their inner acceptance of tax duties and acknowledgment of the sovereignty of the state". Similarly, Braithwaite and Ahmed (2005) refer to tax morale as the "internalized obligation to pay taxes". Frey (1997a) defines tax morale as the "intrinsic motivation to pay one's taxes", while Orviska and Hudson (2002) link tax morale to the concept of "civic duty". Citizens with high levels of civic duty are collaborative even if the system allows non-compliance. Their behavior is not regulated externally by audits and sanctions but internally by their concern for and loyalty to society and by an intrinsic motivation to cooperate.

In this perspective, audits and sanctions can undermine an intrinsic motivation to cooperate (or to pay taxes), and lead to effects opposite to those intended. Frey (1992, 1997b) speaks of a "crowding out" phenomenon when external stimuli like punishments destroy intrinsic motivation.

That punishment can have effects contrary to deterrence was shown by Gneezy and Rustichini (2000). When the management at day care centers in Israel repeatedly observed that the parents were picking up their children late – albeit with feelings of guilt – the management introduced a fine that depended on how late the parents were. However, the effect was the very opposite of increased punctuality. Now, the parents picked their children up later still, but without any feelings of guilt or any promises to be on time in the future. Rather, the parents were in fact pleased to pay the price for extended childcare. Put differently, sanctions do not necessarily serve as an effective deterrent, but are sometimes seen as a price to be paid for desired liberties.

Similarly, tax offenses are also often impossible to counter by way of negative financial sanctions. A sentence to community service, feelings of shame, and a loss of reputation are frequently much more effective (Braithwaite and Wenzel 2008).

Feld and Frey (2007) argue that tax compliance can be enhanced by maintaining good relationships between government, the tax authorities, and taxpayers. In such a setting, taxpayers do not see themselves as subjects but as partners in cooperation, and politicians and tax authorities are entrusted with the task of frugally managing the tax budget and responding to the needs of the population.

Borrowing from the construct of the “psychological contract” between employees and management in organizations, there exist expectations and commitments between government, tax authorities, and taxpayers that go beyond legal regulations (Rousseau 1995). In the sense of a norm of reciprocity, the commitment of one party requires an equivalent commitment from the other. By focusing on the “reciprocity of commitments” between the various actors, the frequent authoritarian hierarchical structure that becomes so clear in the language of taxpayers can be left by the wayside, and negative taxpayer reactions to pressure can also be avoided. Those who presume a “cop and robber” situation may actually make the other into a robber who will constantly attempt to escape the police.

Government and the tax authorities can presume that taxpayers understand that public goods need to be funded, that this funding has to be provided by the taxpayers, and indeed that it is ultimately in the taxpayers’ own interests to insure the provision of public goods. The notion of a “psychological contract” implies that citizens entrust their money to a tax authority to invest it sensibly and productively, on the basis of the decisions of the responsible politicians. It is expected by taxpayers that the tax authorities and the government will not violate the trust placed in them. This psychological contract regulates a mutually respectful approach and openness between the partners. The resulting relationship is characterized by mutual loyalty and emotional ties. Any disappointment of expectations represents a violation of the contract, the rattling of mutual trust, the destruction of a willingness to cooperate, and the termination of cooperation. When taxpayers trust the authorities, cooperation can be expected of them; if they mistrust the authorities, cooperation can at best be obtained by force.

With the postulation of a “psychological contract” between all of the actors, attention shifts from taxpayers acting alone to the relationship between government, the tax authorities, and taxpayers. Taxpayers are seen as cooperative partners who have a sense of community and recognize the value of cooperation. All the same, taxpayers will react with mistrust to any signals of mistrust, as may be represented by controls and sanctions. Instead of the hierarchical structure between authorities and taxpayers implied by “tax compliance”, we now instead speak

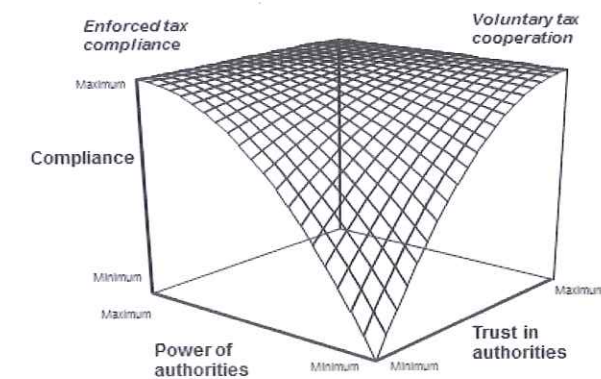
of “tax cooperation”, which indicates a perspective of equality. Referring again to *Figure 1*, in this tradition partners are equal in status whose cooperation is not formally regulated but regulated instead by a psychological contract.

4. COMBINING RESEARCH PERSPECTIVES: THE “SLIPPERY SLOPE FRAMEWORK”

How can these various and varied research perspectives be combined into a single framework? This is obviously a difficult task with no firm answer at this point. Even so, there are some promising approaches. Here we discuss one of them.

In what has been called the “slippery slope framework” (Kirchler 2007, Kirchler, Hoelzl, and Wahl 2008), it is possible to consider the relationship between authorities and citizens, and also to see the climate of interaction as significant in determining whether cooperation takes place voluntarily or needs to be obtained using constraint. As emphasized in *Figure 1*, all actors and their relationships need to be taken into account. Government and the tax authorities are no longer seen as superior agencies that use enforcement to ensure legal compliance in general and tax honesty in particular, but rather are seen as acting in the service of citizens toward the well-being of the community. Importance is now granted to shaping interactions so as to promote mutual trust and cooperation. This perspective corresponds to the “trust paradigm” that Alm and Torgler (2011) identify as one of the three paradigms of tax administration. In the traditional “enforcement paradigm” taxpayers are treated as potential criminals, and the “service paradigm” acknowledges the necessity to ease tax honesty by way of better service offerings from the tax authorities that help to facilitate compliance with the law. The “trust paradigm” emphasizes the importance of building trust between interacting parties, based on the expectation of taxpayers and tax authorities that the other party will act beneficially rather than detrimentally.

Figure 2: “Slippery Slope” Framework



Source: Kirchler, Hoelzl, and Wahl (2008).

The “slippery slope framework” can be represented graphically, as in *Figure 2*. A distinction is made between two kinds of tax honesty: voluntary cooperation and enforced compliance. Voluntary cooperation depends primarily on trust in the government and its authorities. If cooperation does not take place voluntarily, tax honesty can be secured by force to the extent that the government authorities have power to exert pressure on the offender. State “power” is understood to include all measures that serve the purpose of deterrence, and includes above all the (perceived) audit frequency and the severity of negative sanctions. There is also voluntary tax honesty, which rises with increasing trust in the authorities. In such a setting, the tax system is felt to be just, taxpayers believe that they are treated fairly, and cooperation has become the social norm in the state.

The “slippery slope framework” assumes that tax payments are influenced by *trust in authorities* (or the belief that the authorities will act fairly and justly) and *power of authorities* (defined as the tax authorities’ capacity to detect and punish tax crimes). If both trust and power are at their minimum levels, then tax payments will be low, and taxpayers will act selfishly by maximizing their own gains through tax evasion (as in the standard view of taxpayer behavior as a decision under risk). When the trust in authorities increases, tax payments will also increase. Furthermore, if the power of authorities increases, then tax payments will increase as well. The authorities can achieve high levels of compliance either via enforced tax compliance or via voluntary cooperation.

Overall, the difference between voluntary cooperation and enforced compliance is mirrored in taxpayers’ behavior and in the underlying motivation. Referring to Braithwaite’s (2009) motivational postures, the motives of “commitment” and “resistance” should vary with changes in trust in authorities and in voluntary cooperation, and also with variations in power of authorities and in enforced tax compliance.

Wahl, Kastlunger, and Kirchler (2010) test empirically whether tax payments are high in cases of trustworthy authorities, as well as in cases of draconian deterrence and fines. Participants were imagined to live in a fictitious country. Participants were randomly assigned to one of the four experimental conditions, and were assumed to pay their taxes to authorities that were either trusted or not, and powerful or not. They were then informed about their income in 20 tax-filing periods, their tax liability in each period, the audit probability, and fines on detected evasion. In each period, participants decided how much tax to pay, and after filing taxes, participants’ motives for taxpaying were assessed.

Participants contributed more if authorities were described as trustworthy rather than untrustworthy, and if authorities were described as powerful rather than weak. Tax payments were highest when trust and power were high and lowest when trust and power were low. Measures for the motives of voluntary cooperation and enforced compliance varied with trust and power. Voluntary compliance was highest when authorities were trustworthy and powerful, whereas enforced compliance was lowest when authorities were untrustworthy and weak; enforced compliance also increased when power increased and trust decreased.

Most likely, power-enhancing and trust-building measures proposed in the “slippery slope framework” are likely to affect each other, and therefore may have complex interactions and dynamics over time. However, the nature of the interplay is far from clear.

On the one hand it is argued, though in a different context than tax law enforcement, that the exertion of power may evoke suspicion and mistrust in the group upon which the measures are imposed resulting in a vicious circle: mistrust of one party provokes mistrust of the other party, which justifies and deepens the mistrust of the first (e.g., Castelfranchi and Falcone 2010, Farrell and Knight 2003, Nooteboom 2002). On the other hand it can also be argued that power affects trust positively. Bachmann (2001), for instance, proposes that de-personalized forms of power (i.e., the power of a system) such as the law can be perceived as a necessary precondition for trust. In a similar vein, Mulder, Verboon, and De Cremer (2009) argue that the law and its enforcement define the norms to be followed. Further, if sanctioning systems are perceived as a means to enforce societal norms, trust would also increase due to authorities’ power (Mulder, van Dijk, De Cremer, and Wilke 2006).

Regarding the effect of trust on power, in several economic analyses it is pointed out that trust reduces the costs of control (Cummings and Bromiley 1996, Nooteboom 2002). Trusting citizens comply with rules without enforcement (Costa, Roe, and Taillieu 2001, Dekker 2004, Gulati 1995, Inkpen and Currall 2004), and, further, if one party is trusted, the other party will assist this party to fulfill its aims, thereby increasing its power (Tyler 2003). Trust promotes agreement on the necessity and legitimacy of control mechanisms (Inkpen and Currall 2004), and without trust authorities are not recognized as such (Castelfranchi and Falcone 2010).

Power- and trust-building measures involve complex dynamics, and far more research is needed to understand their interplay and their effects on citizens’ compliance. What seems important, however, is to distinguish between different qualities of power and different qualities of trust. Regarding power, the most prominent taxonomy stems from French and Raven (1959), who differentiate five bases of power, especially “legitimate power” and “coercive power”. While legitimate power is connected with positive evaluations of authorities’ power and positive attitudes towards authorities, coercive power describes tax authorities’ ability to enforce a law regardless of its acceptance. It is likely that different qualities of power have different effects on trust. However, only few of the discussions on the relation of power and trust make these distinctions. For example, Korczynski (2000) argues that whereas trust will be undermined if power is used to coerce cooperation, power exerted by an authority that is seen as legitimate can increase the quality of trust based on rational considerations. Similarly, Das and Teng (1998) argue that in organizations formal control mechanisms (e.g., a strict evaluation of performance) undermine trust, whereas social control mechanisms (e.g., stressing organizational values, norms, and cultures) enhance trust. Choudhury (2008) argues that power and control decrease trust when controls include out-dated rules, whereas the opposite is true when the exertion of power is rule-based and authorities monitor actions in a fair manner. As long as the power of authorities is perceived as legitimate, it therefore seems likely to have a positive effect on citizens’ trust. On the other hand, coercive power seems likely to have negative effect on trust (Leonidou, Talias, and Leonidou 2008).

Different qualities of trust are also distinguished in the literature (Lewis and Weigert 1985, Tyler 2003). Most conceptualizations separate a form of trust resulting from automatic and affective processes, from another form based on a rational assessment of the predictability and competence of others and their trustworthiness. In the context of tax behavior, the interplay of qualities of power and trust has not been investigated.

5. CONCLUSIONS: SOME RECOMMENDED PRACTICES

The “slippery slope framework” integrates economic and psychological perspectives on compliance. A successful interaction between citizens and authorities requires that a synergistic climate exists in the state as a whole, and not antagonistic opposition. Elected government officials and the tax authorities have to take an orientation according to which they administer and shape the country at the mandate of, and with the means provided by, the people. However, they must also be able to insure that those willing to cooperate are not exploited by the selfish-acting “free-riders”. The non-cooperative need to be led back to the values of the community by way of strict tactics of regulation, or they must be denied the opportunity to selfishly use social values. It is thus necessary to apply strategies based on both economic and psychological arguments to promote mutual trust and cooperation. How can all of this be done?

Alm and Torgler (2011) identify several measures that include the following:

- The tax laws must be simplified so that taxpayers understand it.
- Broad (not specific) principles of behavior need to be fixed in law in order to minimize the latitude for interpretation and the room for negotiation.
- Controls are necessary to protect honest taxpayers from free riders, and these controls need to be directed at identifiable risk groups and effectively implemented.
- Negative sanctions are necessary at an adequate level and in the proper form, depending on the ability of the tax offender to pay. Fines or prison sentences are two possible forms of retribution; publishing names or imposing compulsory work in social services represent alternative sanctions.
- Tax authorities (and tax auditors) need to be efficiently trained so that they are experts in tax law, and they must treat taxpayers according to their motivations and abilities.
- Taxpayers need to be segmented according to their needs, so that appropriate services can both be offered to facilitate tax honesty and be tailored to meet needs at one “point of sale”.
- The use of tax money must take place transparently; advertising campaigns should be used to inform the public of the services available, so that the fair exchange of tax contributions for state services is clear.
- Tax authorities need to cooperate with legislators, judges, and international authorities.
- Social norms of correct behavior need to be promoted and communicated, and measures need to be taken that strengthen the identification of citizens and/or residents with the community.

Justice needs to be achieved on the distributive, procedural, and retributive levels.

The trend in tax behavior research indicates a move from understanding taxpayers as selfish individuals trying to maximize their own gain to individuals with a sense of community who are ready to cooperate if all actors in the social system contribute to a climate of mutual trust. The list of suggested policies combines considerations from economic and psychological research. In so doing, no preference is given to one perspective or the other on tax behavior. Instead, we believe that many research paradigms and perspectives offer essential contributions to understanding tax behavior, and also that an integration of findings is the most promising path forward.

Indeed, to return to a common theme, people exhibit great diversity in their motivations and in their behavior. This “full house” of behaviors must be recognized in devising a corresponding “full house” of strategies to deal with tax compliance.

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