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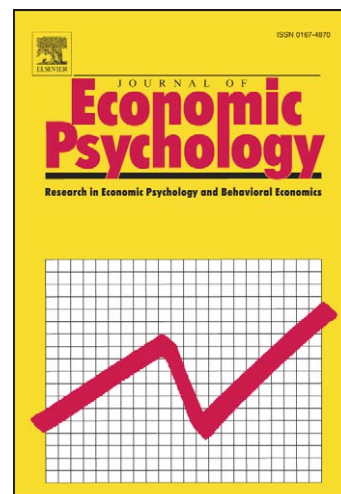
Book Review

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Book Review on

*Erich Kirchler*: The Economic Psychology of Tax Behaviour. Cambridge: Cambridge University Press 2007. ISBN-13 978-0-521-87674-2 Hardback, pp. xvii + 243, \$ 91.00 (£ 45.00).

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ACCEPTED MANUSCRIPT

*Erich Kirchler*: The Economic Psychology of Tax Behaviour. Cambridge: Cambridge University Press 2007. ISBN-13 978-0-521-87674-2 Hardback, pp. xvii + 243, \$ 91.00 (£ 45.00).

Ten years since Andreoni, Erard and Feinstein (1998) took stock of tax compliance research, economists have become increasingly aware that the traditional deterrence model of tax evasion is not sufficient to positively explain the actual extent of tax compliance in different societies. The deterrence model frames tax compliance as a rational risky decision of individuals who weigh the costs against the benefits of non-compliance. The costs consist of expected punishment, i.e. the interaction of fines or prison sentences with the probability of detection as determined by audits, while the benefits are shaped by marginal (income) tax rates and the true actual tax base (income). Expected punishment is hypothesised to have a positive effect on compliance. How tax rates and income affect compliance is however theoretically ambiguous as it depends on taxpayers' risk preferences, the shape of the tax schedule and the dominance of substitution over income effects. Furthermore, traditional economic models acknowledge different abilities to evade taxes in reality, e.g. resulting from withholding taxation or other elements of tax administration. Indeed, tax morale is also thought to have an impact on tax compliance. However, the traditional deterrence model of tax compliance considers tax administration or tax morale as *exogenously* given: Tax administration is simply a technology to detect non-compliance which therefore does not belong to the instruments to affect taxpayer behaviour; tax morale is the result of education and socialisation of individuals and thus also not in the interest of the traditional economic approach. In a nutshell, and perhaps even not unfairly, this may describe traditional economic thinking on tax compliance.

This deterrence model does not explain actual tax compliance satisfactorily. Given the objective expected punishment for non-compliance in many countries, taxpayers should evade much more if they were rational in the narrow economic sense. It would be easily possible to address this gap between theory and reality by assuming some irrational behaviour, such as a subjectively exaggerated chance of being detected. But even proponents of the traditional model, like Sandmo (2006) or Slemrod (2007), meanwhile acknowledge that this is not a useful scientific strategy or that tax morale is key to understand tax compliance more fully. Understanding tax morale is however much more difficult than it might appear at first sight. Several determinants, like, e.g., personal or social norms, fairness or justice considerations, motivations or heuristics play a role and shape taxpayer behaviour.

A this stage of tax compliance analysis, it is evident that only an interdisciplinary approach of, at least, psychologists and economists can provide for the right direction of research. Erich Kirchler's *Economic Psychology of Tax Behaviour* is the authoritative monograph for such an interdisciplinary approach. Although the CTSI group at Australian National University, led by Val Braithwaite, follows exactly the same avenue of research, Kirchler's book is the most modern and structured analysis to date. On the one hand, he provides the most comprehensive survey on the field linking the results from economics, psychology, law, sociology, and political science. This survey extends from the early works on tax psychology by Schmolders to the most recent working papers from all disciplines. On the other hand, Kirchler analyses tax compliance starting from the broad perspective of social representations of taxes, contrasting it with the rational choice model of tax compliance, discussing the particular problems of self-employment and business tax compliance, before focusing on the interaction between tax authorities and taxpayers and rounding the analysis up by proposing a "slippery-slope" model of tax compliance. This structure is particularly useful because behavioural aspects of paying taxes provide for the starting point and the contrast to the following rational choice approach. The final chapters aim at a synthesis of these two broad analytical categories. But not only these contrasts are particularly impressive. In addition, this approach exhibits the necessary caution and care to highlight, how much of our knowledge about tax compliance is uncertain. After reading the book, my first connotation was that so many studies with so many relevant results provide us with a lot of insights, but that we still know so little what is going on.

What leaves the impression that the empirical studies on tax compliance provide for so many insights? Kirchler puts the individual perceptions, attitudes, norms and actions to the fore. First, the subjective knowledge of taxpayers appears to be relatively poor as taxation is very complex. Second, taxpayers and tax authorities could interact in different ways. Tax authorities could either follow a "cops and robbers" approach purely relying on deterrence, or a "service and client" approach responsively regulating taxpayers by taking cooperative attitudes among taxpayers seriously. Kirchler acknowledges that deterrence may have its benefits in particular when pure free riding behaviour must be contained, but he also underlines that such an approach which solely rests on the presumption of narrowly selfish behaviour may produce such behaviour itself. A "service and client" approach rather treats taxpayers as partners in a contractual-like relationship, therefore creates a more cooperative atmosphere from the beginning and thus more cooperation in the end.

Much evidence is in favour of the latter more cooperative approach. Already tax complexity supports calls for a friendly and respectful treatment of taxpayers by the tax authority because mistakes in the tax declaration may simply originate from the poor knowledge of taxpayers about tax laws. Attitudes towards tax non-compliers as hard working and intelligent people triggers the first caution. In addition, personal, social and cultural norms create a taxpaying ethic which shapes tax compliance. Moreover, distributive, procedural and retributive justice may raise or decrease tax compliance depending on the behaviour of the tax state and its tax authority. For example, distributive justice persists if taxpayers perceive government services as adequate exchange for their tax payments. Procedural justice prevails when tax authorities treat taxpayers responsibly and respectfully, while retributive justice incorporates norms related to the rigidity of audits and the appropriateness of penalties. If such complex motivational postures are in place, tax administration cannot rely on a pure deterrence approach. It must be more complex overall. Kirchler provides for a more complex approach proposing a slippery slope model. The model starts from a situation in which taxpayers perceive paying taxes as a civic duty and accept the legitimacy of the state. The more hostile the tax climate becomes in a society, the more the government has to rely on deterrence and enforced compliance. On the way to a society of enforced compliance, however, many hybrid forms exist that demand a cautious use of deterrence giving prerogative to responsive regulation.

Why do we then know so little? Kirchler emphasizes the importance of perceived justice, social norms and attitudes for tax compliance and tax morale. But it is not totally clear how these notions interact with deterrence, the tax burden and income levels as the traditional rational choice variables. When the main deficiency of the traditional (economic) tax compliance model is the exogeneity of tax morale which could be endogenized by justice concerns and norms, it must be stated how deterrence affects tax morale. Schmölder's conclusion that the state is mirrored in citizens minds is nice. But how can the state ensure that this picture is not biased? How is tax morale shaped, what are the institutions raising tax morale? Kirchler's caution lets different approaches stand side by side without clearly pushing some aside as less relevant or less central. How important, e.g., is prospect theory for tax compliance research when normative concerns apparently challenge the traditional deterrence model the most? Are personal, social and cultural norms competing at the same level for an influence on tax compliance or is there a hierarchy between them? Don't personal norms shape the emergence of cultural norms? What is the role of deterrence in that respect? Does deterrence only provide incentives or does it also signal how to behave? What is the importance of symbolic law?

Kirchler's slippery slope model also has many merits, but it heavily rests on classifying taxpayers in groups of more and less cooperative people. The tax state reacts to these differences in taxpayers' willingness to cooperate more or less harshly, more or less responsively. Although it seems obvious that differently honest types of taxpayers exist, it is unclear how to distinguish them and how to find out why one shifts from one group to the other. Wouldn't it be more useful to aim at a general approach in which a taxpayer chooses his/her extent of tax compliance by following the normal incentives provided by deterrence and tax burden, but also the higher level incentives to reflect in which society one lives and wants to live?

Bruno Frey and I (2007) have used a contractual metaphor to highlight the relationship between taxpayers and the state which we call a psychological tax contract. While Kirchler's slippery slope model is much richer in the inclusion of so many different approaches, our analysis is focused on the incentives the state could provide in shaping such a contractual relationship. Our analysis results in similar conclusions regarding the influence of distributive, procedural and retributive justice (although termed differently), but we are more radical in leaving aside those approaches who are not captured by this contractual thinking as well as we continuously ask what deterrence does at the different stages of state-taxpayer interaction. Kirchler's book is the best starting point for thinking about such interactions between the state, the government, the tax authorities and its citizens. I can think of no better reference work at which tax compliance researchers can sharpen their minds.

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