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SOCIAL NORMS AS FACTORS OF TAX EVASION

Abstract:

We address the application of a behavioural approach to tax evasion or tax compliance in the European Union. We focus on the relationship between social norms and tax evasion. We analysed data from our survey (in 3 countries with the highest levels of tax evasion compared to 3 countries with the lowest levels). It seems that social norms on tax compliance in countries with low tax evasion are stronger than in other countries, particularly those with high levels of tax evasion. Focusing on forming social norms could solve tax evasion in some economies (countries).

Keywords:

Behavioural approach; Tax evasion; Tax compliance; Social norms

JEL Classification: H26, H39

1 Introduction to social norms as factors of tax evasion

In this paper we try to address the application of behavioural approach to tax evasion or tax compliance in the European Union (EU further on). We focus on the the relation between social norms and tax evasion.

The first section will try to put the issue in the context of the European tax policy highlighting the fact that tax evasion is one of the EU priorities in the taxation area. There will also be a presentation on data of tax evasion in the EU member states. 3 countries with the lowest level of tax evasion and 3 countries with the highest level will be selected for the purposes of the research. Afterwards, there will finally be a presentation of behavioural approach in tax policy and its usage in the EU particularly focusing on tax compliance with gradual move to the relation of social norms and tax evasion.

The assumptions are, as also previous research suggests, that the strength of social norms on tax compliance in the particular countries have an effect on the level of tax evasion. Additionally, the stronger the social norms, the less respondents should express as favourable towards cheating on taxes.

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2 Macroeconomic overview of tax evasion in the EU area

The importance of the tax evasion problem can be seen in almost all societies / countries. All of them have to face this problem due to its

1. fiscal costs (it limits the budget capacity of countries to finance their policies) and
2. social costs - it is not fair, both
 - horizontally (taxpayers with similar tax capacity (income) face the paying of different amounts of tax) and
 - vertically (it reduces initially politically given level of the redistributive power of the tax-benefit system).

The first and vital step to fighting this problem is to be aware of its negative economic and social impacts (see previous article). According to the European Parliament (2022) it was (and still is) done by

1. removing tax obstacles in the economic activity between members and
2. elimination of the harmful tax-related competition, and in addition, (financial) criminality and tax avoidance.

It may be summed up that tax evasion (as a central topic of our article) is the current EU policy priority “number one”.

Additionally, the European Commission identifies taxation as a crucial part of functioning societies (EC 2018). It states that fair taxation is vital for construction of a strong and sustainable

economy, efficient business environment, as well as social justice. It also identifies tax evasion and tax avoidance as one of the main obstacles in achievement of the economic and social EU goals. One of the reasons is that they reduce public revenues in the EU Member states by 50 to 70 billion of euros every year.

To show the magnitude of the problem there is a table 1 below. However, measuring tax evasion is not a clear process, as a result, there is not a significant amount of conducted research.

Table 1: Tax Evasion Costs by EU Member Country

Country	Tax evasion costs in billion euros	Tax evasion costs as % of GDP (descending)
Italy	190,9	11,5
Greece	19,9	11,3
Romania	16,2	10,1
Malta	0,9	9
Cyprus	1,6	8,9
Bulgaria	3,8	8,3
Lithuania	3,1	8,3
Hungary	9,1	8,1
Poland	34,6	8
Croatia	3,5	7,8
Belgium	30,4	7,3
Latvia	1,7	6,9
Slovakia	5,4	6,8
Slovenia	2,6	6,7
Estonia	1,4	6,7
Denmark	17,5	6,4
Portugal	11,0	6,1
Spain	60,0	5,6
France	117,9	5,4
Czech Republic	8,8	5,2
Finland	10,7	5,1
Germany	125,1	4,1
Sweden	16,9	3,7
Austria	12,9	3,7
United Kingdom	87,5	3,3
Netherlands	22,2	3,2
Luxembourg	1,6	3,1
Ireland	6,9	2,6
Total	823,5	5,5

Note: There are highlighted 2 groups used later in our analysis.

Source: Jalakšová (2021), Murphy (2019), own computation on tax evasion as % of GDP and Eurostat for GDP, accessed at <https://www.statista.com/chart/17133/tax-evasion-cost-to-eu-countries/>

After Italy (11,5 % of GDP), there is Greece and Romania as the countries with the highest portion of tax evasion on GDP with 11,3% and 10,1% respectively. Countries with the lowest portion are Ireland, Luxembourg, and the Netherlands. These 6 countries will be also important for the practical part of this research.

3 Tax evasion and the influence of social norms in the EU

Nicolaide (2014) tries to come up with a theory of public good provision arising from decentralised interactions among individuals as well as governmental institutional effects and creating a connection between them. According to the paper, the individuals decide whether to comply or evade based on their assumption of gains in the private consumption utility; their utility from public goods; and the psychological externality payoff from social norms. Three results are suggested:

- The impossibility to determine tax compliance is eliminated when institutions can conduct effective audits.
- When there are not effective audits, the equilibrium outcome is given by social norms and individual utilities from the public goods.
- The elimination of wasteful spending is necessary for the sake of high public goods utility.

According to the author, the results can be applied for the use in specific European regions and countries. The paper is an example of the possibility to explore the effect of social norms on levels of tax evasion on the EU level. However, there is also a significant space and need for further research, as also the author states that more empirical studies and econometric analysis are necessary.

Additionally, Górecki a Letki (2021) suggest that taxpayers interpret both tax rate and penalties for tax evasion through social norms meaning that policy outcomes should depend on these social norms. Moreover, they looked separately at the effect of descriptive and subjective norms. Their dependent variable was the propensity to underreport an extra income. The results show that particularly subjective norms predict a large portion of taxpayers' propensity to tax evasion. They also succeeded to prove that higher penalties have effect only on individuals that are not subjected to strong tax norms. On the other hand, descriptive norms serve more as an operating factor considering the effect of tax rates. With this finding they found an explanation for the phenomenon of higher tax rates having a counterintuitive result of people evading less since the social costs are comparatively higher. The reason behind it is that individuals do not want to exploit honest taxpayers. Finally, they end their paper with the expression of need for more research similarly to other publications. It generally seems that there is not sufficient research using the behavioural approach to tax evasion, but also specifically dedicated to observing the relation of social norms and tax compliance. This paper should contribute to this research.

4 Research methodology and dataset

As mentioned above, the paper's main aim is to explore the relationship between social norms and tax evasion in the EU. There have been the first tries to incorporate the behavioural approach in the EU tax policy, especially concerning the area of tax compliance, but also specifically in exploring the relations of social norms and tax compliance with the two taxation papers (Nicolaides 2014; Weber, Fooker, Herrmann 2014). Since, in general, the role of such working papers is to start a discussion on the EU level that may potentially lead to policy change, these works seem not particularly successful. Both documents state that more research is needed (e.g., empirical studies or econometric analysis). Unfortunately, the amount of research conducted on the topics from 2014 in the EU is not extensive and every individual piece highlights the importance of further investigation. Hopefully, this article will bring some additional value to the research and will also have policy implications at the EU level.

4.1 Goal and hypothesis

Our research is dedicated to the relation between the social norms and level of tax evasion. Therefore, we set up 1 goal and 1 hypothesis as presented below.

Research Goal: Analyse whether social norms are at least partially responsible for the extent of tax evasion.

Based on the goal, there is also a hypothesis that can be formulated as follows:

Research Hypothesis: Social norms influence the level of tax evasion with social norms being stronger in countries with lower tax evasion levels and vice versa (taxes are in line with social norms).

It is important to note that our focus will be strictly on the 3 countries with the highest cost of evasion as % of GDP (see table 1), meaning Italy, Greece, and Romania, and the countries with the lowest one, meaning Ireland, Luxembourg, and the Netherlands.

4.2 Dataset

Using the questionnaire, 64 responses were collected, out of which 5 had to be taken out since the respondents were not from the 6 focus countries. Most of the responses came from the Netherlands, followed by Romania. The reason for this distribution is that one of the survey exchange software used has a significant presence of Dutch students. As for Romania, the questionnaire was shared in a Romanian group on social media. Other countries have similar groups, but they do not allow survey sharing.

A significant number of respondents in their 20s were primarily students, especially those from the Netherlands. On the other, respondents from Romania were mainly in their 30s. There were only 4 respondents older than 40. The most common age – mode – was 23 representing over 15% of the respondents. The youngest respondent was 19 years old and the oldest was 61, with the range being 42.

The introductory part of the survey includes questions on basic information about the respondent's nationality, country of residence, gender, income categories, level of education as well as the level of education of their parents. All survey questions can be found in the authors' repository upon request.

Other sections of the survey focus on information that may explain part of the difference in tax evasion between the two groups of countries. Those include perception about corruption, attitude towards risk, and perceived likelihood of being audited. The questions were taken from Bobek et al. (2007) for attitude towards risk and perceived likelihood of being audited, while questions on corruption come from Inglehart et al. (2013).

The core of the survey is the social norms. Questions (or statements) on the norms are also based on Bobek et al. (2007). The social norms are separated into four main categories: personal and subjective norms, injunctive norms and descriptive norms. The authors also define them in the following way:

- Personal norms are standards or expectations for behaviour that individuals pose to themselves.
- Subjective norms are the person's perception on how people important to them think they should act.
- Injunctive norms are general expectations of behaviour in society.

- Descriptive norms are standards developed through observations of the behaviour of other actors in the society.

The respondents answer a series of questions in each category on a 1 to 7 scale. It is a typical Likert scale, which is specifically designed to measure attitudes, opinions, and perceptions. It is essential to specify that questions on personal and subjective norms are framed positively. That means that the respondents choosing “strongly agree” have the strongest norms on tax compliance and vice versa. As for the injunctive and the descriptive norms, the questions are framed negatively meaning that respondents that choose “strongly disagree” are subject to the strongest norms on tax compliance. On the other hand, respondents choosing “strongly agree” can be considered as being opposed to paying taxes.

Finally, the rest of the questions concerned religiosity and cognitive abilities.

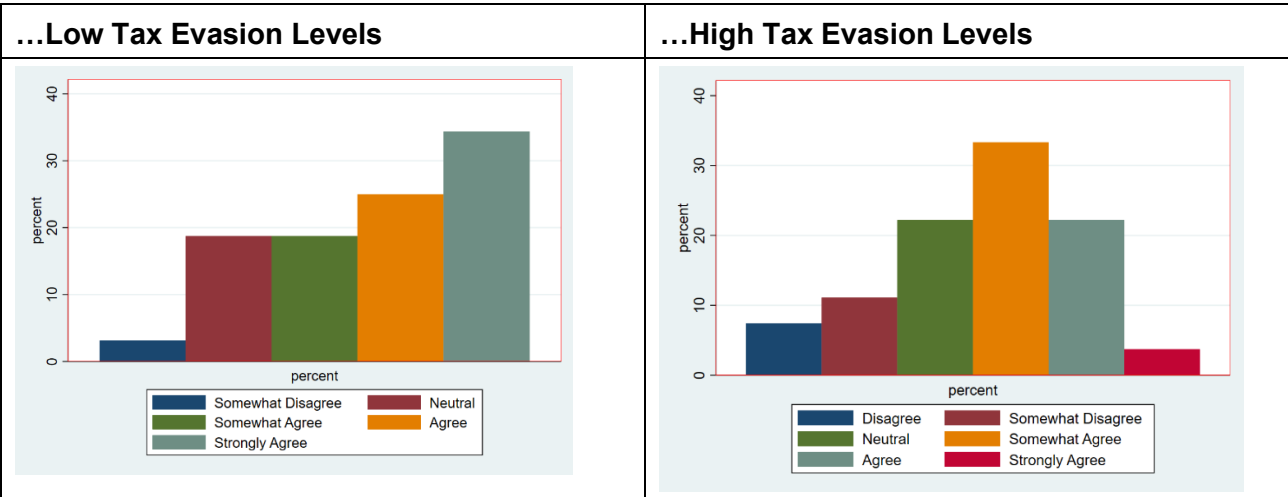
5 Findings on Tax Evasion and Social Norms

This section will focus mostly on findings on personal and subjective norms, injunctive norms, and descriptive norms and their relation to the tax evasion levels in the selected EU countries. Special attention will be given to the comparison and differences between the 2 country groups (Low vs High Tax Evasion Level).

5.1 Personal and Subjective Norms

First the focus will be on the personal and subjective norms. The results are presented in this subchapter using the graphs showing the frequency of responses.

Graph 1: Mean Responses on Questions on Personal and Subjective Norms for Countries with...



Source: Own Creation of the Author in STATA

The most common response here was “Strongly Agree”. As the statements here were framed positively – meaning that by responding “Agree” the individuals report stronger social norms – it is safe to conclude that most respondents are subjected to strong personal and subjective social norms. On the other hand, as can be seen in the graph below, respondents from countries with

higher tax evasion report weaker norms of this group with the mean response being “Somewhat Agree”. This would be in accordance with our Hypothesis.

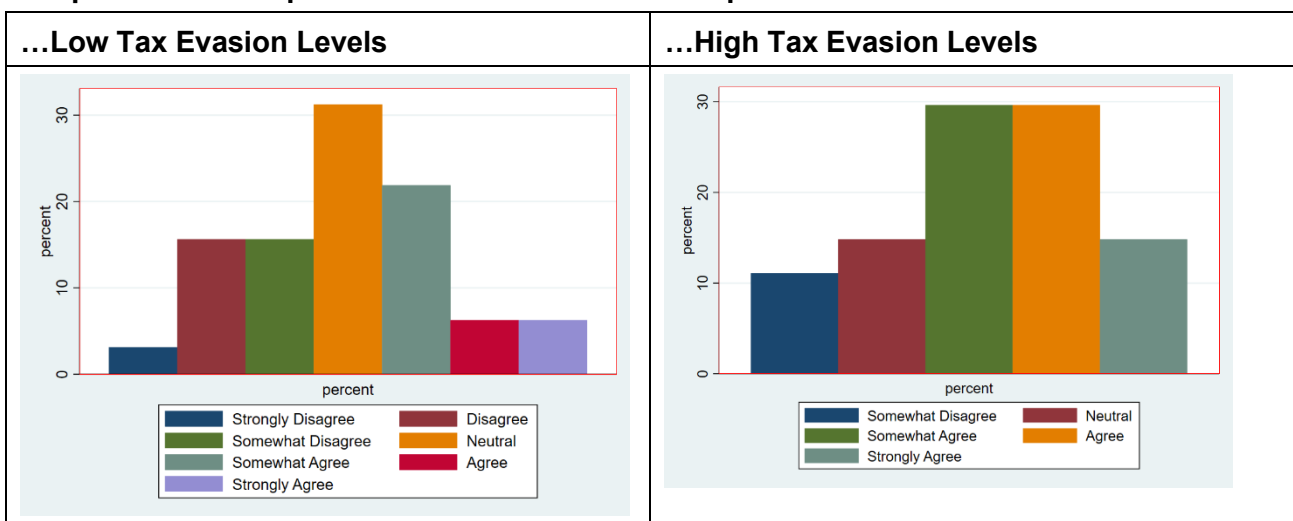
5.2 Injunctive Norms

With injunctive norms the difference was not significant and, therefore, there is no need for a graphical presentation. However, the means were different. For the countries with low tax evasion, it was “Disagree”, whereas, for countries with high levels of tax evasion, it was “Somewhat Disagree”. The collected data would not be in accordance with our Hypothesis.

5.3 Descriptive Norms

The last group of social norms that are addressed in this research are descriptive norms. The graph below is again showing the results for both country groups.

Graph 2: Mean Responses on Questions on Descriptive Norms for Countries with...



Source: Own Creation of the Author in STATA

As can be seen from the graph, the most common response here was “Neutral”. Also here the statements were framed negatively. On the other hand, there were 2 means for the group with high level of tax evasion for “Somewhat Agree” and “Agree”, therefore suggesting weaker descriptive norms.

Based on the information above, it could be possible to assume that personal, subjective, and descriptive norms are stronger in countries with lower tax evasion and vice versa. This is, however, not the case for the injunctive norms.

Results derived and discussed above were also tested using the 2 non-parametric tests (the Chi-squared test and the Mann-Whitney U test). We can sum up there is a statistical difference in responses on social norms in accordance with our Hypothesis.

6 Possible Implications and Actions

The research results have at least partially confirmed our hypothesis and showed that social norms (meaning personal, subjective, and descriptive norms) differ significantly between the specific two country groups.

In recent years, possible interventions on social norms to achieve various changes in the behaviour of individuals have started to be discussed. Till now, the focus behaviours included especially alcohol consumption, other health-related behaviour, or even behaviour related to sustainability.

The findings in this paper show that it may be worth considering this approach and investing in changing social norms on tax compliance and, as a possible consequence, reducing tax evasion in the countries where the issue is the most significant, like Greece, Italy, and Romania.

However, more extensive research should be conducted within the EU area to be able to come up with an efficient strategy as a basis for the tax policies. It is essential as tax evasion is one of the main concerns of the EU when focusing on tax-related issues.

Additionally, 1) perception of corruption, and 2) whether a country is run for the benefit of all or only a few individuals, seem to be important as well. Here, it would be important not to focus only on how individuals perceive their countries in this aspect, but also the real situation – e.g. continue to try and decrease corruption with a targeted focus on the countries that are the worst off.

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