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Taxpayers Behaviour; Homo Economicus as a Rational Maximiser of Self-Interest: Evidence from SMEs in Indonesia

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Abstract:

Humans live in complex societies although constructed tax systems use rules, laws, supervision, formal incentives, and sanctions by designated agents. The existing national tax laws as promulgated by Indonesia government is a powerful force in behaviour changes. This study claims that individual, in assumptions of the idea of Homo economicus, acts to maximise their own utility. Although utility is often assumed to be monetary, it encompasses more motives than maximising one's own material gain, and often be seen as a set of preferences that can range from preferring through the adequate pursuit of their own happiness. This study also finds that in primordial social aspects, the normative policy implications derived from the existing theory may be misleading when tax evasion is feasible. In addition, a high tax morale (individual attitude) does not necessarily translate into a high level of tax compliance (individual behaviour).

Keywords: *Homo economicus, tax compliance, happiness*

1. Introduction

The importance of the small and medium-sized business segment for pecuniary growth has steadily increased over the last decades (Becker, 1981). At the same time, this sector's compliance with tax regulations has been poor (Becker, 1962). This has been attributed to a high reliance on cash transactions (Bromiley, 1986), allowing businesses to under-report income (Eliasson, 1976) and evade VAT (Friedman, 1953).

Homo economicus, an individual who reasonably pursues self-interest without regard for the wellbeing of other citizens, has been regarded as a model for human behaviour in neoclassical economics. A centrepiece of economics, under certain conditions, claims that the deeds of the rational and self-interested homo economicus endorse the general good, usually understood as the efficient allocation of material wealth (Simon, 1976). However, this fundamental human being model has been challenged in empirical studies testing its robustness, and alternative human models, such as homo reciprocus, satisficer, and heuristic decision maker, have been proposed in economics and related disciplines (e.g., Simon, 1978; Friedman, 1953).

The theory of planned behaviour (Katona, 1951) has emerged as one of the most influential and popular conceptual frameworks for the study of human action. Briefly, according to the theory, human behaviour is guided by three kinds of considerations: beliefs about the likely consequences or other attributes of the behaviour (behavioural beliefs), beliefs about the normative expectation of other people (normative beliefs), and beliefs about the presence of factors that may further or hinder performance of the behaviour (control beliefs). In their respective aggregates, behavioural beliefs produce a favourable or unfavourable attitude toward the behaviour; normative beliefs result in perceived social pressure or subjective norm; and control beliefs give rise to perceived behavioural control, the perceived ease or difficulty of performing the behaviour. In combination, attitude toward the behaviour, subjective norm, and perception of behavioural control lead to the formation of a behavioural intention.

Even though the existence of homo economicus in plausible ways significantly has been confirmed with self-report measures of social studies, such as the measures of social-value orientation, there is no certain behavioural research that has thoroughly investigated whether there are individuals who behave in accordance with the behavioural definition of homo economicus, and whether the people behaviourally defined as homo economicus are rational pursuers of self-interest. In addressing these two fundamental enquiries might be leading to preferred set of governance arrangements for a society, we firstly observe participants' decisions in a series of measuring human belief about their actuality influencing on their personality traits and other psychological traits, which are related to the premise of tax burdens on current and future generations. Secondly, we then draw comparative conclusions to achieve more generalisable findings of impeccable logic from the premise of rational, self-interested decisions made by a materialist archetypal human being.

2. Related studies in Homo Economicus

There is a considerable amount of literature and reference that attempts at socializing the rational utility maximiser, or homo economicus. Most of it, however, proposes archetypal human being consistently maximized monetary self-interest, by the introduction of direct social considerations into the objective function, to come out rational decision making. There has been much debate across disciplines about the nature and causes of human selfishness that acts to

maximise their own utility (Simon, 1979). It is hard to draw because human nature is complicated – selfish and altruistic. Tullock, (2002) assumes that individual agents act rationally within a pool of other rational individual agents, each seeking to maximize his or her own utility, and each choosing actions independently based on the available information (Meier, 2006). When the individual holds the homo economicus belief, he or she assumes that people have the motivation to compete with each other to maximize their own self-interest (Sugden, 2009). Similarly, Kirzner, (2000) assumes that individual agents take action rationally within a pool of other rational individual agents, each seeking to maximize his or her own utility, and each choosing actions independently based on the available information (Simon, 1982).

There are, in my view, three main streams characterizing the literature that evolved around the care about the social dimensions in individuals' behaviour. The first one is the one in which areas outside of economics have adopted the rational utility maximizer. These include public choice theory in politics, 2 sociology, 3 and the more eclectic use of the model in dealing with many specific social issues. 4 By expanding the domain to which the model of the rational utility maximizer can be applied, the model appears to become more socially relevant. However, while such an approach could tell us about the behaviour of rational individuals in the social domain, it does not tell us much about how the fact that the agent is a social being will affect his, or her, more private, economic interactions.

The second stream is the one that is emerging from game theory and experimental economics. Here, there are mainly two questions that drive the analysis. First, there is the problem of coordination games; how do agents select a Nash-equilibrium? Second, there is the accumulated experimental evidence that the predictions of the standard model in the cases of Ultimatum and Public Good games are incorrect. Notwithstanding the questions of whether any of these is typical of the economic decisions that individuals make or whether experimental results are reliable, the search for solutions generated a considerable interest in the social dimensions of individual behaviour.

However, one of current leading studies, Meier, (2006), highlight that females are expected to be more engaged in social interactions to maintain strong ties with others. They also mention that men are more likely than are women to distrust others and to come into conflict with others when they hold the belief that individuals have the motivation to compete with each other to maximize self-interest. Common to all these papers that a more psychologically realistic portrait of human behaviour which acknowledges peer influence social stratification may affect the conscious mind. Kirzner, (2000) argue that self-interested person within systems of economic or social exchange usually choose the action that gets them more of whatever they want, rather than less. Some academics who adopt this view (Camerer et al, 2004; Charness and Rabin 2002). They note that more psychologically realistic human beings have the powerful motivation to maximize their own self-interest in social interactions and have abilities of, in different interaction processes, addressing primary problems associated with obtaining material resources and social status.

It has been questioned, through this study, how well the implementation of tax regulations models describes human behaviour always making a utility-maximizing decision. This is a controversial point. In the standard economic approach, people decide whether or not to take an action based on the benefits and costs of taking that action. When benefits exceed costs, it is assumed, an individual takes an action. Fortunately, humans have developed a variety of strategies for self-controlling. Some strategies involve the use of external commitment devices or the avoidance of situations in which one lose control of one's behaviours (Colman et al. 2008). The dilemma that has now emerged in Indonesia is that there is a nascent gap between the aspiration for the profitable private provision of public services and the reality of reforming governments, in terms of stipulating and laving tax. A considerable body of shared, discipline-wide perspective, however, mentions that a person associated with neighbourhood, in some interaction processes, may depend on peer influences, neighbourhood effects, social capital, or some other concepts. The actions chosen and outcomes experienced by others, in a more general class of interactions, affect the preferences, expectations, and constraints of another individual as self-interested utilitarian maximizers of their individual preferences.

3. Data and Methodology

The data collection typically encompasses in-depth interviews but also include other sources of data such as existing research literature and quantitative data. This paper uses a form of purposive sampling, known as theoretical sampling, where participants are selected according to criteria specified by the researcher and based on initial findings. Early analysis of data indicates issues that need exploration; hence the sampling process is guided by the on-going theory development. Interview questions is given as little guidance as possible to allow the interviewees to talk about what is of importance to them regarding a given context. The researcher extracts those phenomena or experiences significant to the interviewee by assigning a conceptual label, known as a code. Several codes can be grouped into more abstract categories which eventually form the basis for the developing theory. Coding highlights problems, issues, concerns and matters of importance to those being studied. The researcher refers to categories as having 'analytic power', due to their potential to explain and predict. 'Constant comparisons' between collected data, codes, categories and initial findings are employed in this study to help to crystallise ideas to become part of the emerging theory.

In order to improve the quality of data, firstly, the researcher tried to use low-inference descriptors to enhance reliability of the qualitative study. Low-inference descriptors involves recording observations as concrete as possible. Recording interviews can positively affect the outcome of the interview in several ways. For example, the researcher hence concentrate on what the interviewee said and then organize follow-up questions. It also provides the opportunity of an unbiased record of the conversation, and thus enhances the reliability of the qualitative study. In this study, the researcher tried to record the interviews with the participants' permission. Eighteen of twenty-three interviews were audio-recorded, and were then transcribed carefully in order to provide a basis for reliable analysis. In addition, the researcher also tries to check the accuracy of the data by sending the transcripts or notes of the interviews back to the participants and getting their feedbacks.

Secondly, during the data collection process, effort is made to reduce errors and bias, and to make sure that what the researcher has captured is the true value of what interviewees and the researcher maintains a neutral role in the research. For example, different types of questions, such as main questions, follow-up questions and probing questions, were asked to ensure the consistent answers were got from interviewees. It is because of asking probing questions is a powerful technique to reduce threats to reliability and validity in terms of allowing the research to accommodate some of the problems caused by the complexities and limitations of the human mind. Besides, attempts were also made to avoid leading questions and other potential introduction of bias.

Furthermore, procedure of qualitative data analysis, as declared before, interviewbased case study was used as the primary method of research in this qualitative study, and the technique of grounded theory data analysis was employed to process the case data. Miles et al., (2014), define grounded theory as method for engendering theory from the information systematically gathered from social study. Parker and Roffey (1997), point out that the method of grounded theory may be one of the possible best choices for case study. Therefore, this technique was adopted to analyze interview transcriptions, records and notes. All the practical information was manually evaluated and analyzed because of one consideration, as highlighted by Suddaby (2006), that grounded theory is "an interpretive process and qualitative software programs are not suitable for the interpretation of data in which they can just be used in coding and organizing data". The interview information, according to the prior works of Bryman, (2004) and Beattie et al. (2004), was analyzed through some steps such as open coding, axial coding, selective coding, familiarization and reflection.

4. Finding and Analysis

The existing national tax laws as promulgated by government is a powerful force in behaviour changes. The government, acting in the interest of the taxpayers generally, is another party with a clear stake in tax compliance. Individuals as tax payers will engage in a behaviour or series of behaviours to receive something they value. For a long time, in this case, the underlying premise was that those individuals considered costs and the benefits and then made a rational decision to act in their best interest. In response to the new reforms of tax rate laws, according to the recent study, the main cognitive antecedents of human behaviour may heavily influence the decision, by without ignoring money as a tool to promote socially desired behaviors. One of our informants cited that:

"... I pay taxes, and I obey the rules yesterday I was almost late and surprisingly still got an intensive,,,,, and this is good start because the business income is not always in certain position...." (Inf.6).

One point should be set immediately that within and across individuals in certain manner, everyone agrees that people have reasons for what they do. They have motivations, and they use reason (well or badly) to respond to those stimuli and grasp their aims. One participant's responses to the tax compliance reported:

"So far, from a personal point of view, I have no difficulty - satisfaction, I am as taxpayer always comply with regulations and taxes that I paid are in accordance with the existing regulations.... there is already a calculation technique and the percentage that makes taxpayers are easy in paying taxes, sometimes my child helps to count taxes due but I still scrutinised them as just corrections" (Inf.4).

He is assumed to have a well-organized and stable system of preferences, and a skill in computation that enables him to calculate, for the alternative courses of action that are available to him, which of these will permit him to reach the highest attainable point on his preference scale. This have certainly been concerned with rational choices, particularly with respect to computational and predictive abilities. He had arrived at the comforting points that general happiness is to be achieved mainly through the adequate pursuit of their own happiness by individuals; while, reciprocally, the happiness of individuals is to be achieved in part by their pursuit of the general happiness. According to Informant's judgement, it is far from the spirit of the philosophy of pleasure to deprecate the importance of human unselfishness - the control essential of human selfishness, or exercise an appreciable force in comparison with the impulse of self-interest. Here, the use of money brings about deleterious effects that challenge common sense. In other words, people are always self-interested, nor do they have consistent preferences or be mainly concerned about maximizing benefits and minimizing costs (He is supposed to take care of themselves and the immediate family). He commonly knows what he will want years in the future so he can save just the right amount to make himself as happy as possible over his lifetime.

A large body of work on tax behaviour has been inspired by, or relates to, the seminal theoretical papers by Buss (1999) and Frank (1988). These papers draw upon the standard economic framework, which assumes that taxpayers weigh the expected utility of the benefits from successful tax evasion with the risky prospect of detection and punishment. Gigerenzer, and Goldstein, (1996) call for more research exploring the diverse psychological, moral, and social influences on compliance behaviour, to help explain and understand the current level of compliance. Prior research has found that moral obligation has a direct effect on tax compliance (Gintis et al 2005); Haidt and Graham 2007; Harrison et al. 1998). However, Trevino et al. (2006) consider moral obligation (ethical values) as a boundary for the operation of other influential factors. Based on this view, a person with high moral obligation will simply comply and will not be affected by other factors. Although this is no study precisely quantifying the level of tax evasion, the main reasons that respondents agreed were explanations for why some people do not pay their taxes are:

"It is hardly deniable that...people think they pay too much tax on what they earn already...the taxes collected are used poorly". (Inf.3).

Public perception that the tax system is fair is important for tax compliance: taxpayers are persuaded to evade paying taxes if they perceive the tax system to be unfair. Kahneman et al's (1982) research supports the idea that tax fairness is a multidimensional model. The theory of optimal taxation has placed a very low emphasis on the intrinsic motivations of why people pay taxes, i.e. on tax morale (Sahlins, 1972; Sen, 1977). The concept of tax morale was introduced in the tax compliance literature to resolve the tax compliance puzzle, i.e. to explain the high degree of tax

compliance in the presence in many countries of a very low deterrence level (Stout, 2011; Van Lange et al., 1997). The rationale behind the link 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. In essence, tax fairness dimensions relating to general fairness, our respondents mentioned that:

"...I still pay taxes, but for tax reform I do not really understand....as the employer I just pay it.... usually later will be given direction when in the tax office..." (Inf.2).

"actually, I do not know, it has been appropriate or not.... the most important point, we as taxpayer always pay taxes on time...and hope don't too much burden taxes rate ..." (Inf.3).

Based on respondents' answers the decision to comply involves more complex considerations and many actors, namely other taxpayers, the government and the tax authorities. In this setting, tax compliance generally depends on maintaining a good cooperative relationship between authorities and tax payers that involves reciprocity of commitments and mutual respect, going beyond legal regulations. The enforcement paradigm, here, proved inadequate to explain observed behaviours of taxpayers, as levels of tax compliance and their differences across countries could not be explained simply by the effectiveness of tax authorities in enforcing tax laws. Basically, when speaking of tax compliance, it is impossible not to refer to the concepts of the tax system affecting social norms and tax morale. The more individuals are involved in the development of the perceptions of procedural justice. A high level of fairness perception should enhance trust in authorities and it should, finally, result in a higher level of tax compliance. In the literature, there is a consensus with regard to the positive relationship between participation and compliance: having the right to vote, for instance on features of the tax system, increases taxpayers' willingness to comply. In this regard, one of the informants in this study mentioned that:

"The stipulated tax is in accordance with the size of the business, I am still a small business so the tax paid is also smaller than the business with a larger level (Inf.5)"

With regard to the taxes collected, in any case, it appears that perceived fairness and procedural justice are also said by another informant:

"It is clear that...taxes are for those whose businesses are already stable...(Inf.5)"

The perceptual effects of spontaneous attention as demonstrated informants' answers above, signifying that taxpayers have the tendency to follow specific rules rather than acting in the line of standard economic rational choice theory of cheating. This means rules might be an explanation why taxpayers behave co-operatively – these practices place an undue tax burden on certain segments of the tax-paying population, while making it easy for other segments to significantly lower their tax burdens. As a result, taxpayers may follow rules they know or trust to produce good results. Socially desirable responses as well as in the development of the tax system may increase taxpayers' fairness perceptions, and motivation to pay taxes arising from the moral obligation to pay taxes as a contribution to society. Thus, the rationale for claiming self-interested actors within systems of economic or social exchange is controversial.

In light of the present investigation's findings, this view might well be resented, for good reasons, by sociologists, but the cross that economists have to bear in this view of the dichotomy can be seen if we note that the approach of "rational behaviour," as it is typically interpreted, leads to a remarkably mute theory. Behaviour, it appears, is to be "explained in terms of preferences, which are in turn defined only by behaviour." the need for "ideal observational conditions" for the implications of the approach to be "refuted or verified. If we wish to make room for this, we can expand the definition of commitment to include cases in which the person's choice, while maximizing anticipated personal welfare, would be unaffected under at least one counterfactual condition in which the act chosen would cease to maximize personal welfare. Commitment in this more inclusive sense may be difficult to ascertain not only in the context of others' choices but also in that of one's own, since it is not always clear what one would have done had the circumstances been different. This broader sense may have particular relevance when one acts on the basis of a concern for duty which, if violated, could cause remorse, but the action is really chosen out of the sense of duty rather than just to avoid the ill fare resulting from the remorse that would occur if one were to act otherwise.

Positive actions by the state are intended to increase taxpayers' positive attitudes and commitment to the tax system, taxpayment, and thus compliant behaviour. The way people are treated by the authorities affects their evaluations of authorities and their willingness to co-operate by complying with taxes rules. Indeed, researcher have found that in situations that need dichotomous responses—like the binary trust game—participants show trust differently from the way they do in situations that require diversified responses—like an investment game. One of participants said that:

".... I do not know exactly regarding tax reforms.... the most important thing, I pay tax as stipulated by government.... (inf. 5, 2, 1)"

"...taxation is largely a national matter....businesses and individuals just for complying with tax regulation...I purely don't have knowledge and information regarding tax reforms...anyway when I paid tax in the tax office, I didn't get confused as there are professional tax officers who will guide tax payers... (inf.1).

Tax compliance costs are a growing concern among taxpayers which have to bear them and tax administrations that wish to increase the efficiency of tax systems. Even though there is a participant tends to behave more selfishly. The construct of perceived behavioural control was added in an attempt to deal with situations in which people may lack complete volitional control over the behaviour of interest. It is immediately apparent that carrying out this intention is not completely under the person's control. Humans have developed a variety of strategies for self-regulation. Some strategies involve the use of external commitment devices or the avoidance of situations in which one is likely to lose control of one's behaviour. But an important source of self-regulation is internal: people cultivate a tendency to experience negative emotions—in particular, guilt and fear—when they engage in certain "undesirable" activities. Such emotions often serve the purpose mediatizing the delayed costs in the form of immediate emotions.

5. Conclusion

When we are looking at attempts to socialize the rational utility maximiser, it makes sense to dwell a bit on the concept of rationality that we would wish to employ. Most contributions in this area seem to adopt the rational utility maximiser as he is while adding social aspects into his, or her, preferences. However, I argued that such an approach seems to be oblivious of the opportunistic nature of the traditional rational utility maximiser and thus creates an internal inconsistency between the “man of society” and the opportunist. These led to a near-collective idea such as “team reasoning” according to which people make choices that will benefit others too, and on the other hand, to notions of social preferences where the “other” becomes explicit in one’s very individualistic preferences. The idea of “team reasoning,” as a manifestation of the social dimension in individual behaviour, is rather problematic. It requires that agents will have such a strong sense of community that they will be able to understand its objectives and identify with the entire system within which they operate.

6. References

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