

Improving Tax Authorities' Performance

IGC Africa Growth Forum

Adnan Khan

International Growth Centre, London School of Economics

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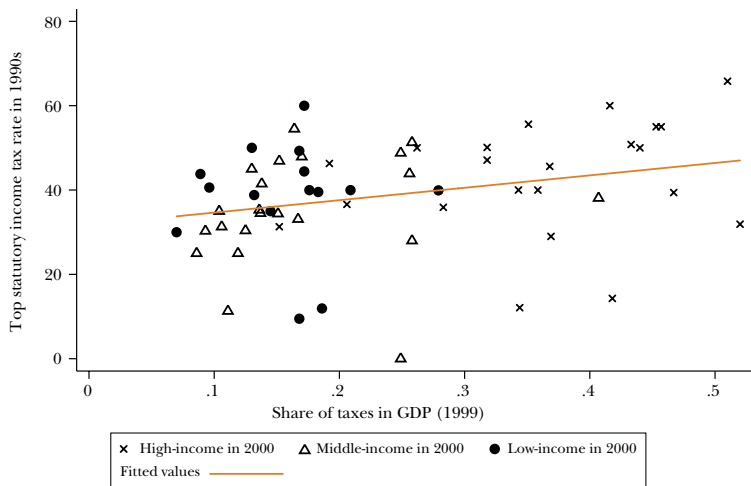
Taxation and development

- ▶ Taxation is central to state development (Besley and Persson 2014)
- ▶ Effective/efficient taxation requires investments in fiscal capacity - these need to be studied to provide an evidence base for policymaking
 - ▶ copying tax policies from developed countries is not a solution
 - ▶ policy analyses not based on rigorous, credible research can often do more harm than good
- ▶ Credible research on taxation that generates actionable policy recommendations requires close collaboration between researchers and policymakers
- ▶ IGC is sponsoring such collaborations. This talk is about one such engagement

Framework on Taxpayer-Tax Collector Engagement

- ▶ Performance of tax authorities depends to a large extent on the engagement between Taxpayers (TP) and Tax Collectors (TC)
- ▶ This involves determination/payment of true tax liability to the state
- ▶ ... but this can also involve
 - ▶ low effort by tax collector
 - ▶ collusion/extortion between taxpayer and tax collector

Tax revenues and max statutory tax rate (Besley 2014)



Framework on Taxpayer-Tax Collector Engagement

- ▶ Given the likelihood of low effort and collusion, what policy instruments can address these:
 - ▶ Performance pay
 - ▶ Cost of evasion for tax collector
 - ▶ Cost of evasion for taxpayer
 - ▶ Audit/monitoring
 - ▶ Technology/3rd party information
 - ▶ Management/operational practices

Studies on Taxpayer-Tax Collector Engagement

- ▶ Incentives
 - ▶ *Performance pay for tax inspectors*
 - ▶ *Merit-based transfers and postings*
- ▶ Cost of evasion for tax collectors
 - ▶ *Selection margin (fixed effects)*
- ▶ Cost of evasion for taxpayer
 - ▶ *Tax morale mechanisms (Bangladesh and Pakistan)*
- ▶ Audit/monitoring
 - ▶ *3rd party information*
- ▶ Technology
 - ▶ *EBM project; Online customs clearance in Pakistan*
- ▶ Management/operational practices
 - ▶ *Cross-country comparison of tax administration performance*

Modality of Engagement

- ▶ These projects involve close collaboration with and full ownership of tax authorities in Pakistan
- ▶ This involved:
 - ▶ sharing data
 - ▶ engaging in design
 - ▶ collaborating in evaluation, and
 - ▶ scale up of recommendations
- ▶ Examples:
 - ▶ FBR sharing of admin data has generated a series of path-breaking studies by Kleven et al.
 - ▶ Close cooperation with Govt of Punjab has generated a unique collaboration over half a decade

Secondary byproducts of research - data visualization and performance dashboard

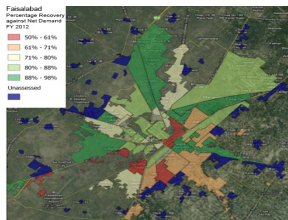
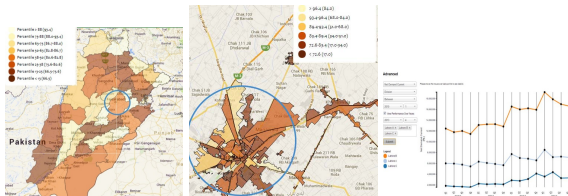


Figure 1: Tax Circles in Faisalabad



Performance pay for tax collectors

- ▶ Poor tax enforcement in part may be due to problems with tax inspectors (collusion, low effort)
- ▶ Historically solved by high-powered incentives but concerns about extortion led to a move away towards flat compensation for tax staff
- ▶ In good Weberian bureaucracies, with honest civil servants & 3rd party verification, flat wage system may make sense
- ▶ But what about in a developing country? Would collection-based pay make sense there? And what would the costs be?
- ▶ No clean study of this tradeoff (more revenue through incentives vs. greater political/morale cost)
- ▶ We (Khan, Khwaja, Olken 2014) study this tradeoff in a field experiment with Punjab government for property tax inspectors

Design of performance pay

- ▶ Randomly allocate all 482 tax units (called “circles”) into performance-pay or controls for two fiscal years
- ▶ Performance-based rewards are large
 - ▶ Tax officers in treatment group (team of three staff) receive 20-40% of all revenue collected above a historical benchmark
 - ▶ Many staff get close to doubling their base wages
- ▶ Explore the impacts on tax-revenue and non-tax outcomes (taxpayer satisfaction, corruption, accuracy of assessment)
- ▶ Explore three variants of performance pay schemes with differing emphasis on non-revenue outcomes
 - ▶ Revenue only scheme
 - ▶ Revenue PLUS scheme (+/- for taxpayer satisfaction and accuracy)
 - ▶ Flexible Bonus scheme - flat wage plus end bonus based on wider range of performance metrics

Overview of Results

- ▶ Incentives work:
 - ▶ Incentives increase revenue by 9.3 log points
 - ▶ No change in taxpayer satisfaction or assessment accuracy
- ▶ Which incentives work - effects of subtreatments
 - ▶ Flexible bonus didn't work (implications for wage increases!)
 - ▶ Effects largest for revenue scheme
- ▶ Performance pay can also generate perverse outcomes by increasing bribes, so needs to be accompanied with citizen grievance redressal mechanism
- ▶ Currently working with government in scale up of policy recommendations

Merit-Based Transfers and Postings

- ▶ Scheme:
 - ▶ Make groups (of ten) circles
 - ▶ Inspectors face performance tournament within group
 - ▶ At the end of year, choose circles within group in order of performance rank
- ▶ Ongoing – in 150 circles (groups of 10)
 - ▶ 15 groups of ten circles:
 - ▶ Type A – rank on recovery
 - ▶ Type B – rank on assessment value
 - ▶ Inspectors were transferred at the end of year on the basis of performance and preference

Tax Morale

- ▶ A typology of tax morale (Luttmer-Singhal 2014):
 - ▶ Intrinsic motivation (within-individual preference)
 - ▶ Social norms (depend on other individuals)
 - ▶ Reciprocity (depends on the state)
 - ▶ Culture (long-run societal effect)
- ▶ Examples of tax morale research:
 - ▶ Bangladesh Taxpayer recognition project on social incentives - with active collaboration of NBR
 - ▶ Punjab social compact project

Tax and Social Compact

- ▶ Due to low provision of public goods and low level of trust in state, there is a real risk of citizens disengaging with the state besides tax collection falling
- ▶ This project attempts to strengthen this link by connecting citizen's tax payments in a more credible manner with his receiving benefits from the state
 - ▶ Establish a link between taxes paid and services received
 - ▶ Specifically tying tax collection to demanded services
 - ▶ Facilitate matching incentive grants
- ▶ Experimental design where we will measure both the impact on tax collection and overall citizen satisfaction, including the key element of broader trust in the state as evidenced by the real action of tax payment.

Summing up

- ▶ Taxation is not just about raising revenues but is central to building an effective and accountable state
- ▶ Rigorous and credible research that incorporates the constraints faced by tax authorities can generate actionable policy recommendations
- ▶ Taxation is a big priority for IGC and we will welcome opportunities to work with you on these questions