

Tax Enforcement and Development

Tax Policy Design and Enforcement Conference Lusaka

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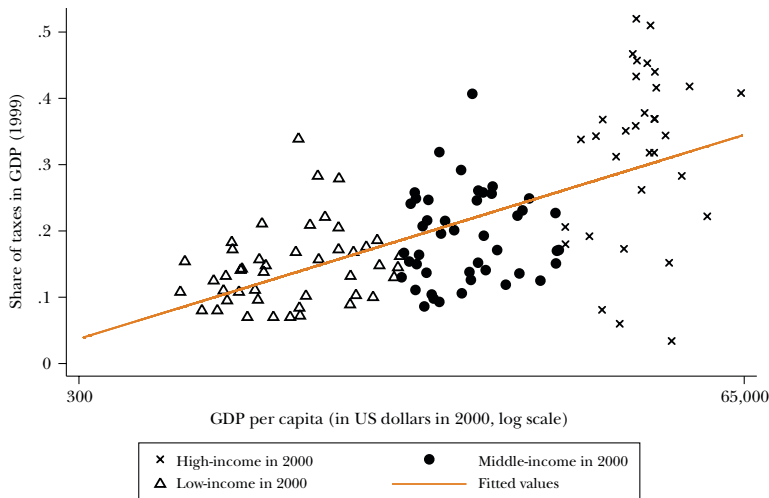
International Growth Centre, LSE

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Taxation and Development

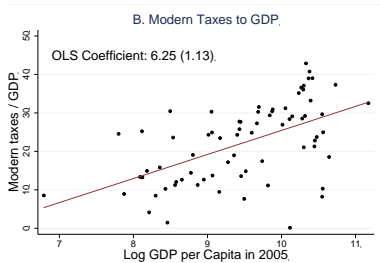
- ▶ Taxation is central for state building and effective service delivery
 - ▶ inability to tax is both a symptom and a cause of underdevelopment
 - ▶ “How does a government go from raising around 10% of GDP in taxes to raising around 40%?” (Besley-Persson 2013)
- ▶ African tax challenge is effective enforcement
 - ▶ what shapes tax enforcement and tax capacity? What investments are needed in fiscal capacity building in Africa
 - ▶ copying tax policies from developed countries is not a solution
 - ▶ close collaboration between Revenue Authorities and researchers can generate valuable insights and actionable recommendations grounded in local context

Tax revenues and income are positively correlated across countries (Besley 2014)

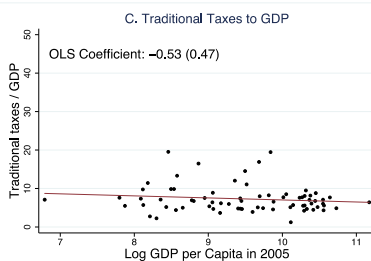


... but this positive correlation only holds for modern taxes

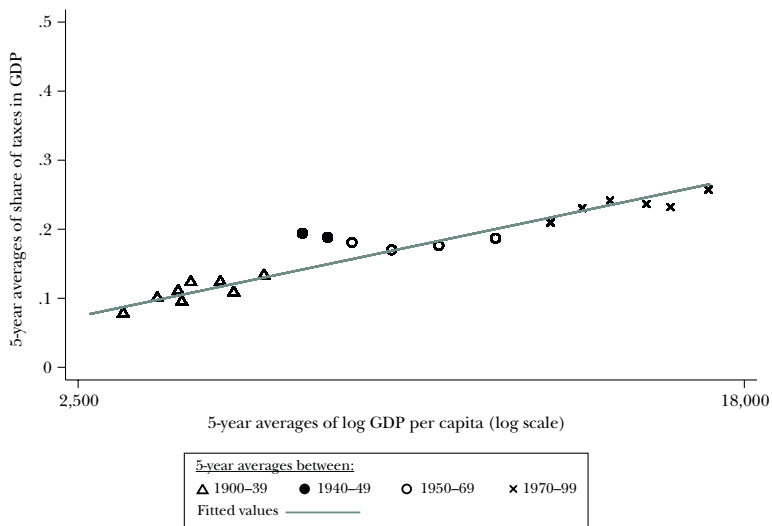
Modern Taxes to GDP



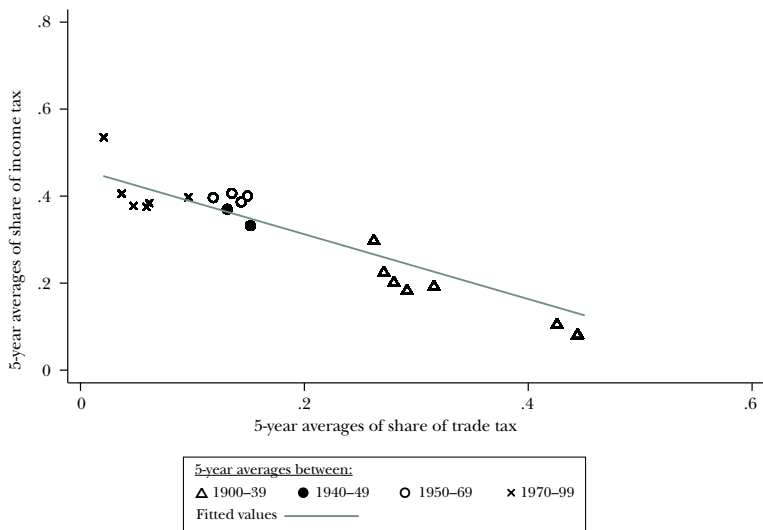
Traditional Taxes to GDP



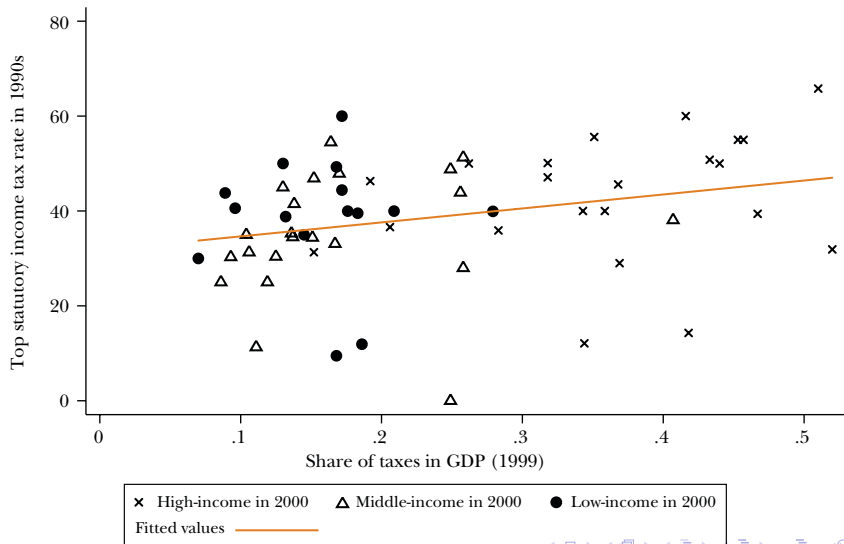
Tax revenues have increased for the same countries over time



but its composition has shifted from trade to income taxes



Max Statutory Income Tax Rate and Tax Revenues (Besley 2014)



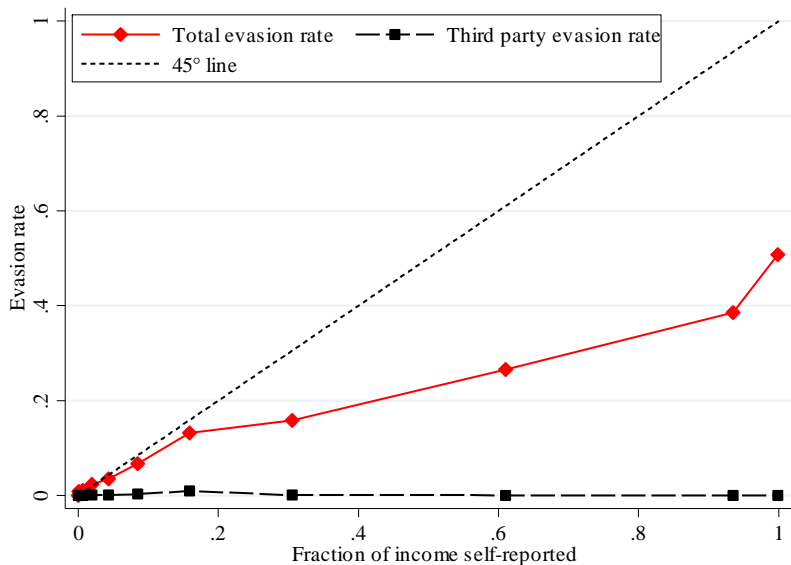
Tax Enforcement

- ▶ So effective enforcement lies at the heart of the challenge of taxation
- ▶ How do we strengthen tax enforcement and state capacity in particular:
 - ▶ information and its effective use
 - ▶ incentive structures in tax enforcement
 - ▶ voluntary compliance
 - ▶ political economy

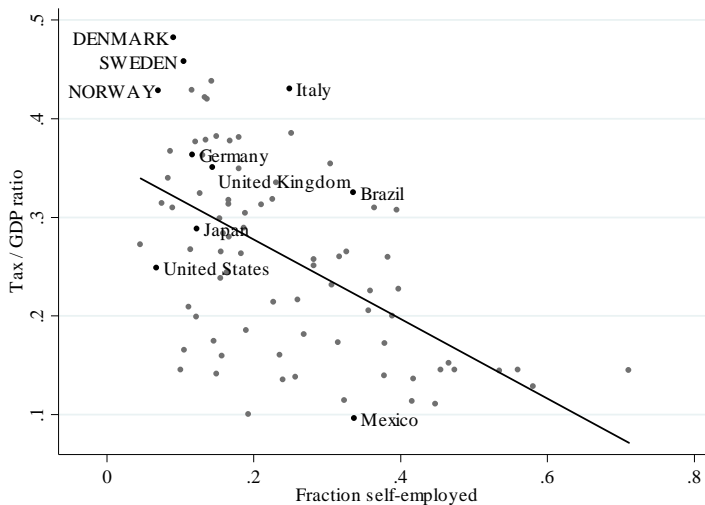
Tax Enforcement: Role of Information

- ▶ Addressing tax evasion involves:
 1. Audits
 2. Penalties
 3. Third-party information reporting & withholding
 4. Other verifiable information trails
- ▶ Kleven et al. (2009, 2011): tax enforcement is successful when verifiable third-party information (3-4) has wide coverage
- ▶ Absent wide coverage of 3-4, we want to know
 - ▶ can we expand 3-4 and what are the effects?
 - ▶ how should we design 1-2?

Third-Party Reporting: Denmark (Kleven et al. 2011)



Third-Party Reporting: Cross-Country



Tax Administration

- ▶ Tax staff matters for performance
 - ▶ pay is typically low, untied to performance, limited career advancement opportunities, substantial non-pecuniary benefits
- ▶ Key challenge is to improve tax administration to account for incentives (people act in their self-interest) and motivation. This has implications for:
 - ▶ Recruitment
 - ▶ Performance pay
 - ▶ Career concerns: postings and promotion

Tax Compliance

- ▶ Voluntary Tax Compliance comes from 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)
- ▶ How can this be affected through policy, credible actions, and narratives

Political economy and change of organizational culture

- ▶ Taxation is important for government reform as it sends a costly signal
- ▶ Leadership has a key role in shaping identity, norms and narratives that are mutually consistent
- ▶ Changing these is hard as this is a **locally stable belief system** but can be done

Context: Tax Reform in Punjab, Pakistan

- ▶ Project involves close collaboration between Govt of Punjab and our research team (joint with Ben Olken, MIT, and Asim Khwaja, Harvard) since 2009
- ▶ Key features of this engagement
 - ▶ joint problem discovery, design and testing at scale
 - ▶ organic capacity building
 - ▶ specificity and generalizability

Does performance pay for tax collectors improve performance?

- ▶ We study the **tradeoff (more revenue through incentives vs. greater political/morale cost)** and explore three variants of PP schemes with differing emphasis on non-revenue outcomes
- ▶ **Incentives work**, increase revenue by 9.7 pp, and more than pay for their costs, with no change in taxpayer satisfaction or assessment accuracy
- ▶ Effects largest for **revenue scheme**, flexible bonus didn't work
- ▶ How do these work:
 - ▶ for most taxpayers: tax paid unchanged, and bribes increase
 - ▶ but, for some: tax paid increases substantially, and bribes fall
- ▶ Overall, performance pay if properly designed can increase performance but it needs to be accompanied with audit mechanism

Do Performance-based postings work

- ▶ Postings are often used by bureaucracies: dole out favors, political pressure, reward/punish staff. But many **challenges** to using postings as incentives
- ▶ We propose an **incentive-compatible** mechanism for allocating civil servants named and test it at scale through a field experiment
- ▶ Results: revenues were 5-8 pp higher; this is 2/3rds as large an effect as the maximally effective PP scheme

Organic capacity building - data visualization and performance dashboard

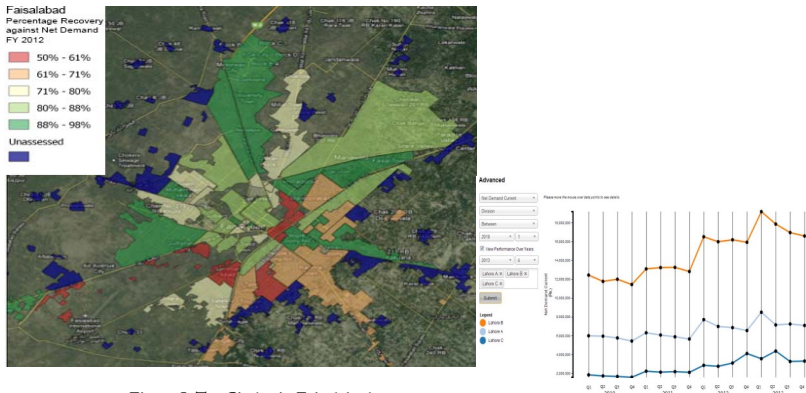
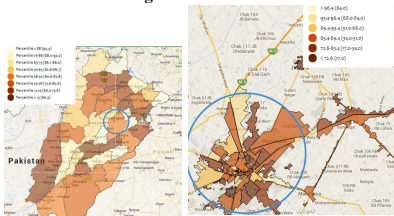


Figure I: Tax Circles in Faisalabad



Voluntary Tax Compliance

- ▶ Strengthening the social compact between citizens and state in Punjab by:
 - ▶ linking property tax payments with local services (ongoing)
- ▶ Examples of IGC tax morale research:
 - ▶ Bangladesh NBR Taxpayer recognition project on social incentives

Building tax enforcement

- ▶ Taxation is central to development and building effective states
- ▶ Improving tax enforcement involves effective use of information, addressing incentive structures, measures to increase tax compliance, and supportive political actions
- ▶ Collaboration with researchers can generate new policy-relevant knowledge and catalyse reforms in government. IGC aims at playing this role and looks forward to working with you