

Taxation and Development: Challenges and Policy Solutions

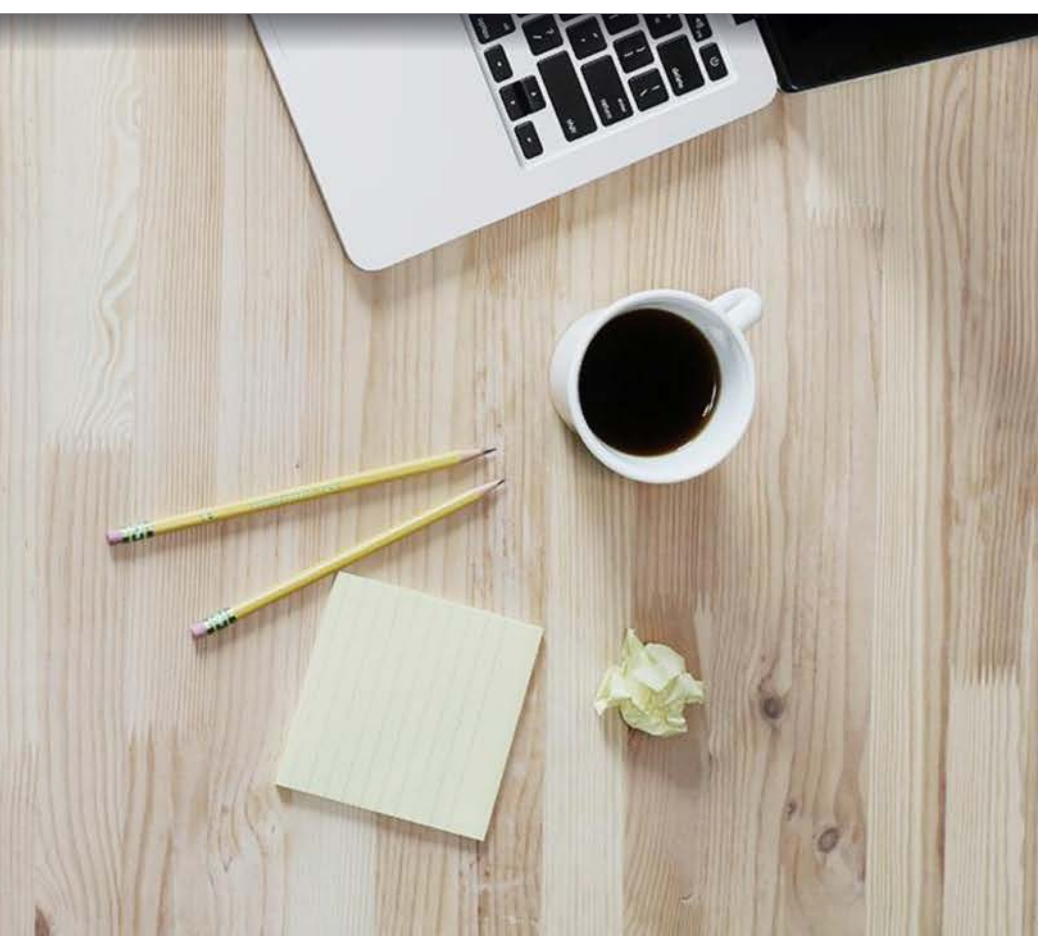
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Public Finance and Public

Management in Africa

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Outline

1. Motivation
2. Challenges
3. Topics
 - ❑ Tax compliance
 - ❑ Enforcement
 - ❑ Tax morale
- ❑ Tax administration
- ❑ Tax policy
4. Conclusions

Taxes Matter!



**No regrets over
the poll tax,
says Thatcher**

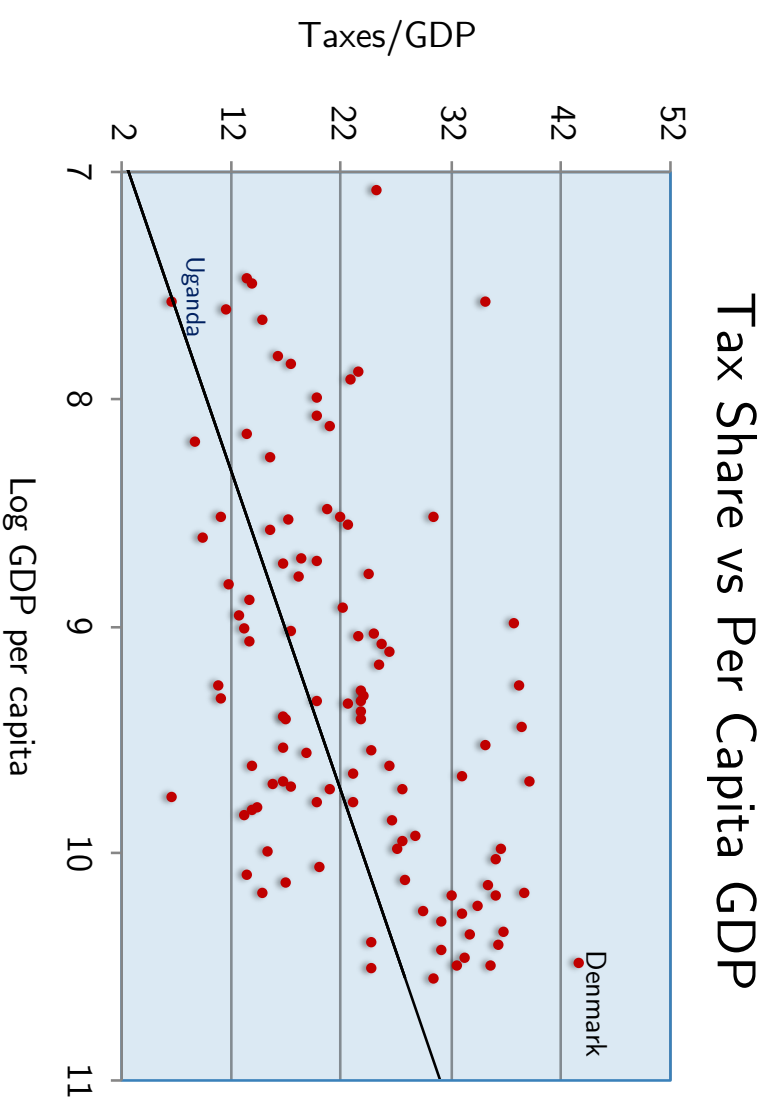
By George Jones, Political Editor
MRS THATCHER told senior ministers yesterday that
she has no regrets over the introduction of the poll tax

Taxation and Development

- ❑ Taxation is central to development of the state (Besley and Persson 2014)
- ❑ Central challenge of development is how does a government go from raising around 10% of GDP in taxes to raising around 40%?
- ❑ efficient taxation requires investments in capacity: Tax Systems approach (Slemrod and Gillitze)
- ❑ Policy not based on evidence can often do more harm than good

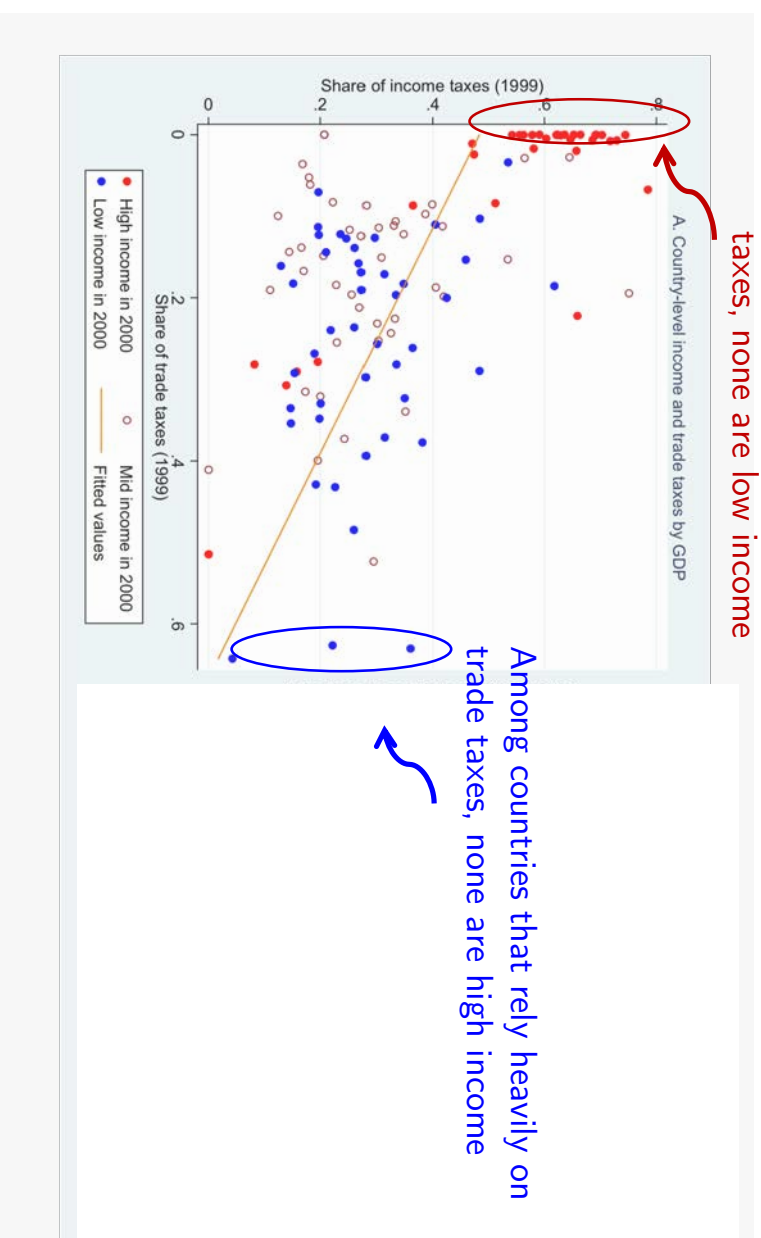
Stylized Fact #1

The tax share in GDP is increasing with per-capita income



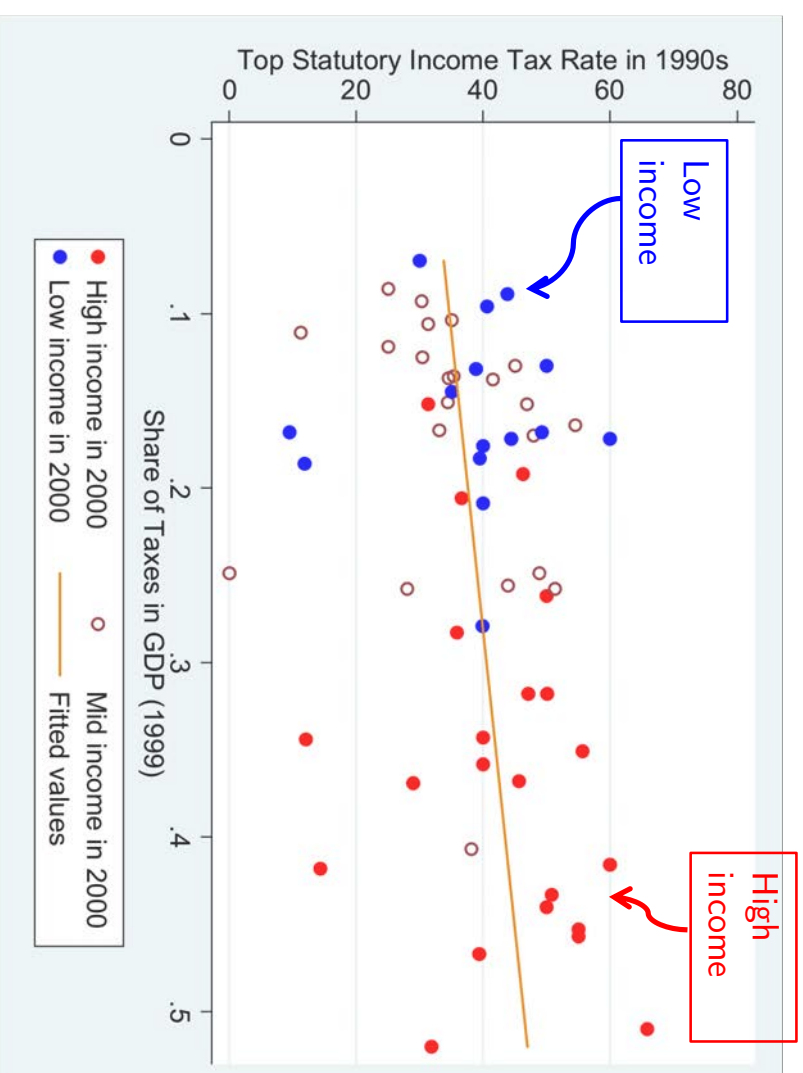
Stylized Fact #2

Higher-income countries rely much more on income taxes as opposed to trade taxes than do poorer countries



Stylized Fact #3

Even with comparable statutory rates, developed countries raise much more revenue (as a share of GDP) than developing countries



Challenges in Raising the Share of Taxes in GDP



Three views of informal firms

- ❑ Very productive, but held back by taxes and regulations
- ❑ Undercut official firms in prices, stifling the development of more efficient, larger, businesses
- ❑ Have lower-quality entrepreneurs, less productive

But, here's a fact: it has been proven very difficult to identify policies that successfully move firms to the formal economy.

More Challenges

- ❑ Low tax compliance (attributed partly to low tax morale?) coupled with poor tax administration

“Estimates of non-compliance are scarce, but Value-Added Tax (VAT) ‘gaps’ have been put at 50-60% in some developing countries, compared to 7-13% in developed countries.” (IMF 2011)

- ❑ A growing number of ad-hoc set of tax exemptions and incentives (tax policy)

Discussion

1. Tax compliance
 - *Tax enforcement*
 - Tax morale
2. Tax administration
3. Tax policy

Enforcement

Traditional focus –

- ❑ Taxpayers will cheat if the rewards are greater than the expected costs
 - ❑ audits and penalties

Audits very costly

- ❑ time consuming for tax authorities and taxpayers.
- ❑ require educated auditors, hard to retain in the public sector

Enforcement

New evidence

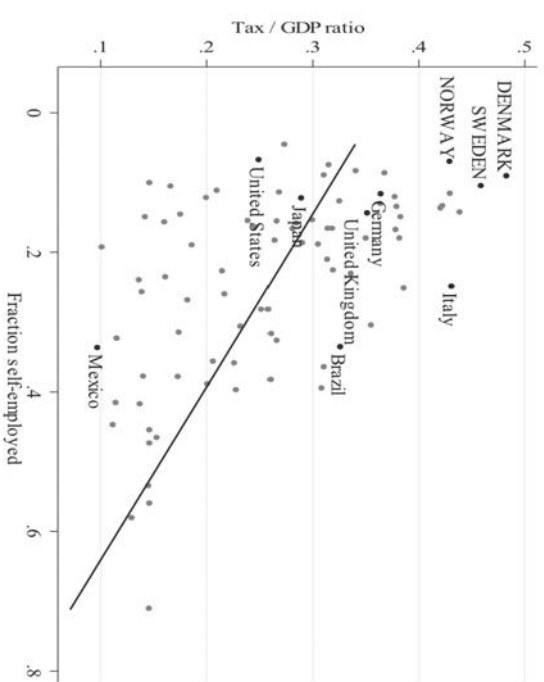
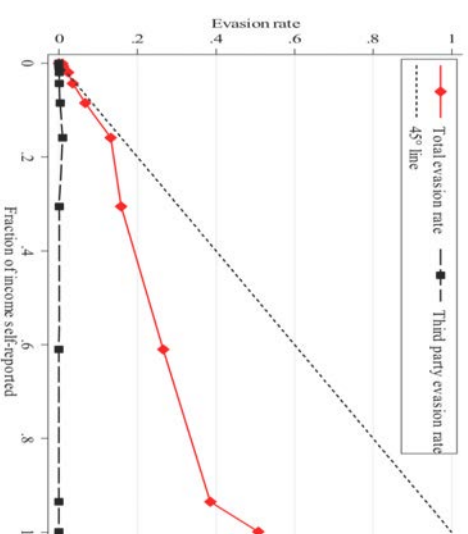
- ❑ information is a far more efficient means of reducing non-compliance and evasion

Third-party information

- ❑ Employers
- ❑ Other verifiable information trails (credit cards, receipts, etc.)
- ❑ Information that has wide coverage

Evasion
increases with
self
employment,
both at the
individual level
and across
countries

Tax Evasion and Third-Party Information Evidence From Danish Audit Experiment



Tax Take and Third-Party Reporting
across Countries

Evidence that
third-party
information
matters is
strong and
compelling

Pomeranz (2015) [**VAT** in **Chile**]

- ❑ Randomized letters from revenue authority (threatening audit)

Kumler, Verhoogen, and Frias (2013) [**Payroll Tax** in **Mexico**]

- ❑ Give workers incentives to ensure accurate employer reports of earned income

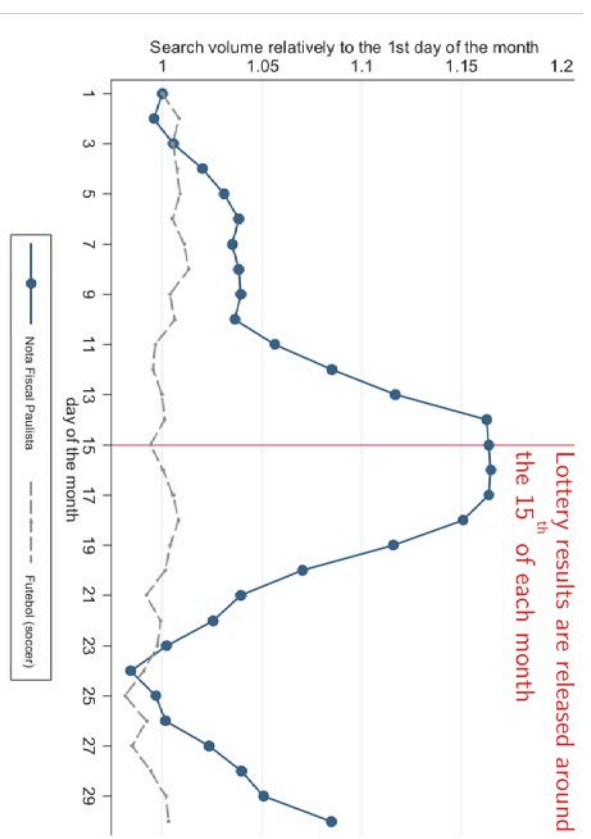
Carillo, Pomeranz, and Singhal (2014) [**CIT** in **Ecuador**]

- ❑ Third-party information is ineffective if taxpayers can make offsetting adjustments on less verifiable margins

Evidence that third-party information matters is strong and compelling

Naritomi (2015) [VAT in Brazil]:

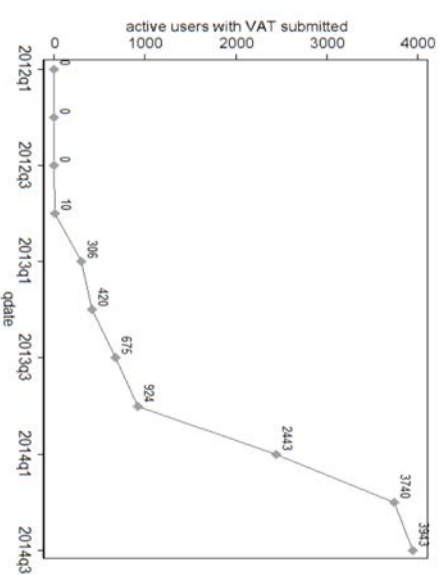
- ❑ Providing incentives for consumers to ask for VAT receipts effectively uses consumers as auditors
- ❑ force non-compliant firms to comply



Technology and Tax Compliance

Electronic fiscal devices as a means of collecting VAT transactions data that is not subject to tampering

- e.g. Rwanda



- VAT revenues increased with adoption of machines (between 2012-2014)
- modest amount, 5% over a 3 year period.
- **But**, this impact is based on a very-low usage rate (20%)

Technology and Tax Compliance

Current work in Rwanda:

- ❑ Evaluating innovative audit scheme, using mystery shoppers as initial screeners for potential audit

Policy questions:

- ❑ Does the audit scheme raise revenues?
- ❑ Are there spillover effects on surrounding firms/is there a threshold in a network that triggers a widespread change in perceptions and behavior?
- ❑ What is the incidence of the audit scheme?

Discussion

1. Tax compliance
 - Tax enforcement
 - *Tax morale*
2. Tax administration
3. Tax policy

What is tax morale

Question is not why do taxpayers fail to pay taxes? But, why do taxpayers pay taxes?

Channels (Luttmer & Singhal 2014)

1. Intrinsic motivation (innate preferences)
2. Social norms (depend on other individuals)
3. Reciprocity (depends on the state)
4. Culture (long-run societal effect)

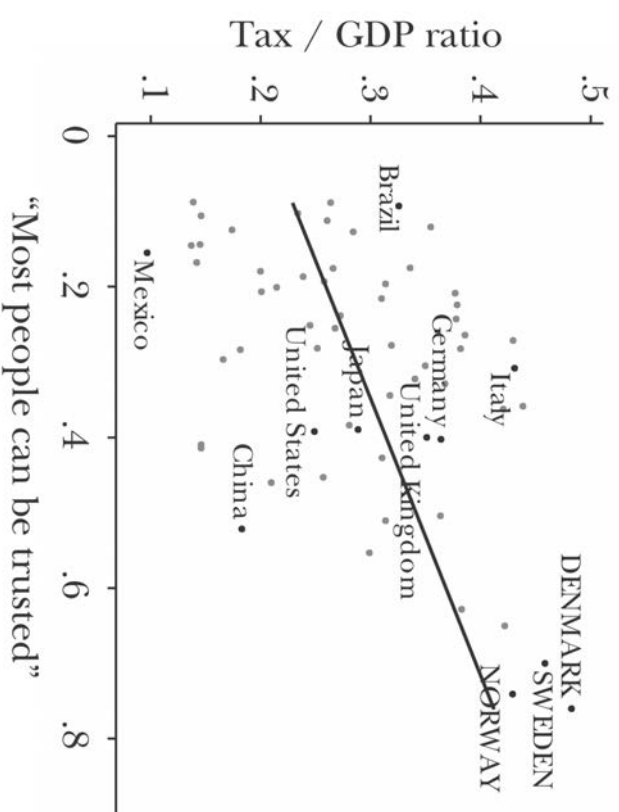
What is tax morale

We know relatively little

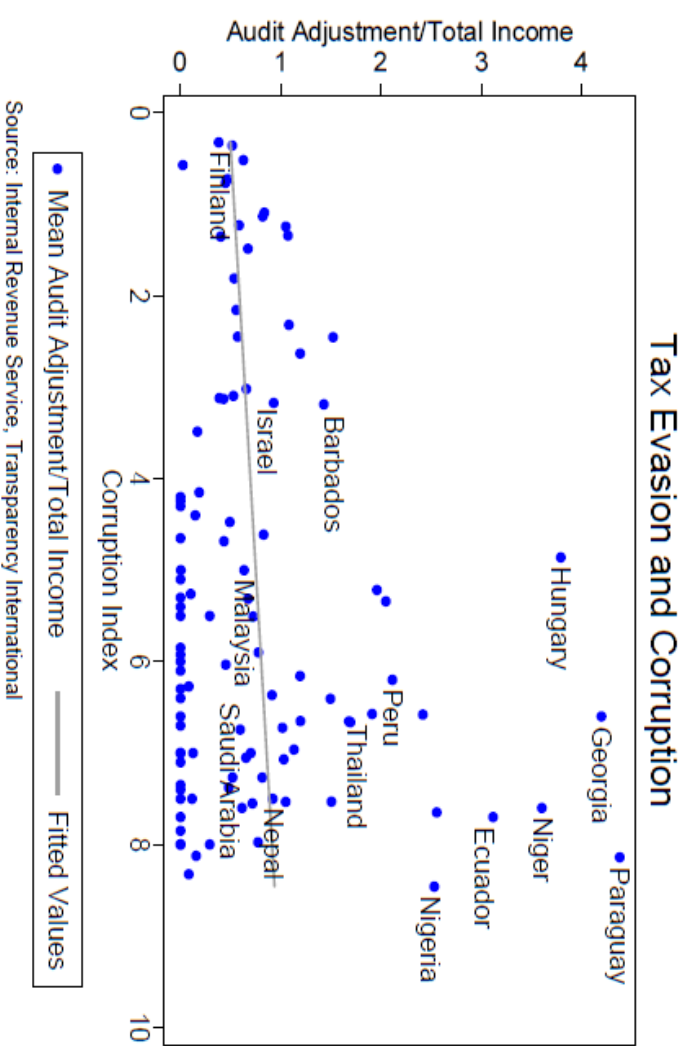
1. What is the quantitative importance of tax morale mechanisms?
2. Can policy makers affect tax morale through policy design?

What we can say is that tax share and compliance are correlated with proxies for tax morale across countries

Tax morale rises with trust



Tax evasion and corruption



Approaches to move tax morale: Advertisement campaign in the Philippines

When you don't pay your taxes,
you're a burden to those who do.
Do your share. knowyourtaxes.ph

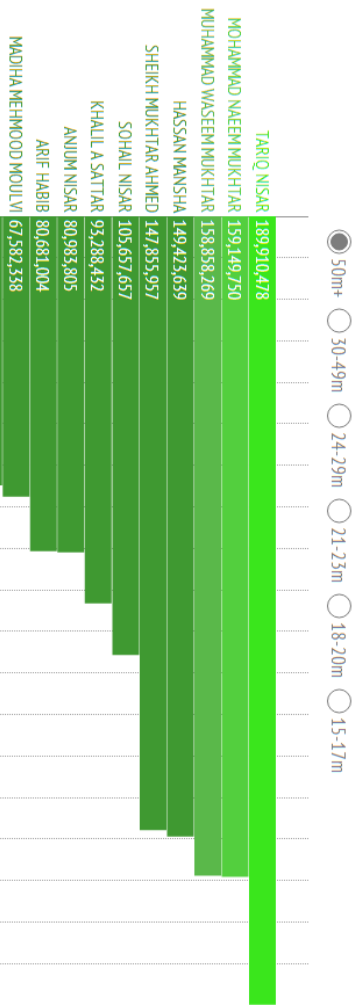
ITR Filing and Payment Deadline: April 15
BIR Hotline: 981-8888

A message from

Supported by

A different approach in Pakistan and Punjab: Recognition of highest taxpayers

Taxes paid by salaried individuals



Interventions
to improve
tax morale
are mixed,
and highly
dependent on
context

Del Carpio (2014) [Peru Property Tax]

- ❑ information about compliance norms had a strong positive impact on compliance

List et al (2014) [UK Income Tax]

- ❑ norms and public goods messages improves the timely payment of taxes

IGC research

- ❑ Khan-Khwaja-Olken (ongoing): Credibly linking citizen tax payment with public goods & services [Pakistan]

Discussion

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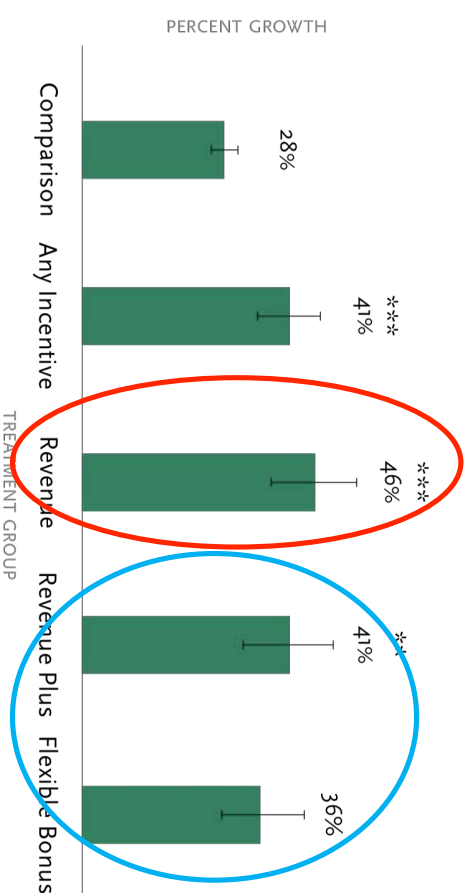
Performance pay for tax collectors

Khan, Khwaja & Olken (2016)

Performance pay scheme in Pakistan

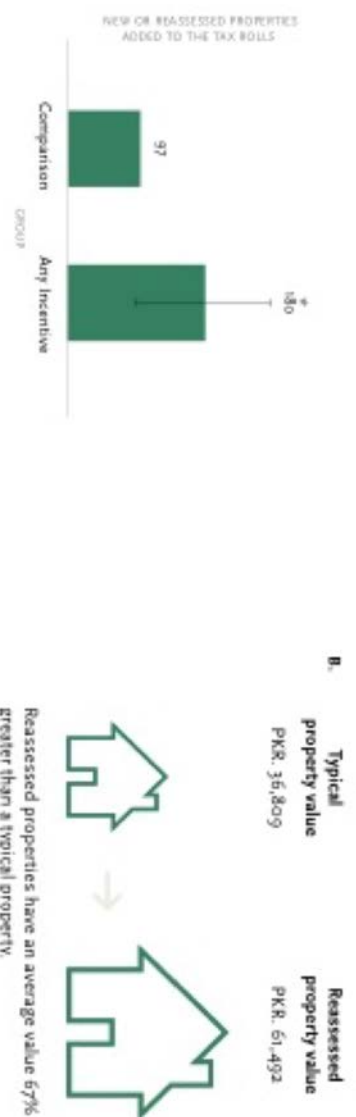
- ❑ Revenue (simplest)
- ❑ Revenue PLUS (reward also in assessment accuracy & taxpayer satisfaction)
- ❑ Flexible Bonus (subjective & flexible but more complex)

Performance pay for tax collectors



Source: JPAL, 2016

Tax base expanded by new and reassessed properties



Discussion

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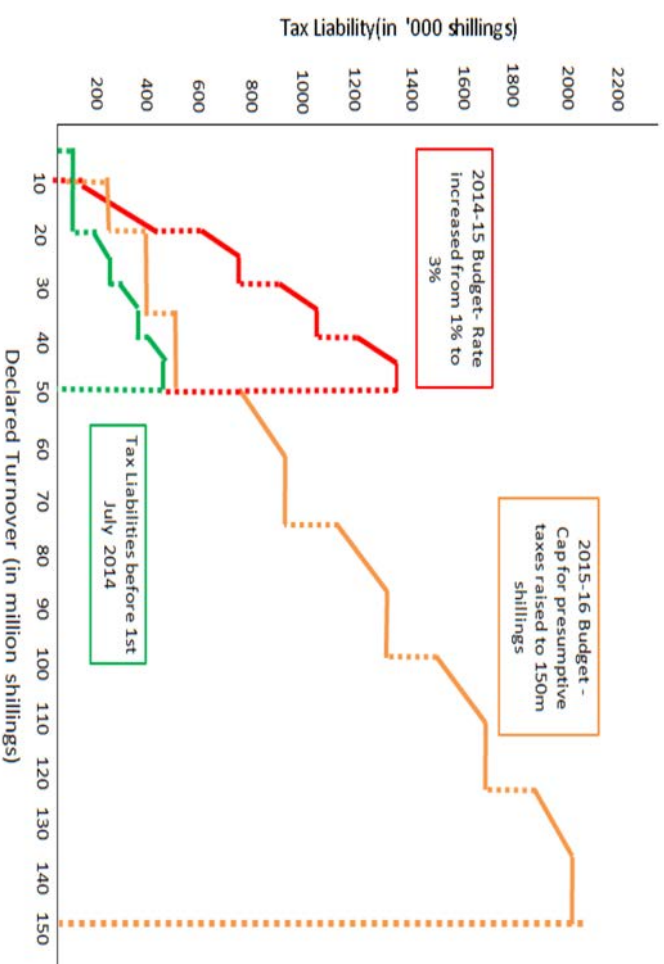
Tax exemptions and incentives

Taxes not collected because of exemptions reach as high as 2% GDP (e.g. Uganda)

Tax expenditures spending through tax system

- ❑ Inefficient: distort resource allocation
- ❑ Not transparent, create rent seeking (unproductive activities)
- ❑ Create uncertainty if discretionary

Presumptive Taxation



Imposed on turnover of firms below revenue threshold

- incentivizes firms to stay small (either in actual economic activity or, more likely, by evading taxes)

Key Lessons

1. Third-party information: People don't pay taxes because they're honest, but because they fear the consequences

- ❑ withholding (income)
- ❑ technology (VAT)
- ❑ consumers

2. Framing and Salience

- ❑ tolls
- ❑ norms

Key Lessons

3. Raising tax revenues in challenging environments requires a lot of attention to specific country context

- ❑ administrative data and field experiments

But we also have to set the right policy