Social Incentives and Tax Compliance in Bangladesh

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Sector(s): Political Economy and Governance

Fieldwork: Innovations for Poverty Action (IPA)

Location: Bangladesh

Sample: 16,252 firms

Initiative(s): Governance Initiative (GI)

Target group: Large enterprises

Outcome of interest: Taxation

Intervention type: Incentives Information

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Research Papers: Increasing Tax Compliance through Social Recognition

Partner organization(s): Bangladesh National Board of Revenue (NBR) , International Growth Center (IGC), Innovations for Poverty Action (IPA), UK International Development

Improving tax administration is an important priority for many low- and middle-income country governments. An efficient and equitable tax system can increase government revenue, lessen dependence on foreign aid, and strengthen state authority. Researchers studied the impact of an innovative taxpayer recognition program that appealed to business owners' desires for social recognition on firms' value-added tax (VAT) compliance and payment rates in Dhaka, Bangladesh. Preliminary results suggested that in areas where some firms were already paying taxes, sharing information on compliance in the area increased compliance and payments from neighboring firms that had not been making tax payments.

Policy issue

Improving tax administration is an important priority for many low- and middle-income country governments. An efficient and equitable tax system can increase a government's revenue, lessen its dependence on foreign aid, and strengthen state authority. However, improving tax collection is challenging. Traditional methods of increasing tax revenue rely on punishments for noncompliance, but these approaches can be ineffective when tax collectors and auditors lack incentives to behave honestly and can collude with evading taxpayers. An alternative approach may be to recognize or reward good taxpayers by leveraging a firm's interest in social recognition. Researchers conducted one of the first randomized evaluations to test the impact of an innovative taxpayer recognition program in Dhaka, Bangladesh.

Context of the evaluation

Bangladesh has a tax revenue-to-GDP ratio of 9 percent, substantially lower than neighboring countries. The VAT comprises the largest portion of the country's tax revenue, but the amount collected is much lower than the amount owed. Many firms remain unregistered. Even among registered firms, only 16 percent of firms file monthly VAT returns, and there is likely substantial evasion among filers. In Dhaka, researchers found that only 9.3 percent of firms filed VAT in 2012. To address this issue, the Bangladesh National Board of Revenue has introduced several small-scale taxpayer recognition programs over the past few years to incentivize better tax compliance from individuals and firms.

A Bangladeshi man calculates the taxes he owes.

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Details of the intervention

Researchers evaluated the impact of a taxpayer recognition program that seeks to increase VAT compliance and payments through social incentives. In collaboration with the Bangladesh National Board of Revenue (NBR), researchers identified 23,034 firms that report to one of six VAT collection offices in Dhaka and grouped them into geographic clusters.

All firms, including those in a comparison group, were sent letters informing them about the importance of tax compliance, which were successfully delivered to 16,252 firms. The letter included each firm's VAT registration record, filing information, and amount of the latest VAT payment, giving firms the chance to correct any mistakes regarding their status. Providing this information demonstrated that the NBR could match tax information to firms, giving credibility to the intervention. The letter noted that each firm was a part of a "cluster" of firms and provided the identities of other firms grouped together in the recipient's cluster. The letter also informed firms that they and the other firms in their cluster would receive a second letter in six weeks.

Researchers randomly varied the content of the first letter, in terms of (a) whether or not it provided information about the average tax and registration compliance rates in their cluster at baseline (*Baseline Information*), and (b) the content promised in the second letter. The random variation in the content of the first letter contained neither, one, or both of the following information interventions:

1. *Recognition cards*: Firms were told that the second mailing would include a Taxpayer Recognition Certificate if the firm completed its VAT filing and its entire cluster met a minimum filing rate.
2. *Peer group information*: Firms were told that, in the second mailing, their tax compliance behavior would be shared with other firms in their cluster.

The variation in sharing *Baseline Information*, coupled with the *Recognition Cards* and *Peer Group Information* interventions created eight different versions of the initial letter, which were randomly distributed across clusters.

Researchers monitored administrative records on registration and tax payments in order to study the effects of the variation in the content of the initial letter. This allowed them to test whether peer- or card-based recognition was successful at shifting social norms and increasing compliance.

Results and policy lessons

Researchers are still collecting data for a complete analysis—all results reported below are preliminary.

In low-compliance clusters, defined as clusters where less than 15 percent of firms had paid the VAT in 2012 (and frequently, no firms did), none of the intervention letters had any impact on VAT payment rates. However, in high-compliance clusters, where at least 15 percent of firms had paid the VAT in 2012, firms that received the peer group information intervention were 3.4 percentage points more likely to make a payment in the study period compared to other firms in high-compliance clusters that did not receive the information. The impact of the peer group information was even larger for firms that did not pay any VAT in 2012; these firms were 6 percentage points more likely to make a payment during the intervention, reflecting more than a 100 percent increase over those firms in the comparison group.

Moreover, firms in high-compliance clusters that received the peer group information and decided to pay the VAT paid 17 percent more on average than firms not receiving this intervention. These high-compliance clusters accounted for 66 percent of total VAT revenues generated during the intervention.

While the results indicate there was a strong response to the peer group information intervention, the mechanism behind the observed increase in payments was not completely clear. Some of the increase may have been driven not just by increased tax payments but also the improved recording of payments that had already been committed.