

Tax Farming Redux: Experimental Evidence on Incentive Pay for Tax Collectors

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Abstract

An important question in the design of a civil service system is the role of incentives. In tax, high-powered incentives for tax collectors could increase effort and revenues, but it might come at a high political cost if taxpayers experience greater pressure by collectors especially if the latter resort to extortion and over-taxation. We report the results of the first large-scale, randomized field experiment designed to investigate these issues. Working with the Punjab, Pakistan provincial government, we experimentally allocated collectors in the entire provincial property tax department, consisting of 482 property tax circles, into one of three high-powered incentive schemes or a control group. Two years later, we find that incentivized circles showed 8 percent higher collections than the control, with the increased revenue coming from an expanded tax base and far exceeding the cost of the incentives. Yet incentivized circles do not report greater taxpayer discontent. Moreover, while we find that the incentive scheme that rewarded purely on collection performs better in terms of tax revenue raised, it does no worse on customer satisfaction and assessment accuracy compared to the two other schemes that explicitly rewarded these non-revenue margins. However, digging deeper into our findings reveals an interesting heterogeneity. The average taxpayer in incentivized circles reports higher level of bribes and instances of corruption. In contrast, conditional on their property being reassessed, which typically leads to higher level of tax, tax payers report lower levels of bribes and instances of corruption. These results are consistent with a world with collusion between collector and taxpayer in which the increased return to the collector for raising tax changes the bargaining process between them. As a result taxpayers in incentivized circles either have to pay higher bribes to avoid being reassessed or end up having to pay substantially higher taxes if the bargaining process breaks down. Our results therefore suggest that while incentives for tax collectors can substantially boost revenue collected and lead to little overall discontent, they do empower the tax collector in a manner that can both lead to increased revenue and rents at the expense of the taxpayer.