

### Special Section 3: Behavioral Insights for Resource Mobilization

Despite a number of attempts to reform tax administration and compliance, the tax-to-GDP ratio in Pakistan remains lower compared to our peers. One reason for this shortfall could be over emphasis on traditional approaches and lack of innovative tools such as behavioral approaches in tax policy. There is a growing recognition and mainstreaming of behavioral economics around the world, inspired by success stories of utilizing behavioral tools to complement tax efforts. This offers a unique opportunity for tax authorities in Pakistan to re-think their approach towards resource mobilization and to unleash country's true revenue potential.

The application of behavioral insights into national tax policy is a relatively new discipline. The systematic work at national level can be traced to 2010, as the Government of UK created first ever Behavioral Insights Team (UK BIT) to collect behavioral insights to complement their revenue collection efforts. Since then many countries have adopted and established their dedicated nudge units.<sup>1</sup> For instance, countries such as US, Canada, Germany, Netherlands, France, and Denmark have fully operative behavioral insight units, while other countries are increasingly following suit. These behavioral units usually communicate with tax payers and send information in a particular format to achieve the desired objectives.

Generally, behavioral approaches take into consideration basic human tendencies to influence tax payer's behavior. The existing economic models simplify assumptions to draw insights into human decision making. Most assume people are rational, unemotional, and self controlled. However, in real life we see a number of departures from standard rational choice. According to the work of Richard H. Thaler, the 2017 noble prize winner in Economics, the human behavior is greatly limited by three puzzles: cognitive limitations, self control problems, and their decision making is greatly influenced by social preferences.<sup>2</sup> He further points out that human behavior can be influenced through feeding additional information about social, moral, and economic impact of those decisions called

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<sup>1</sup> A nudge unit is a specialized team that carries out experiments to draw relevant behavioral insights for tax policy.

<sup>2</sup> **Cognitive limitations:** People do mental accounting to avoid complexity in their decisions making. They use separate accounts for different categories of expenditures for instance on housing, food, and travel etc. They usually get stuck up while substituting among these expenditures. **Self control problems:** people generally make plans and don't stick to these. **Social preferences:** the decision making is subject to social influence.

nudging.

On these lines, simple techniques can be adopted to manipulate human tendencies for making rational decisions. First of all the behavioral insight team analyzes a given situation to identify the real cause of behavioral deviation. Is the given deviation an outcome of cognitive limitations, lack of self control, or a social preference? Once, a behavioral cause is identified, it becomes easier for the tax authority to design a suitable nudge to mould human behavior.<sup>3</sup> For instance, if lack of information or complexity in filing tax returns is identified as the main cause for non-payment/non-filing, a specific campaign to disseminate the relevant information or making returns filing easier can make a lot of difference. On the other hand, if non-filing of tax returns is an outcome of natural tendency or a social norm then such hurdles can be removed by designing appropriate nudges to mould tax payer's behavior.

Currently, the dominant model pertaining to tax communication corresponds with different tax payers by sending different text messages to raise revenue collection. Some of the country experiences regarding the impact of behavioral approaches to raise tax collections are summarized below:

- The British government was the first country to successfully adopt behavioral tools in its tax policy. Before its implementation, they conducted a controlled experiment under which they divided 100,000 taxpayers with overdue bills into two groups: one group was sent a standard reminder for tax payment; the other was sent letters with additional message to nudge the tax payers. One such additional message was “about 90 percent of Britons pay their tax on time”. In another instance, it was pointed out that “the delinquent was in the minority”; a third stated “tax is vital for funding services like provision of health care and construction of roads”. The letter with additional messages resulted in higher tax receipts from the second group vis-à-vis the first group that received standard letters. The results further showed that the message informing that the ‘recipient was in the minority’ raised tax payments by 5.1 percent. Against this, simply asking to pay taxes on time or stating about spending on public goods resulted in tax receipts rising modestly by 1.3 - 2.1 percent.
- The Danish Tax Authority implemented an initiative to avoid tax evasion

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<sup>3</sup> A nudge is a subtle shift in tax policy that will make it easy for people to pay tax in their broad interest.

among young citizens due to perceived complexity of tax procedures. Using behavioral research, they created a simplified human-centered platform for tax payment. These changes increased the usage of the tax guidelines given in the platform by 7 percent and tax revenues by over 20 percent.

- The Croatian Tax Administration used techniques like disseminating messages such as “every receipt you take is an assurance of a more organized society and a more secure future.” They also launched a prize competition for foreigners in 2015 “Can I have the receipt, please?” Specifically, it offered foreigners a chance to win a paid summer vacation. To participate in the competition foreigners were required to post 20 receipts for purchases made in Croatia. The lottery-like initiative greatly helped Croatian tax administration in mobilizing revenues from growing tourism industry through encouraging documentation in the economy.
- In Estonia, the Tax & Customs Board regularly launches campaigns to raise awareness and modify individual’s behaviors towards paying taxes. There are general campaigns to shift the focus from paying taxes as a burden to something which contributes to public good. Moreover, specific campaigns are also in vogue to stress that what the taxpayer has to lose, if s/he decide to accept unregistered labor payments.

Learning from these country experiences, the tax authorities in Pakistan can use behavioral tools to nudge people for voluntary tax payments and filing of income tax returns. In this context, it is suggested to establish a behavioral insight team or nudge unit in the country to perform controlled experiments to draw behavioral insights. These insights, in turn, can be used to create different nudges to motivate tax payers and boost revenue collection.

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