Low tax revenues act as a serious constraint to economic growth, provision of services and, more generally, effective state-building. Pakistan, in particular, does poorly on tax revenue collection, including collecting property taxes. The lack of a motivated tax collection workforce is a contributing factor.

In 2009, the Excise and Taxation (E&T) department in Pakistan’s Punjab Province began implementing a series of human resource reforms designed to incentivise tax collection appropriately and improve overall departmental performance. Researchers collaborated with the provincial government to undertake an evaluation of the impact a pay-for-performance scheme for tax collectors had on tax revenue, while maintaining or improving assessment accuracy and customer satisfaction.

Main findings

- The incentive schemes produced substantial and unambiguous results on tax revenue collection. The treatment group outperformed the control group by a margin of more than 12 percentage points in total tax collections over the two-year treatment period.

- Of the three schemes implemented, the revenue-based honorarium scheme performed best in terms of impact on collections. In both years, this scheme consistently had the largest effect and largest return on investment. A third-party survey also suggested that the E&T department did not suffer any detectable costs associated with service delivery (either in terms of customer satisfaction or assessment accuracy), as a result of incentivising inspectors.

- On average, taxpayers in the tax circles included in the treatment group report the same level of satisfaction with the department as taxpayers in the tax circles in the non-incentivised group.

- The performance pay scheme is a cost-effective programme for improving tax collection. The increase in tax revenue offset the costs of providing incentives across all schemes.

- The project also resulted in additional outputs that improved the E&T department’s functioning. It led to the digitisation of the department’s historical circle-level collections data and standardisation of statement templates. It has also resulted in better monitoring practices to improve tax collection and staff performance, including the development of a data visualisation and management tool.

Do incentives improve tax collectors’ performance and increase tax collection in Pakistan?
How was tax collection incentivised?

All 482 tax circles – geographical areas serviced by a set of tax collectors – in Punjab were randomised into one of three treatment groups getting a pay-for-performance scheme or a control group. Here are the three pay-for-performance schemes:

- Revenue-based honoraria. Tax officials were rewarded with bonus pay proportional to the additional revenue they collected above a predefined benchmark, which was determined by the historic levels of tax collection for each tax circle.

- Revenue plus honorarium scheme. This scheme was similar to the above-mentioned, however checks against over-aggressive tax collection were incorporated by factoring in assessment accuracy and taxpayer satisfaction, through a third-party survey.

- Flexible bonus scheme. In this scheme, tax officials were rewarded with additional bonus pay at the end of the year that was conditional on performance.

An additional scheme was added for supervisors in the E&T department and an alternative comparison group was introduced in the second year. In this second comparison group, information was provided on the tax collectors’ performance with no monetary incentive. This helped ensure that the effects of the pay-for-performance schemes were due to the pay-for-performance component and not simply to having information provided to tax collectors in a specific format.

Lessons for future research and practice

Evidence from this impact evaluation provides insights into how pay-for-performance schemes can be employed by different government departments. Preliminary evidence showed that the benefits of performance pay may continue even after the period in which this occurs. Governments can thus introduce performance pay periods, which are cost-effective, every few years.

Introducing complementary interventions that can both improve tax revenue collection and reduce corruption may be a way to address both these issues. There is limited evidence on the impact of non-financial reward systems, such as merit-based and transparent transfers and postings. Providing incentives to citizens to improve service delivery by tying it to tax collection could potentially lead to a stronger tax payment culture and greater trust in state mechanisms. The results of introducing the simplest revenue scheme (which worked the best for field staff) were not conclusive for supervisory staff; hence further research is required to design an effective supervisory scheme.