Engendering Compliance: Evaluating and Improving a Randomized Tax Holiday Policy

Tax compliance is a major issue in many developing countries, where governments routinely lack capacity to elicit payment of taxes by citizens. What explains these obstacles, and can positive rather than negative incentives boost compliance? Given severe selection problems, it is typically challenging to answer these questions in non-randomized observational studies.

This project will study a unique policy innovation in Montevideo, Uruguay, in which the municipal government uses a lottery to award tax holidays to eligible taxpayers who are current on their payments of municipal taxes. Since 2004, and across four kinds of taxes (property, vehicle, sewage, and head), the municipality of Montevideo has randomly selected taxpayers and—conditional on a history of good taxpaying—rewarded them with a year free of tax payments.

The research funded under this proposal will assess the impact of winning tax holidays on subsequent tax compliance, as well as citizens' attitudes towards taxation and governance. The researchers hypothesize that winning the lottery induces greater tax compliance by citizens and may also positively influence attitudes towards the equity and fairness of the tax system.

The researchers will also use an experimental intervention to study the effects of informing non-winners about the existence of the lottery—which has not been effectively advertised by the government—allowing them to estimate multiplier and spillover effects of the program at full scale. Messages informing taxpayers of the existence of the lottery or reminding them of fines and sanctions for non-payment will be printed on municipal tax bills, and also mailed to households in the form of flyers, according to the assigned treatment condition. A major goal here is to compare the effects of negative incentives—e.g., the possibility of sanctions and fines for non-payment—to the positive incentives provided by the tax holiday lottery.

The project's subject population consists of adult physical persons in Montevideo who possess a taxpayer ID number and are therefore potentially eligible for the government's tax holiday lottery. A stratified sample of 24,200 households will be selected from this population using taxpayer records maintained by the municipal government of Montevideo. Researchers will analyze municipal administrative/tax compliance data for this sample of households and will also administer informational interventions and conduct household surveys in a sub-sample of 5,500 households, interviewing one adult member of each household. This project will be conducted over a two-year period, beginning in 2014.

Prize lotteries are increasingly used in a number of developing countries to encourage greater tax compliance and may contribute to the critical task of boosting the government's taxation capacity. We believe this study will develop the first rigorous evaluation of the impact of this kind of positive incentive for tax compliance.