2023 CLA CASE COMPETITION

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Case Title:

It Takes Tax Morale to Raise Local Revenues

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Summary:

The collection of taxes is contingent on efficient administration, trust in governmnet, and political stability. Without these prerequisites, it is difficult to develop and improve equitable, effective, and efficient tax systems. In developing nations like North Macedonia, tax noncompliance and tax evasion are more prevalent. USAID's Strengthening Resource Mobilization Activity (SRMA is assisting the country's local governments to increase the collection of own-source revenue, ultimately contributing to improved service delivery and citizen satisfaction with public governance. Typically, preventing tax evasion and noncompliance is not a hot topic. Traditional methods for combating these practices include detection and punishment, and it has been demonstrated that enforcement results in increased tax compliance. Nevertheless, there are more nuanced, unconventional methods that act on behavioral, social, and psychological factors and are deemed effective. These strategies appeal to a person's sense of 'embarrassment' in their community by appealing to social norms, a sense of personal responsibility for not performing one's civic duty, or the possibility of sanctions.

SRMA has been using a variety of Collaborating, Learning, and Adapting (CLA) approaches to increase the revenue in each municipality, contributing to strengthening the technical evidence base on "what works" to increase tax compliance (relevant to USAID Learning Agenda Question 4 "Anti-corruption"), collaborating in novel ways with partner municipalities to influence taxpayers' behavior, and adapting the Activity's technical offer based on the evidence gathered. In 2021 and 2022, in collaboration with the Center for Economic Analyses, our local research partner, and seven partner municipalities, SRMA conducted a tax behavior experiment utilizing behavioral economics methods to assist in changing the behavior of non-compliant taxpayers in relation to local property tax and to strengthen local revenue mobilization among North Macedonian municipalities.

1. **WHAT: What is the general context in which the case takes place? What organizational or development challenge(s) or opportunities prompted you to collaborate, learn, and/or adapt?**

Since 2021, the USAID Strengthening Resource Mobilization Activity (SRMA) has been assisting local governments in North Macedonia to raise and independently manage the funds required to fund the services demanded by their constituents. The Activity collaborates directly with municipalities to build capacity through on-the-job training and mentoring to strengthen domestic revenue mobilization, access external funding, and effectively manage municipal funds for the benefit of all citizens of North Macedonia. The approach of the Activity is permeated by communication with partners that is open and transparent. This Case Study relates to Question 4 of the USAID Agency Learning Agenda, which emphasizes applied research and analysis on social norms and behavioral approaches to combat corruption and promote good governance and government transparency. Early in its implementation, SRMA determined that there are systemic problems with taxpayers' delinquent property tax obligations, one of the essential local own source revenues. Numerous municipalities in North Macedonia are concerned about the amount of delinquent property tax that has accumulated over time. In addition to providing partner municipalities with customized technical assistance, SRMA offered non-traditional approaches to address the challenge. Behavioral economics is a method of communication between the municipality and taxpayers that is distinct from the "classic" enforcement-based methods typically used in the United States. In 2021 and 2022, the SRMA collaborated with seven municipalities to conduct a learning experiment and test an approach derived from behavioral economics (known as tax behavioral 'nudging') using alternative communication practices with noncompliant taxpayers to boost tax morale. We wanted to test if the approach has a positive effect on local revenue mobilization among municipalities in North Macedonia and if the different nudge messages are effective at altering the behavior of noncompliant taxpayers.

2. **What two CLA Sub-Components are most clearly reflected in your case?**

Technical Evidence Base

External Collaboration

3. **HOW: What steps did you take to apply CLA approaches to address the challenge or opportunity described above?**

The Center for Economic Analysis, our local research partner, developed a local tax behavioral insights methodology and a list of partner municipalities with a low property tax collection rate, based on the findings of the Activity's Political Economy Analysis, to be included in the tax experiment. We sought out municipalities with tax administrations inadequately equipped to detect tax evaders, assess property according to market value for taxation purposes, and enforce tax collection. The property tax was chosen for the experiment because it is recurrent, locally administered, collected from both individuals and legal entities, and represents the largest source of municipal revenue.

We used a randomized controlled trial (quasi-experiment) to determine the efficacy of various behavioral messages designed to encourage non-compliant taxpayers to pay their delinquent property tax obligations. The sample of non-complaint taxpayers was sent one of three types of letters containing a nudging message: social norm, public good, or deterrence. The messages were sent to non-compliant taxpayers via the postal service and were addressed from the municipalities. The effects were measured relative to the control group (difference-in-difference) as well as gender and age-related variations.

Seven partner municipalities participated in this experiment: Berovo, Gevgelija, Gostivar, Jegunovce, Kochani, Lipkovo, and Vrapchishte. In terms of population and size, geographic location, revenue collection, and property tax contribution to overall municipal own-source revenues, these seven partner municipalities formed a diverse group.

The SRMA team collaborated with the mayors and tax departments to introduce and implement an alternative communication by sending targeted letters in local languages to non-compliant taxpayers. By creating and adapting three types of messages, SRMA assisted the partner municipalities in conducting the tax experiment. The letter of dissuasion included the following statement: "Not paying taxes imposes an unfair burden on all taxpayers who are honorably meeting their obligations. The municipality may carry out execution procedures, thereby subjecting you to additional costs." The social norm letter stated, "According to our records, the majority of the municipality's residents have paid their property tax." You are part of a minority that has not yet fulfilled this obligation." The public good letter: "Are you aware that 100 percent of property tax revenues are spent on your needs and the needs of our citizens? Using these revenues, the municipality finances preschool and primary education and builds local infrastructure and social programs. Do not behave irresponsibly and pay your taxes..."

Once the data was collected and analyzed from the partner municipalities, we organized learning sessions to share the findings with the leadership of each partner municipality that participated in this experiment.

During the tax behavior study, the Activity provided all partner municipalities with tailored technical assistance packages on own source revenue collection. The Activity designed a national campaign titled "My Tax for My Municipality" in recognition of the fact that 71 percent of the absolute value of revenue collected by all municipalities in 2019 will come from individuals, compared to 29 percent from legal entities. Initiated in March 2022, the ongoing campaign aims to increase taxpayer awareness and stimulate higher collection rates.

By adopting an adaptive management approach, SRMA carefully considered the results of these approaches, particularly those from 2021, and the feedback received during the "peer-to-peer" sessions . We then incorporated results into the messaging of the property tax campaign "My tax for My Municipality," which targeted all major ethnic groups of the taxpayers in the country via an animated video, radio jingle, electronic leaflet, and a template for messaging to be used beyond the Activity's sustainment.

4. RESULTS: Choose one of the following questions to answer.

We know you may have answers in mind for both questions; However please choose one to highlight as part of this case story

A. DEVELOPM ENT RESULTS

Citizens are more likely to pay local taxes when their municipalities send them messages appealing to their sense of morality and social responsibility, according to the results of the tax behavioral approach. Instead of simply sending formal reminders or legally mandated warnings, this message also explains the significance of local taxes in enhancing their quality of life. The experiment demonstrated that employing innovative communication strategies by local tax authorities can significantly boost tax morale and increase revenue collection.

The experiment revealed that male noncompliant taxpayers are more influenced by messages emphasizing deterrence, whereas female noncompliant taxpayers respond positively to social messages emphasizing social norm. Regarding age groups, the results indicate that the youngest group of taxpayers (18 and 35) are especially receptive to messages emphasizing the public good, while older adults (over 75) are influenced by social norms and middle age groups (36-55 and 56-75), who frequently own properties, respond to both social norm and deterrent messages.

As a result of the experiment, property tax obligations decreased in each of the seven municipalities: and Berovo -25%, Gevgelija -32%, Gostivar -6%, Jegunovice -7%, Kocani -34%, Lipkovo -4%, Vrapcishte -12%. The Ministry of Finance reported that five of these seven municipalities increased revenue. To exemplify, Vrapchishte increased by 6.93 percent after an 18-month partnership; Berovo increased by 15.7 percent.

As part of its learning agenda, SRMA discovered that many of its partner municipalities lacked adequate communication with their constituents regarding tax revenue collection and tax usage. To address this issue, SRMA collaborated with municipalities and assisted them in developing Citizens' budgets, which were published on municipal websites and made accessible to the public. This initiative increased the public's awareness of the significance of paying local taxes and the effect it has on their quality of life.

5. **ENABLING CONDITIONS: How have enabling conditions - resources (time/money/staff), organizational culture, or business/work processes - influenced your results? How would you advise others to navigate any challenges you may have faced?**

SRMA promotes a sustainable culture of CLA across all North Macedonia's institutions and serves as a learning lab to test innovations. The Activity's Learning Agenda, developed in collaboration with USAID, systematically and deliberately promotes purposeful learning and provides evidence to coordinate efforts, make course corrections, and ensure effective implementation. SRMA encourages learning before, during, and after program and policy interventions by continuously challenging the SRMA team and counterparts to use research evidence and experience from other activities, and reward individuals and institutions who share their experience and lessons learned. SRMA built the "Peer-to-Peer" Learning model on this premise. We recognized that tax morale is essential for generating local revenues and ensuring the well-being of citizens through efficient tax collection and proper municipal use and focused on raising public awareness of tax and fee collection to increase the collection rate of municipal own-source revenues.
Recognizing the variations between municipalities and the outcomes, SRMA acknowledges there is "no one-size-fits-all" solution to the complex tax-collection challenges municipalities face. Therefore, SRMA takes a local system's understanding to its approach by prioritizing the leadership and knowledge of mayors and local administrations in identifying unique challenges and implementing suitable solutions. SRMA employs flexible approaches to provide Technical Assistance to partner municipalities, involving mayors and individual staff members, fostering collaboration between departments, ensuring transparency and accountability to citizens and businesses, and strengthening cooperation with the Central Government on policy development. Local leaders and Central Government officials have recognized and lauded the value of the holistic approach SRMA is implementing.