

International Forum on  
Economic Development and Public Policy



*Fiscal Reform To Support Strong  
and Equitable Growth:  
Striking The Right Balance*

# Behavioral Insights on Promoting Tax Compliance

Hotel Grand Hyatt, Nusa Dua - Bali  
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Presented by:

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## Current Condition in Indonesia

## Behavioral Economics

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- Indonesia generates low levels of revenues from personal income tax (PIT), which is to some degree a common feature among emerging-market economies.
  - Given these low levels, personal income taxes, though in principle less growth-friendly than consumption taxes, provide scope to enhance tax revenues.
  - To the extent that this can be achieved by broadening the tax base.
- Indonesia operates a PIT system with a fairly high threshold income level and progressive rates.

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- Indonesia operates a PIT system with a fairly high threshold income level and progressive rates.

- Top marginal income tax is broadly in line with current practice in the region.

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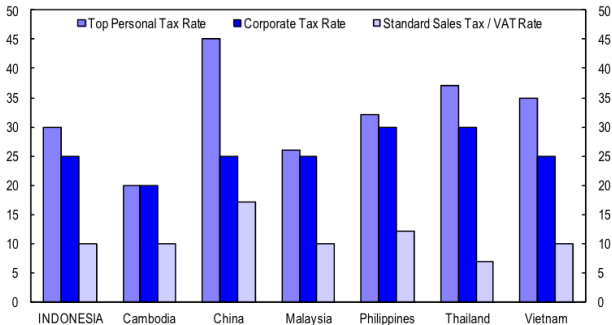
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Source: [www.taxrates.cc](http://www.taxrates.cc).

- Empirical evidence suggests that the contribution of the tax system to reducing income inequality in Indonesia is only marginal (Nugraha & Lewis, 2011).
- In 2014, the total population with taxable income is about 44.8 million people.
  - Only 60% (equivalent to 26.8 million people) is a registered taxpayer;
  - and from those who already registered taxpayers, only 10.3 million who submitted annual tax income.
  - Self-employed individuals are not fully captured by the withholding system, and no systematic approach exists for assessing their tax liabilities.
  - Another group of income earners that are hard to capture for the tax system are informal-sector employees.

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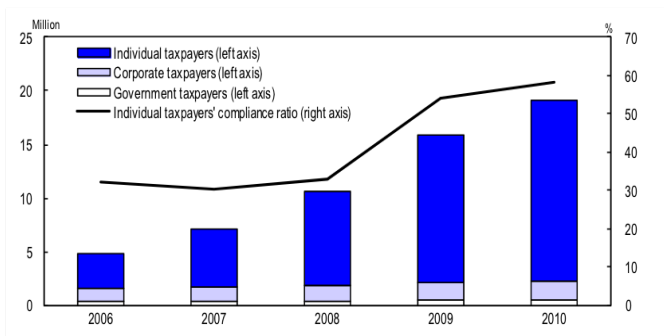
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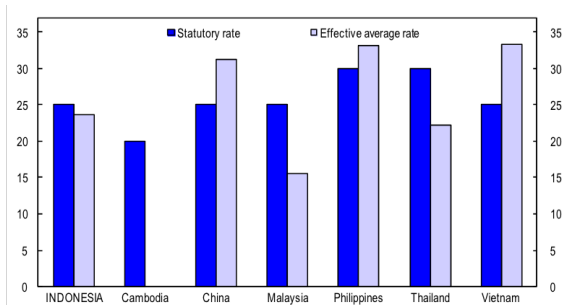
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- Number of taxpayers over time.



Source: Indonesia Directorate General of Tax, Annual Report 2010.

- Indonesia currently generates around 45% of its tax revenues from corporate income tax (CIT).



Note: Data on the effective average tax rate in Cambodia are not available.

Source: Abbas, S., A. Klemm, J. Park and S. Bedi (2012), "A Partial Race to the Bottom: Corporate Tax Developments in Emerging and Developing Economies", *IMF Working Papers*, No. WP/12/28, International Monetary Fund, Washington, D.C. and [www.taxrates.cc](http://www.taxrates.cc).

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- Similarly, there are 1.2 million firms which are registered as the corporate taxpayers.
  - Only 45.8% (equivalent to 550 thousand firms) which submitted annual corporate tax.
- Thanks to better enforcement strategy, PIT and CIT increase significantly by 24.93% and 18.12%, respectively.

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- To understand the impact of a tax system, it is important to know who complies with the tax law as well as who does not.
- Three major determinants of tax compliance (Becker, 1968; Allingham and Sandmo, 1972): (1) tax rate; (2) penalty rate; and (3) probability of audit.
  - There is considerable evidence that enforcement efforts can increase tax compliance.
  - Other forces at work since observed compliance levels cannot be fully explained by deterrence and economic factors (for a survey, see Torgler, 2002).

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- The core theory used in economics builds on a simple but powerful model of behavior, i.e individuals make choices so as to maximize a utility function.
  - Using the information available, and processing this information appropriately.
  - Individuals' preferences are assumed to be time-consistent and independent of the framing of the decision.
- An umbrella of approaches that seek to extend the standard economics framework.
  - Individuals are bounded in many dimensions that makes their decisions deviates from standard economic theory.

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- Typically, behavioral economics borrows the insights from the neighboring social sciences, particularly from psychology and sociology.
- The emphasis of behavioral economics is on well-documented empirical findings.
  - If the secondary data is unavailable, behavioral economists will use experimentations, including survey.
- To explore alternative ways to model choice, with applications illustrating the workings of such models.
- To effect how researchers in applied fields make both positive and normative analyses.

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- **Contribution to public policy:**
  - Behavioral economics allows policy makers to bench-test competing policy options. Based on the results, economists can elucidate the different effects - anticipated and unanticipated - of alternative government policies.
- **Contribution to business:**
  - Behavioral economics guides market designs and procedures to be tested before being scaled up to become marketplaces in the field.
- **Contribution to academic:**
  - In addition to their value in research, behavioral economics insights are changing the way economics is taught.

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- Continue efforts to expand the number of taxpayers, in particular among the self-employed.
- Publish estimates of tax expenditures, including investment incentives, on a routine basis to enhance their transparency, and conduct periodic evaluations of all of them.

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- **Make it easy:** Make it as straightforward as possible for people to pay tax, for example by pre-populating a form with information already held.
- **Highlight key messages:** Draw people's attention to important information or actions required of them, for example by highlighting them upfront in a letter.
- **Use personal language:** Personalize language so that people understand why a message or process is relevant to them.



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- **Prompt honesty at key moments:** Ensure that people are prompted to be honest at key moments when filling in a form or answering questions.
- Tell people what others are doing: Highlight the positive behavior of others, for instance that '9 out of 10 people pay their tax on time'.
- Highlight the risk and impact of dishonesty: Emphasize the impact of fraud or late payment on public services, as well as the risk of audit and the consequences for those caught.

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- Using social norms: investigates whether informing people that the vast majority of those in their area have already paid their tax can significantly boost payment rates.
- Highlighting key messages and norms: examines whether we can increase tax compliance by simplifying the principal messages and actions required, as well as using social levers and norms.
- Better presentation of information: explores different ways of presenting information to discover which is most effective at encouraging the tax payment.

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- Using beliefs about tax: tests the effectiveness of different messages—related to the fact that most people think that paying tax is the right thing to do—on payment of tax debts by companies.

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