

Faculti Summary

<https://faculti.net/the-state-capacity-ceiling-on-tax-rates/>

The speaker discusses their research on the fiscal capacity of low-income countries and its relationship to economic development. They highlight two main motivations: first, the crucial role of tax revenue in funding public services and infrastructure; and second, the significant disparity in tax collection between low-income (about 10% of GDP) and wealthy countries (about 40% of GDP). The speaker, along with their co-authors, investigates two critical questions: the optimal setting of tax rates in low-capacity countries and the impact of tax enforcement on tax compliance and revenue.

They describe a study conducted in Canga, Democratic Republic of the Congo, focusing on property tax collection, which represents a significant portion of government revenue. The research utilized a randomized controlled trial (RCT) to understand the effects of varying tax rates on compliance and revenue. Key findings showed that lowering tax rates significantly increased taxpayer compliance, even surpassing the rate of decrease due to reduced rates, ultimately leading to higher overall tax revenue.

Furthermore, the research examined the influence of enforcement on taxpayer behavior, finding that weak enforcement led to a greater response to tax rate changes. Through additional RCTs, the researchers tested different enforcement strategies, confirming that low enforcement fuels compliance responsiveness to tax changes.

From these findings, they deduce that adjusting tax rates and enforcement strategies should be complementary, suggesting that governments with limited enforcement capacity might benefit from lowering tax rates, while those capable of improving enforcement should consider raising tax rates alongside stronger compliance measures.

Looking ahead, the researchers plan to analyze the impact of implementing a progressive property tax system in Canga, using advanced methods such as drone imagery for property assessments. They aim to compare the effects of a progressive tax system against a flat tax system, contributing further insights into tax policy effectiveness in low-income contexts.