---

1 Introduction and overview

Richard M. Bird and Enid Slack

Taxes on land and property exist all over the world. In both principle and practice, these taxes can have important fiscal and non-fiscal effects. The revenue such taxes produce is often an important source of finance for local governments. In turn, the extent to which local governments have control over property taxes is often an important determinant of the extent to which they are able to make autonomous expenditure decisions. The level, design and control of property taxation are thus critical elements in effective decentralization policy in many countries. From a more general policy perspective, land and property taxes may be viewed as either equitable and efficient ways of raising revenue or regressive and undesirable forms of public finance, depending upon one's assumptions, the environment and how exactly the taxes are designed and applied.

Definitive conclusions on these matters do not emerge easily from an examination of the complex structure of property taxes around the world. Consider, for example, the case of Germany, in which two variants of land tax are imposed on (in effect) four different bases at five different 'base rates' which in turn are modified by locally determined 'leverage factors.' Other than noting that the revenues from this complex set of taxes are small and that reform has proved politically impossible so far, it is hard to say anything very definite about the effects of such a system. Germany is not alone in this respect. Taxes on land and property are among the oldest forms of all taxes. Old taxes need not necessarily be 'good taxes,' as the saying has it, but they almost invariably have over the years become encrusted with various peculiar features that are generally difficult to alter and that often obscure their impact.

The case studies that constitute the bulk of this volume make this point clear. These reviews of the taxation of land and property in 25 countries (five in each of five regions – OECD, Central and Eastern Europe, Asia, Africa, and Latin America) focus on the potential contributions of land and property taxes to the revenues of urban and rural governments and to more efficient land use. Since the ability of the property tax to make such contributions largely depends upon the specifics of the tax (tax base, tax rates and administration), special attention is paid to such characteristics.

The initial terms of reference given to the authors of all case studies were to provide information on four basic items: (1) How much revenue is collected from taxes on land and property? (2) What is the tax base, and who

2 *Land and property taxation*

determines it? (3) What are the tax rates, and who sets them? (4) How is the tax administered? In addition, authors were asked to provide relevant information on other land-based taxes, on the frequency of reassessment, on differentiations in taxes on types of property, on enforcement and tax arrears, and so on. Moreover, in each of the five regions noted above, one country – the first listed in each region (Canada, Hungary, Indonesia, Kenya and Colombia, respectively) – was selected for a somewhat fuller study of reform experience. In these cases, authors were asked also to provide some discussion of the rationale, nature and impact of reform efforts.

In total, 15 authors living in 11 countries were involved in preparing these case studies. The great differences from country to country in both practices and the availability of information mean that the results presented here are not uniform from country to country. Some reports are more detailed and comprehensive than others. Some are more factual; others more interpretative. Some, especially those from federal countries, focus on experience in only one part of the country. Some are based on direct fieldwork; others depend more on existing studies. Some focus almost entirely on the property tax; others cast their net more widely. Although all of these case studies were revised and updated by their authors in mid-2003 and have in some cases been further revised by the principal authors of this book, some important information is still missing in some countries because it is simply not available.

Table 1.1 sets out some key characteristics of the 25 countries covered in this book. These countries were selected to cover most regions of the world and also to some extent to depict different ‘styles’ or practices in taxing land and real property. Although the sample chosen is not representative in any statistical sense, and the information obtained is in any case too diverse and disparate to lend itself to statistical manipulation, many of the conclusions reached on the basis of this study reinforce those of earlier cross-country comparative studies of land and property taxes. Some of these earlier studies focused on developed countries (OECD, 1983), some on transitional countries (Malme and Youngman, 2001), some on developing countries (Municipal Development Programme, 1996; Rosengard, 1998), and some have cast their nets more widely (Youngman and Malme, 1994; McCluskey, 1999; Brown and Hepworth, 2000; Andelson, 2000). Some studies focused on rural land taxation (Bird, 1974; Strasma et al., 1987), some on urban property taxes (Bahl and Linn, 1992), and some on land value taxation as opposed to property taxation more generally (Andelson, 2000; McCluskey and Franzsen, 2001).

Altogether, the various comparative studies cited cover, to varying degrees, land and property tax systems in at least 40 countries in addition to those included in the present book. Moreover, there are, of course, many other

Table 1.1 Some key characteristics of case study countries

Country	Estimated population 2003 (million)	Area (thousand km ²)	GDP per capita (PPP 2002 US\$)	Exchange rate (local currency = US\$)	Central government current revenues, 2000 (% of GDP)	Urban population (% total)	Type of government
Australia	19.7	7 687	27 000	1.8406 dollars	23.6	84.7	Federal
Canada	32.2	9 976	29 400	1.5693 dollars	21.8	76.9	Federal
Germany	83.4	357	26 600	1.0626 euros	31.3	87.1	Federal
Japan	127.2	378	28 000	125 388 yen	20.4	78.5	Unitary
UK	60.1	245	25 300	0.6672 pounds	36.0	89.4	Unitary
Hungary	10.1	93	13 300	257 887 forints	37.4	63.6	Unitary
Latvia	2.4	65	8 300	0.6182 lati	28.5	69.0	Unitary
Poland	38.6	313	9 500	3.99 zloty	29.9	64.8	Unitary
Russia	144.5	17 075	9 300	31.2651 rubles	24.6	77.0	Unitary
Ukraine	48.1	604	4 500	5.3266 hryvnia	26.8	67.8	Unitary
Argentina	38.7	2 767	10 200	3.0633 pesos	14.2	89.3	Federal
Chile	15.7	757	10 000	688.953 pesos	22.2	85.2	Unitary
Colombia	41.7	1 139	6 500	2 504.24 pesos	12.6	73.1	Unitary
Mexico	104.9	1 973	9 000	9.656 pesos	14.8	74.0	Federal
Nicaragua	5.1	130	2 500	14.2513 córdobas	31.8	55.5	Unitary
China	1 287.0	9 597	4 400	8.277 yuan	7.2	31.1	Unitary
India	1 050.0	3 288	2 540	48.6103 rupees	12.7	27.8	Federal
Indonesia	234.9	1 919	3 100	9 311.19 rupiahs	18.1	38.8	Unitary
Philippines	84.6	300	4 200	51.63 pesos	15.4	56.8	Unitary
Thailand	64.3	514	6 900	42.9601 baht	16.0	21.0	Federal
Guinea	9.0	246	2 000	1 950.56 francs	11.7	31.4	Unitary
Kenya	31.6	583	1 020	78.7491 shillings	25.8	31.3	Unitary
South Africa	42.8	1 220	10 000	10.5407 rand	26.7	50.0	Federal
Tanzania	35.9	945	630	876.412 shillings	—	30.5	Unitary
Tunisia	9.9	164	6 500	1.4217 dinars	28.6	64.1	Unitary

Sources: Central Intelligence Agency, *The World Factbook 2003*; revenue data and urban share from World Development Indicators, World Bank.

4 *Land and property taxation*

studies of individual countries, as noted in many of the case studies included here. On the other hand, some of the countries studied here have not been covered in earlier studies, and no other study has so systematically attempted to cover the world.

The diversity in the application of land and property taxes even among the 25 countries covered in this volume is striking. There are differences in the determination of the tax base, the setting of tax rates, and the ability to levy and collect the tax. In some countries, one property tax covers all types of property. In others, there are different taxes for different components of real property. Countries may, for example, have separate taxes on land and buildings; separate taxes on residential and non-residential property; or separate taxes in urban and rural areas. Moreover, not only are there significant differences in how land and property are taxed across countries; there are often significant differences within countries.

The greater the degree of local discretion in establishing the tax base and setting the rates, the more diversity there is in property taxes within a country. This is particularly true in federal systems, in which the state or provincial government often provides the legal framework under which municipalities can operate. For this reason, or for reasons of information availability, some case study chapters focus on a specific province or state within the country and may not provide comprehensive information for the country as a whole. Indeed, as a general rule, information on local taxes is often surprisingly difficult to secure and seldom easily comparable even within unitary countries. Furthermore, although recent reform efforts in a few countries are discussed, no doubt other reforms are currently under consideration in these and other countries, so that some of the information included here may already be obsolete.

For these reasons, a certain degree of modesty is obviously called for with respect to what is accomplished in this book. Nonetheless, we are aware of no other recent volume that has attempted to cover the world even to the limited extent we have achieved here. Complexity, diversity, inadequate and imperfect information, and change have long been characteristics of property taxes in many countries. The countries studied here are no exception to this rule. While we venture some generalizations about land and property taxes in this and the next two chapters, we are well aware that the devil in land taxation is in the details, and that the details are often devilishly hard to determine. Still, the more we know, the better we can understand what details may be critical in different situations and how best to tackle the ongoing task of reforming this ancient set of fiscal instruments to cope with the diverse and changing circumstances of the modern world.

In the balance of this chapter we first place land and property taxes in context and then summarize a few major conclusions we have drawn from

this study. In Chapter 2 we present a more detailed comparison of the major characteristics of land and property taxes in our 25-country sample.¹ Finally, in Chapter 3 we summarize experience with property tax reform in several of the countries covered in the book.

The role of the property tax

The property tax as a source of revenue

Tables 1.2 and 1.3 provide a useful introductory overview of the role of the property tax as a revenue source. Four key conclusions emerge from these tables and from the Government Finance Statistics (GFS) data that underlie them:²

1. Taxes on land and property are at best minor revenue sources in all countries. For the developing countries included in these tables, for example, such taxes accounted for only about 0.4 percent of GDP (Table 1.2) and about 2 percent of total tax revenues in the 1990s, down slightly from earlier decades, although the equivalent share for the OECD countries remained at a bit more than 1 percent of GDP (Table 1.2) and about 4 percent of all tax revenues throughout the period.³
2. Nonetheless, as Table 1.3 shows, property taxes are important sources of subnational revenue in many countries, and more so in developing than in developed or transition countries. In the 1990s property taxes accounted for 40 percent of all subnational taxes (rather than the subnational rev-

Table 1.2 Subnational property tax as share of GDP, 1970s–90s (%)

	1970s	1980s	1990s
OECD countries	1.24	1.31	1.44
(number of countries)	(16)	(18)	(16)
Developing countries	0.42	0.36	0.42
(number of countries)	(20)	(27)	(23)
Transition countries	0.34	0.59	0.54
(number of countries)	(1)	(4)	(20)
All countries	0.77	0.73	0.75
(number of countries)	(37)	(49)	(58)

Source: Calculated by Roy Bahl and Bayar Tumennasan, Andrew Young School of Public Policy, Georgia State University, from data in IMF *Government Finance Statistics Yearbook*, 2001.

6 Land and property taxation

Table 1.3 Subnational property tax as share of subnational revenue, 1970s–90s (%)

	1970s	1980s	1990s
OECD countries (number of countries)	17.4 (16)	17.0 (17)	17.9 (16)
Developing countries (number of countries)	27.6 (21)	24.3 (27)	19.1 (24)
Transition countries (number of countries)	6.7 (1)	8.51 (4)	8.8 (20)
All countries (number of countries)	22.8 (38)	20.4 (48)	15.6 (59)

Source: See Table 1.2.

enues shown in Table 1.3) in developing countries, 35 percent (up from 30 percent in earlier decades) in developed countries, but only 12 percent in transition countries. In the same period, property taxes financed a bit more than 10 percent of subnational expenditure in developed and developing countries, although little more than half that much in transition countries.

3. Property taxes are much more important in rich (OECD) countries than in developing or transition countries. Although these details are not shown in the tables, for the last year for which all data were available (1995) the highest property tax to GDP ratio (4.1 percent) was in Canada, followed by the United States (2.9 percent), and Australia (2.5 percent): it seems unlikely to be a coincidence that all three are rich federations. On the other hand, the lowest ratio recorded (0.01 percent) was also in a rich federal country (Austria), and some developing and transition countries (South Africa, Latvia) had relatively high (over 1 percent) ratios. There is clearly more to property tax effort than simply wealth, as we shall discuss later in connection with Table 1.4.
4. None of the characteristics mentioned above has changed much in recent decades, with the exception of a relative decline in the importance of property taxes as a share of subnational revenue (and expenditure) in developing countries.

Dependence on property taxes as a source of local government revenue varies across jurisdictions depending upon many factors, such as the expenditure responsibilities assigned to local governments, the other revenues available

to them (such as intergovernmental transfers, user fees and other taxes), the degree of freedom local governments have with respect to property taxation, the size and growth of the tax base available to them, and their willingness and ability to enforce such taxes.

The PT/GDP ratio reported in Table 1.2 may be thought of as the product of the multiplication of a number of other ratios, as follows:

- MV/GDP – the ratio of (market) property values to GDP
- AV/MV – the ratio of assessed base to market values (assessment ratio)
- TV/AV – the ratio of taxable base to assessed base (exemptions)
- T/TV – the ratio of taxes assessed to taxable base (statutory tax rate)
- T*/T – the ratio of taxes collected to taxes assessed (enforcement).⁴

Governments can do little directly with respect to the first of these ratios – although, as noted later, local governments may in some circumstances be able to affect the share of the potential base that is located within their jurisdiction. It may be more meaningful to compare property tax collections not with GDP but rather with (estimated) market values.

This ratio is commonly called the ‘effective rate of property tax’ (ERPT = T^*/MV). In the United States, for example, a recent study found the median effective rate on a house valued at US\$150 000 to be 1.2 percent in 1998.⁵ The same study found the median ERPT on commercial property to be 2.3 percent and on industrial property to be 1.7 percent. The range from state to state was impressive, however: with respect to residential property, the estimated state ERPT ranged from 0.4 percent to 2.9 percent. The range was almost the same with respect to industrial property (0.4 – 3.0 percent), but with respect to commercial property it was considerably greater – 0.7 percent to 6.0 percent.

These numbers suggest two interesting conclusions with respect to the United States. First, property taxes are generally heavier on non-residential (and especially commercial) properties than on residential (single-family) homes.⁶ Second, when there is considerable local discretion with respect to property taxes, as is the case in the United States, there are also likely to be great differences in effective tax rates. Relatively little information on effective rates is available for developing and transition countries, but, as discussed later, both these conclusions seem likely to hold much more widely than just in the US case. In addition, the ERPT tends to be considerably lower in most developing countries than noted above for the US. For example, Chapter 11 reports an estimate of 0.07 percent for the Philippines and Chapter 9 shows a range of between 0.1 and 0.2 percent for Indonesia.

Of course, such numbers do not tell us why effective property taxes are so low, but it seems likely that all the administrative factors mentioned above play a role. As noted in Chapter 2, it is clear from the case studies, for

8 Land and property taxation

example, that the assessment ratio is low in many countries. It is also clear that there are often large exemptions. Moreover, statutory rates are generally low, and collection efforts poor, as evidenced, for instance, by high arrears ratios. All these factors seem especially marked in many transition countries in which in addition land markets are generally not well developed.

As discussed further in Chapter 2, in many – indeed, most – developing and transition countries, local governments as such have very little scope to affect many, or in some cases any, of these factors. Although it is often surprisingly difficult to determine exactly how much ‘autonomy’ local governments have in fiscal matters, it appears that in many such countries assessment, exemption, rates and sometimes even collection are essentially controlled by higher-level governments.⁷ The present and future of subnational property taxes are thus inextricably related to much broader issues related to intergovernmental relations and fiscal decentralization more generally.

Table 1.4 Case study countries: property tax effort, 1995

Country	Subnational property taxes (GFS data) as % of GDP	PT effort
Australia	2.49	2.03
Canada	4.07	3.51
Germany	1.05	0.39
UK	1.43	0.64
Hungary	0.30	0.89
Poland	1.11	2.20
Russia	1.24	1.45
Argentina	0.92	0.84
Chile	0.61	0.76
Mexico	0.31	0.36
Nicaragua	0.13	1.53
India	0.10	0.84
Indonesia	0.32	1.49
Thailand	0.14	1.65
South Africa	0.65	3.82

Note and source: The second column is a measure of ‘effort’ derived as the ratio of the actual PT/GDP ratio and the ‘predicted’ ratio based on a regression equation incorporating (in log form) measures of urbanization, population, per capita GDP and decentralization (measured as subnational expenditure as a share of total expenditure). The data reported here are a subset of those reported in Bahl (2001).

Finally, Table 1.4 reports some results from a recent study by Roy Bahl (2002) of the factors determining property tax ‘effort’ for, among others, some of our case study countries.⁸ In this study, the PT/GDP ratio is taken to reflect a number of independent factors – the wealth of the country (as measured by the level of its per capita GDP), its population and its degree of urbanization. A regression equation including these variables explains (statistically) about half of the observed variation across countries and suggests that countries tend to rely more heavily on property taxes as income levels rise and they become more urbanized.

Another specification of this equation, including also the degree of decentralization (as measured by subnational expenditures as a share of total government expenditures) as an independent variable, was used by Bahl (2002) to calculate ‘predicted’ PT ratios for each country. Property tax ‘effort’ (as shown in Table 1.4) can then be calculated as the ratio of the actual ratio to the predicted ratio. That is, if a country’s actual ratio is exactly equal to the ratio predicted, given the values of the independent variables, then the reported effort would be 1.00. If the actual ratio is greater than the predicted ratio, effort is greater than 1.00, and so on.

While such calculations are obviously crude, Table 1.4 nonetheless suggests two important conclusions:

- Actual ratios are not a good predictor of effort: some countries (for example Canada) have both high ratios and high effort; others (for example the UK) have high ratios but low effort; still others (for example Nicaragua) have low ratios and – at least by this calculation – high effort; and, finally, some countries (for example Mexico) have both low ratios and low effort. How much a country collects in land and property taxes is not, it seems, a reliable guide to how hard it is trying to do so.
- On the other hand, it follows from the same information that countries that make similar efforts may secure very different results (compare, for example, Germany and Mexico on the low side and Canada and South Africa on the high side), and, correspondingly, that countries with similar results (for example Germany and Poland) may be making very different efforts.

From a policy perspective, what this simple exercise suggests is that while countries are inevitably constrained in what they can do by environmental factors, there appears to be considerable leeway for many countries to do better than they have been doing. Low-effort countries such as Mexico and Germany, for example, could clearly collect much more in property taxes if they wanted to do so, although it would be much harder for low-income

10 Land and property taxation

Mexico than for high-income Germany to raise, say, an additional 1 percent of GDP in such taxes (Bird, 1976). As is so often the case in fiscal matters, many poor countries could do more than they do in terms of taxing land and property, but no matter how much they do they are unlikely to reap the same relative rewards for their effort as more fortunate countries. To them that hath, it seems, more comes more easily, in this as in other respects.

The property tax as a local tax

The property tax has, historically, been associated with local government in most countries. One reason that taxes on land and property have been considered especially appropriate as a local revenue source is that real property is immovable – it is unable to shift location in response to the tax. Although a change in property tax may be capitalized into property values in a particular community, and in the long run tax differentials may affect where people locate, these effects are of a smaller magnitude than those that would occur with income and sales taxes at the local level.

Another reason why property taxes are considered to be appropriate as a source of revenue for local governments is the connection between many of the services typically funded at the local level and the benefit to property values. Fischel (2001), for example, has argued that the property tax in the United States is like a benefit tax because taxes approximate the benefits received from local services. To the extent that this is the case, local property tax finance of local services will promote efficient public decisions since taxpayers will support those measures for which the benefits exceed the taxes. Both the benefits derived from such local services as good schools and better access to roads and transit, and so on and the taxes used to finance such services are capitalized into property values. Since taxpayers are willing to pay more for better services and lower tax rates, either will translate into higher property values.

Of course, this analysis is based on a number of assumptions, including the following:

- Local property taxes in fact finance services that benefit property values.
- Both tax rates and service levels are decided by local voters.
- Voters who wish to ‘buy’ other combinations of services and tax rates are free to move to other jurisdictions.
- Voters – impelled by their sensitivity to property values – act rationally in response to such signals.
- Local governments do what voters want them to do.

The strength and validity of many of these links seem suspect in the context of many countries. Moreover, this line of argument seems even more tenuous

when it comes to explaining the generally higher taxation on non-residential property observed in many countries. Although we shall not discuss this question further here, as Bird (2003) argues in detail, an income-type value-added tax appears to be a much more sensible way to ‘price’ local services to businesses than a property tax.

In contrast to this ‘benefit’ approach, many see the property tax as a tax on capital or, to the extent it falls on housing, as a tax on housing services. Zodrow (2001), for example, argues that the property tax in the United States results in distortions in the housing market and in local fiscal decisions. In particular, since the US property tax, which is based on market value, falls on both land and improvements, it both discourages building and results in the under-utilization of land. The result is that the country ends up with less capital per unit of land than is economically efficient. Homeowners who improve their house, for example, will face higher taxes as a result and will thus be discouraged from doing so. As George ([1879] 1979) said, and as many others have argued since, a tax on land values alone would avoid this economic inefficiency and would indeed stimulate the efficient use of land. We shall return to this point below.

The incidence of the property tax

Who pays the property tax, and is it an equitable tax? There appear to be as many answers to these questions as there are views about the property tax. For example:

- Those who view taxes on residential real property as essentially taxes on housing services tend to think that property taxes are inherently regressive, since, as a rule, housing constitutes a relatively larger share of consumption for poorer people.
- Those who view property taxes as essentially a tax on capital tend to think that such taxes are inherently progressive, since, as a rule, income from capital constitutes a relatively higher share of income for richer people.
- Those who view the portion of the tax that falls on land as being paid out of economic rent consider it to be inherently equitable to tax such ‘unearned increments’ arising (often) from public actions.
- Those who view property taxes as essentially benefit taxes tend to think that there is no more sense in asking if the ‘price’ of local public services (the property tax) is regressive than in asking if the price charged for anything else is regressive: voluntary exchange (‘taxes’ – really generalized user charges – for services) does not, in their view, raise any question of incidence.

12 Land and property taxation

Although hardly conclusive, the empirical evidence on capitalization on the one hand and 'tax exporting' on the other, at least in the United States and Canada, suggests that there may be some truth in all of these views.⁹ In the end, it seems, what one beholds in the property tax in terms of equity appears to depend to a large extent on what one thinks of the property tax in the first place.

Why property taxes are different

In addition to the obscurity of its incidence, at least four characteristics of the property tax differentiate it to some extent from other taxes: its visibility, its inelasticity, its inherent arbitrariness and, in some countries, the extent to which it reflects local autonomy.

As usually applied, the property tax is a very visible tax. Unlike the income tax, for example, the property tax is not withheld at source. Unlike the sales tax, it is not paid in small amounts with each daily purchase. Instead, the property tax generally has to be paid directly by taxpayers in periodic lump-sum payments. This means that taxpayers tend often to be more aware of the property taxes they pay than they are of other taxes.¹⁰

Moreover, to a considerable extent, the property tax finances services which are also very visible, such as roads, garbage collection and neighborhood parks. Visibility is clearly desirable from a decision-making perspective because it makes taxpayers aware of the costs of local public services. This awareness enhances accountability, which is obviously a good thing from both an economic (hard budget constraint) and political (democratic) perspective. It does not, however, make the property tax popular. On the contrary, as we discuss further in Chapter 2, it often appears to be harder to raise (or reform) property taxes than other taxes.

The base of the property tax – no matter which of the bases discussed in Chapter 2 is employed – is invariably relatively inelastic, meaning that it does not increase automatically over time. Bahl (2002), for example, notes that the GDP elasticity of the property tax has been close to unity for decades. Property values generally respond more slowly to annual changes in economic activity than do incomes.¹¹ Taxable area, of course, responds even more slowly. Furthermore, as discussed in Chapter 2, few jurisdictions update property values for taxation purposes on an annual basis.

As a result, in order to maintain property tax revenues in real terms (let alone to raise property tax revenues), it is necessary to increase the rate of the tax. As with visibility, inelasticity leads to greater accountability (taxing authorities have to increase the tax rate to increase tax revenues) but it also leads to greater taxpayer resistance.

Most taxes are based on flows – income or sales. The tax base may sometimes be the source of argument between taxpayer and tax authority, but

there is, in principle, a measurable economic activity on the basis of which the tax is levied. In contrast, taxes on land and property are (generally) based on stocks – asset values. Unless the asset subject to tax is sold (by willing buyers to willing sellers) in the tax period, someone has to determine the value that serves as the basis on which to assess the tax.

Valuation is inherently and inevitably an arguable matter. If there is a ‘self-assessment’ system, owners are likely to undervalue their property; if there is an ‘official’ (cadastral) assessment system, owners are likely to feel that their property is (at least in relative terms) overvalued. In the end, someone has to determine the tax base for the property tax in a way that is not true for any other significant tax. It is not surprising that the results are often perceived to be unfair and arbitrary. It is also not surprising that the process of obtaining ‘good’ (close to market, fair) valuations is not likely to be cheap. In short, to administer a property tax at the same level of fairness (non-arbitrariness) as most other major taxes is both a costly operation and one whose results are unlikely to be accepted as fair by most taxpayers.

Finally, to the extent property taxes are levied only by local governments, they obviously act as a major support for local autonomy. The extent to which such autonomy is either desired or attained is very country-specific. Even in such countries as Canada and Australia, with important local governments and important local property taxes, not all taxes on property are levied by local governments. In some countries, such as Latvia and Chile, the property tax is much more a central than a local tax. Indeed, if one defines a ‘purely local’ tax as one in which local governments can (1) decide whether or not to levy the tax, (2) determine the precise nature of the tax, (3) establish the base on which to tax individual taxpayers, (4) determine the tax rate, and (5) enforce the tax, very few countries have such taxes.

As discussed in Chapter 2, in most developing and transition countries, ‘local’ property taxes are, in most of these respects, more ‘central’ than ‘local’ in nature. Since an essential ingredient of responsible local autonomy – or, if one prefers, of a ‘hard’ subnational budget constraint – is that tax rates be set locally (and not by a senior level of government),¹² the property tax systems existing in most countries considered here are still far from achieving this goal.

An additional result of the lack of local control over property taxes in Central and Eastern Europe is a disincentive to privatize properties. One reason many cities in transitional countries are unwilling to dispose of properties is that they can control the revenue they receive from leasing them, but they often have no control over property tax revenues. To avoid such distortions, local governments need better control over local tax sources if they are to get out of the land development business, for which they are generally ill suited.

What can property taxes do?

Finance local governments

The property tax generates a significant proportion of local government revenues in a few countries, mainly in the OECD. In most developing and transition countries, however, the property tax yield provides only a small, though not insignificant, share of the revenue available for local governments.

Property tax revenues are low in many developing and transitional economies in part because of the way in which the tax is administered. As shown in detail in this book, as a rule the coverage of the tax is not comprehensive, assessments are low, as are nominal tax rates, and collection rates are also often low. Low tax rates are sometimes imposed by higher-level governments and sometimes by local governments themselves, which find rate increases in this most visible of taxes very difficult to sell politically.

Simply raising the legal tax rate would seldom be considered appropriate, however, because it would place the burden of the increase on 'those few individuals whose properties are on the tax rolls, accurately valued, and from whom taxes are actually collected' (Dillinger, 1991, p. 5). Increased nominal rates are likely to be acceptable only along with such major improvements in tax structure and administration as more comprehensive coverage, better assessments, more frequent assessment revaluations and enforced penalties for late payment.

In general, revenues would be higher if the property tax were based on the value of land and buildings (instead of just on land), if there were few exemptions, if there were no favorable treatment of particular property classes, if the nominal tax rate were set higher, and if the scope for local tax competition were limited.

Despite its many problems, however, as de Cesare (2002, p. 9) has recently said, 'the property tax remains the predominant option for raising revenues at the local government level in Latin America' and, it might be added, elsewhere as well. The potential yield of land and property taxes is unlikely to be huge, revenues from this source will not be very elastic, and administrative costs are substantial. Nonetheless, an expanded property tax is indeed both a logical and a desirable objective for many countries, particularly those in which local governments are expected to play an increasing role in allocating public sector resources. But significant additional revenues from this source can seldom be expected in the short run, and, although property taxes are usually relatively more important in smaller communities, most additional revenues will likely be found in, and accrue to, the larger urban areas.

Affect land use

The instruments used by local governments to raise revenues can have an impact on the nature, location and density of development. Local governments can affect urban form not only with planning tools but also with municipal financial tools. In some cases, municipal financial tools work together with planning tools, but in other cases they may have the opposite effect (Slack, 2002).

The property tax is one fiscal instrument that can clearly influence land use patterns, especially in urban areas. In terms of the impact on the density of development, for example, increases in property tax should be expected to result in a reduction in density (other things being equal). Where the tax is levied on the assessed value of property (land and improvements), any investment that increases the value of the property (such as any improvement to the property including an increase in the density) will increase the assessed value and make the property subject to a higher tax.¹³ Higher property taxes thus provide an incentive for less densely developed projects – for example, scattered single-family houses rather than apartment buildings. On the other hand, a tax on land only will provide an incentive for greater density relative to a tax on both land and improvements. The choice of highest and best use as the tax base (rather than current use) is also likely to result in higher densities.

It is important to emphasize, however, that to the extent that property tax differentials are matched by differentials in expenditures on public services, they should not result in a distortionary impact on location or land use. Although the property tax cannot be regarded as a direct ‘user fee’ through which individuals pay directly for the services they receive, where both tax rates and service levels are determined locally, it can often be thought of loosely as a benefits tax to the extent that public services provided to the property-owner enhance the value of the property and result in higher property taxes. Where such ‘matching’ does not occur, however, there will be a pattern of positive and negative subsidies that will influence urban development patterns, usually in a way that worsens it. As Oldman et al. (1967) argued some years ago in the context of an analysis of Mexico City’s finances, such misallocations are potentially much more damaging in the case of the rapidly urbanizing cities of the developing world. These concerns seem still valid today.

In reality, taxes on land and property are seldom matched by service benefits. For example, non-residential properties are often overtaxed relative to benefits received compared to residential properties; tax competition among municipalities often does not reflect differential service benefits; and favorable tax treatment of farm properties can create distortions.

In summary, a number of policy choices can be made with respect to the structure of the property tax that will have an impact on land use. Such

choices include what is included and excluded from the tax base, how property value is defined for different classes of property (for example, residential, farm, commercial and industrial properties), what percentage of the value is taxable, and how effective tax rates vary within and between classes of property.

Unfortunately, the information on many of these aspects available in most countries is inadequate to permit analysis of the effects of the existing – almost certainly non-optimal – tax systems on land use. Given the very low effective tax rates currently applied in most countries, the resulting distortions may not be too high. Nonetheless, given current pressures for further decentralization in many countries and the desirability in most countries of increased land and property taxation as a source of local finance, it is important to ensure that any future property tax reforms take into account not only the need to be politically acceptable and administratively feasible but also that the increased taxes be designed properly from an economic perspective. As argued in Chapter 2, this does not mean that ‘gadgets’ such as land value increment taxes and progressive land taxes, with their high and perhaps insuperable political and administrative costs, should play a role. On the contrary, what it means in most instances is that more attention should be paid to developing simple, uniform and above all effective local property taxes, with the only differentiation being perhaps somewhat heavier taxation of land than of improvements.

Notes

1. An earlier version of much of the material in this and the next two chapters appears in Bird and Slack (2002).
2. For more data and discussion, see Roy Bahl (2002). We are grateful both to Roy Bahl and to Bayar Tumennasan for providing these data and for permitting us to make use of their work.
3. The data in Tables 1.2 and 1.3 do not include taxes on land and property accruing to central governments. Subnational governments comprise both regional (province, state) and local (municipal) governments. Since in most countries property taxes basically accrue to local governments, we shall often simply refer to them as local taxes.
4. This is a variant of the presentation in Bahl (2002). The ratio T^*/T may be broken down in a number of ways. For example, some taxes levied in year 1 may not be collected in that year – arrears. On the other hand, some taxes collected in year 1 may pertain to taxes levied in prior years. Penalties and interest with respect to late payments may be shown as tax collections or as a separate item. Some taxes assessed may be appealed and, if the appeal is successful, refunded. It is thus not always clear exactly what is encompassed in T^* in different countries.
5. Data for selected cities in all states (excluding Louisiana) from 50-State Property Tax Comparison Study, Minnesota Taxpayers' Association, January 1999.
6. Multi-family dwellings (apartment buildings) are generally taxed much more heavily than single-family homes, but this important issue cannot be discussed in detail here.
7. By far the most systematic review of this question is OECD (1998, 2001). Unfortunately, similar work has not yet been done for non-OECD countries.
8. Again, we are grateful to Roy Bahl and Bayar Tumennasan for giving us access to the data underlying Bahl (2002).

9. This literature is reviewed in most textbooks. For one example, see Bird and Slack (1993).
10. In some cases, however, mortgage institutions include property tax payments with monthly mortgage payments. This procedure reduces the visibility of the property tax for taxpayers who pay their taxes along with their mortgage payments.
11. There may be exceptions of course, as for example in the case of the well-known 'bubble' in asset prices in Japan in the 1980s, where at one point the effective rate of the fixed property tax in Tokyo was estimated to have fallen to 0.05 percent (Ishi, 2001).
12. This argument is developed in more detail in Bird (2001).
13. This assumes that an increase in the value of the property will be reflected in the value assessed for taxation purposes, which is of course not always the case.

References

- Andelson, Robert V. (ed.) (2000), *Land-Value Taxation Around the World*, 3rd edn, Malden, MA: Blackwell.
- Bahl, Roy (2001), 'Property Taxation in Developing Countries: An Assessment in 2001,' Lincoln Lecture, Lincoln Institute of Land Policy, Cambridge, MA, 23 October.
- Bahl, Roy (2002), 'The Property Tax in Developing Countries; Where are we in 2002?' *Land Lines*, Lincoln Institute of Land Policy.
- Bahl, Roy and Johannes F. Linn (1992), *Urban Public Finance in Developing Countries*, New York: Oxford University Press.
- Bird, Richard M. (1974), *Taxing Agricultural Land in Developing Countries*, Cambridge, MA: Harvard University Press.
- Bird, Richard M. (1976), 'Assessing Tax Performance in Developing Countries: A Critical Review of the Literature,' *Finanzarchiv*, **34** (2), 244–65.
- Bird, Richard M. (2001), *Intergovernmental Fiscal Relations in Latin America: Policy Designs and Policy Outcomes*, Washington, DC: Inter-American Development Bank.
- Bird, Richard M. (2003), 'A New Look at Local Business Taxes,' *Tax Notes International*, **30** (7), 695–711.
- Bird, Richard M. and Enid Slack (1993), *Urban Public Finance in Canada*, 2nd edn, Toronto: John Wiley & Sons.
- Bird, Richard M. and Enid Slack (2002), 'Land and Property Taxation Around the World: A Review,' *Journal of Property Tax Assessment & Administration*, **7** (3), 31–80.
- Brown, P.K. and M.A. Hepworth (2000), 'A Study of European Land Tax Systems,' Cambridge, MA: Lincoln Institute of Land Policy Working Paper.
- De Cesare, Claudia (2002), 'Toward More Effective Property Tax Systems in Latin America,' *Land Lines*, Lincoln Institute of Land Policy, January, pp. 9–11.
- Dillinger, William (1991), *Urban Property Tax Reform: Guidelines and Recommendations*, Urban Management and Municipal Finance, Washington, DC: World Bank.
- Fischel, William A. (2001), 'Homevoters, Municipal Corporate Governance, and the Benefit View of the Property Tax,' *National Tax Journal*, **54** (1), 157–73.
- George, Henry ([1879] 1979), *Progress and Poverty*, New York: Robert Schalkenbach Foundation.
- Ishi, Hiromitsu (2001), *The Japanese Tax System*, 3rd edn, Oxford: Oxford University Press.
- Malmé, Jane H. and Joan M. Youngman (eds) (2001), *The Development of the Property Tax in Economies in Transition*, WBI Learning Resources Series, Washington, DC: World Bank.
- McCluskey, William (ed.) (1999), *Property Tax: An International Comparative Review*, Aldershot, UK: Ashgate.
- McCluskey, William J. and Riel C.D. Franzsen (2001), 'Land Value Taxation: A Case Study Approach,' Lincoln Institute of Land Policy, Cambridge MA, Working Paper.
- Municipal Development Programme (1996), *Property Tax in Eastern and Southern Africa: Challenges and Lessons Learned*, Working Paper No. 2, Municipal Development Programme for Eastern and Southern Africa, Harare.
- OECD (1983), *Taxes on Immovable Property*, Paris: OECD.
- OECD (1998), *Taxing Powers of State and Local Governments*, Paris: OECD.
- OECD (2001), *Fiscal Design Across Levels of Government. Year 2000 Surveys*, Paris: OECD.

18 Land and property taxation

- Oldman, Oliver et al. (1967), *Financing Urban Development in Mexico City*, Cambridge, MA: Harvard University Press.
- Rosengard, Jay K. (1998), *Property Tax Reform in Developing Countries*, Boston: Kluwer Academic Publishers.
- Slack, Enid (2002), *Municipal Finance and the Pattern of Urban Growth*, Commentary No. 160, Toronto: C.D. Howe Institute.
- Strasma, John et al. (1987), *Impact of Agricultural Land Revenue System on Agricultural Land Usage*, Burlington, VT: Associates in Rural Development.
- Youngman, Joan M. and Jane H. Malme (1994), *An International Survey of Taxes on Land and Buildings*, Deventer: Kluwer Law and Taxation Publishers.
- Zodrow, George R. (2001), 'The Property Tax as a Capital Tax: A Room with Three Views,' *National Tax Journal*, **54** (1), 139–56.