

Making the Property Tax Work

Experiences in
Developing and
Transitional Countries

*Edited by
Roy Bahl,
Jorge Martinez-Vazquez,
and Joan Youngman*



Making the Property Tax Work



Making the Property Tax Work

*Experiences in Developing and
Transitional Countries*

Edited by

Roy Bahl, Jorge Martinez-Vazquez,
and Joan Youngman

 LINCOLN INSTITUTE
OF LAND POLICY
CAMBRIDGE, MASSACHUSETTS

© 2008 by the Lincoln Institute of Land Policy

All rights reserved.

Library of Congress Cataloging-in-Publication Data

Making the property tax work : experiences in developing and transitional countries
/ edited by Roy Bahl, Jorge Martinez-Vazquez, and Joan Youngman.

p. cm.

Includes index.

ISBN 978-1-55844-173-6

1. Property tax—Developing countries. 2. Real property tax—Developing countries. 3. Local finance—Developing countries. 4. Real property—Valuation—Developing countries. I. Bahl, Roy W. II. Martinez-Vazquez, Jorge. III. Youngman, Joan M.

HJ4129.5.M35 2008

336.2209172'4—dc22

2007042164

Designed by Walter Schwarz, Figaro

Composed in Esprit Book by Binghamton Valley Composition in Binghamton, New York. Printed and bound by Puritan Press, Inc., in Hollis, New Hampshire.



The paper is Rolland Enviro, an acid-free, 100 percent recycled sheet.

MANUFACTURED IN THE UNITED STATES OF AMERICA



CONTENTS

List of Tables ix

List of Figures xiii

Foreword xv

Gregory K. Ingram

PART I INTRODUCTION

1 The Property Tax in Practice 3

Roy Bahl, Jorge Martinez-Vazquez, and Joan Youngman

PART II THE SETTING

2 The Property Tax in Development and in Transition 19

Joan Youngman

3 The Determinants of Revenue Performance 35

Roy Bahl and Jorge Martinez-Vazquez

Commentary 58

Gregory K. Ingram

PART III FAIRNESS, POLITICAL ISSUES, AND SCOPE

4 Incidence and Economic Impacts of Property
Taxes in Developing and Transitional Countries 63

Edward B. Sennoga, David L. Sjoquist, and Sally Wallace

5 Property Tax and Rural Local Finance 103

Richard M. Bird and Enid Slack

6 Alternative Value Capture Instruments:
The Case of Taiwan 127

Steve Waicho Tsui

Commentary 162

Indira Rajaraman

Commentary 166

Natalia V. Takhtarova

PART IV DATA COLLECTION AND INFORMATION TECHNOLOGY

- 7 Data Challenges in Implementing a Market Value Property Tax: Market and Market-Informed Valuation in Russia, Ukraine, and the Baltic States 183

John L. Mikesell and C. Kurt Zorn

- 8 Computer-Assisted Mass Appraisal Options for Transitional and Developing Countries 207

Joseph K. Eckert

- Commentary 229

Paul Smoke

PART V APPROACHES TO VALUATION

- 9 Is Area-Based Assessment an Alternative, an Intermediate Step, or an Impediment to Value-Based Taxation in India? 241

U. A. Vasanth Rao

- 10 The Feasibility of Site Value Taxation 268

Riël C. D. Franzsen and William J. McCluskey

- Commentary 307

Gary Cornia

PART VI PROPERTY RIGHTS, COLLECTIONS, AND ENFORCEMENT

- 11 Taxing Land Without Market Value in Ancient China 315

Yu-Hung Hong

- 12 Extending Property Taxation into Previously Untaxed Areas: South African Townships and Tribal Areas 334

Michael E. Bell and John H. Bowman

- 13 Collection and Enforcement of the Property Tax 372

Sally Powers

- Commentary 387

Claudia M. De Cesare

PART VII THE BALTIC EXPERIENCE

- 14 Land Taxation Reform in Estonia 395

Tambet Tiits

15 Value-Based Property Taxes in Lithuania	411
<i>Albina Aleksiene and Arvydas Bagdonavicius</i>	
Commentary	436
<i>Vytautas Šulija</i>	
Contributors	447
Index	451
About the Lincoln Institute of Land Policy	465



TABLES

- 2.1 Band of Values in Great Britain's New Residential Property Tax 22
- 3.1 Property Tax as Share of GDP 40
- 3.2 Property Tax as Share of Total Subnational Government Expenditures 41
- 3.3 The Determinants of the Relative Use of Property Taxation (Dependent Variable: Property Tax Revenues to GDP), 2SLS Estimation 46
- 3.4 Fiscal Decentralization Indicators 47
- 3.5 Ratio of Third-Tier Government Expenditures to Total Subnational Government Expenditures, Selected Countries 48
- 3.6 Selected Measures of Property Tax Administration 50
- 3.7 Simulated Impacts of Alternative Property Tax Administration Reform 51
- 3.8 Simulations of Revenue Implications of Property Taxes Representing 1 Percent of GDP, Year 2000 (21 Countries) 53
- 4.1 Matrix of Incidence in Developing and Transitional Countries 66
- 4.2 List of Variable Definitions 75
- 4.3 Social Accounting Matrix: Summary of Salient Features 77
- 4.4 Social Accounting Matrix 78
- 4.5 Elasticity Choices 83
- 4.6 Mobility Between Urban and Rural and Fixed Capital Supply 85
- 4.7 Immobility Between Urban and Rural and Fixed Capital Supply 89
- 4.8 Mobility Between Urban and Rural and Elastic Capital Supply 90
- 4.9 Immobility Between Urban and Rural and Elastic Capital Supply 91
- 4.10 Social Accounting Matrix: Sensitivity Analysis 94
- 4.11 Sensitivity Analysis: Mobility Between Urban and Rural and Fixed Capital Supply 96
- 4.12 Sensitivity Analysis: Immobility Between Urban and Rural and Fixed Capital Supply 97

- 4.13 Sensitivity Analysis: Mobility Between Urban and Rural and Elastic Capital Supply 98
- 4.14 Sensitivity Analysis: Immobility Between Urban and Rural and Elastic Capital Supply 99
- 5.1 Property Tax Treatment of Farmland in Selected Countries 112
- 6.1 Tax Structure in Taiwan 130
- 6.2 Example of LVT Liability 138
- 6.3 Tax Burden in Taiwan 142
- 6.4 Taiwan's Local Taxes (Business Tax Included) 146
- 6.5 Taiwan's Local Taxes (Business Tax Excluded) 150
- 8.1 Current Weights 216
- 8.2 Market-Calibrated Coefficients for Communal Fee Calculation in Zagreb 217
- 8.3 Zagreb Residential: Current Versus Market-Calibrated Communal Fee by Zone 218
- 8.4 Krakow: Ad Valorem Tax Impact 221
- 8.5 Data Table: Brčko Impact Study 224
- 9.1 Revenue Growth Under Annual Rental Value and Under Area-Based Assessment in a Sample of Three Cities 253
- 9.2 Computation of Property Tax Under the Proposed Capital Value System 264
- 10.1 Vacant and Improved Land Sales Within the Central Business District, 2001 275
- 10.2 Status of Site Value Taxation in Australia 286
- 10.3 Status of Site Value Taxation in the Other Countries Surveyed 287
- 10.4 Valuation and Tax Collection Issues 288
- 10.5 Importance of Property Tax (or Rates) as Percentage of Local Revenues 298
- 10.6 The Changing Status of Rating in Australia 299
- 11.1 Grain Tributes in the Qing Dynasty 327
- 11.2 Estimated Amount of Land Taxes in 1908 328
- 12.1 Ranking of Five Plots on the Basis of Three Top Criteria, Makumeke Workshop 359
- 12.2 Features of the Five Plots Evaluated in the Makumeke Workshop 360
- 12.3 Evaluation of Two Property Tax Forms Under Traditional Criteria 369

- 15.1 Revenue Information of Lithuania 420
- 15.2 Comparable Data of Land Normative Values and Market Values 423
- 15.3 Statistical and Market Data on Construction Structures in the Country by 1 January 2005 429
- 15.4 Factors Considered in the Valuation Models 430
- 15.5 Results of the Investigation of Appeals Submitted Against the Taxable Value Estimated by the Way of Mass Valuation 433



FIGURES

- 6.1 Contribution of Land Taxes to Local Tax Revenue (Business Tax Included) 135
- 6.2 Contribution of Land Taxes to Local Tax Revenue (Business Tax Excluded) 135
- 6.3 Land Tax Revenues 136
- 8.1 3D Response Surface Model of Sale Price Residuals for St. Thomas, U.S. Virgin Islands 211
- 8.2 Croatia Use Tax Formula 215
- 8.3 Rezoning on St. Thomas, U.S. Virgin Islands 219
- 8.4 Database for Brčko Impact Study 226
- 10.1 Systems Used by Local Authorities in Percentage Terms 274
- 10.2 Sales of Vacant and Improved Residential Plots in Tshwane Metropolitan Area 279
- 11.1 The *Tsing Tien* System 320
- 14.1 General Tax Burden in Estonia 406
- 14.2 Ratio of Local Tax Revenues to Total Tax Revenues in Estonia 407
- 14.3 Total Land Tax Revenues in Estonia 408
- 15.1 Lithuania's GDP Growth, 2000–2005 415
- 15.2 Organizational Structure of Lithuanian Real Property Administration System 418
- 15.3 Number of Assessed Land Parcels 424
- 15.4 Mass Appraisal System 427
- 15.5 Annual Number of Transactions 429



P A R T
I

INTRODUCTION



The Property Tax in Practice

Roy Bahl, Jorge Martinez-Vazquez, and Joan Youngman

Students of public finance and fiscal decentralization in developing and transitional countries have long argued for more intensive use of the property tax. It would seem the ideal choice for financing local government services. The chapters in this book take this argument one step further by drawing on recent experience with property tax policy and administration. Two main sets of issues are addressed. First, why hasn't the property tax worked well in most developing and transitional countries? Second, what can be done to make the property tax a more relevant source of revenue for local governments in those countries?

In chapter 3, Roy Bahl and Jorge Martinez-Vazquez analyze the numerous advantages of the property tax as a local government revenue source. These advantages include:

- It is potentially revenue productive and revenue-income elastic because it has a large and rapidly growing base (property values).
- It can be progressive to the extent it is structured so that its burden falls on owners of land and on those who own or occupy structures with a higher value.
- Under certain circumstances it can act as a quasibenefit charge in that land values will respond to the level and quality of public services provided.
- Local governments have a comparative advantage in identifying and valuing properties because they are familiar with the local base.
- It is a tax that higher-level governments tend not to want.

On the other hand, there are some serious disadvantages to the property tax. The most important are the high cost of accurate valuation and the political difficulty of enforcement. These drawbacks are exacerbated by an

unpopularity of the property tax that seems to be far out of proportion to the burden it imposes on taxpayers.

Based on revenue performance, one might conclude that the disadvantages have won out. In their empirical analysis, Bahl and Martinez-Vazquez show that property taxes in member countries of the Organisation for Economic Co-operation and Development (OECD) are equivalent to about 2 percent of gross domestic product (GDP), but in developing and transitional countries, the share was less than 0.7 percent. The trend has been only slightly upward over the past three decades. Higher levels of property taxation are associated with economic development (an external factor) and expenditure decentralization (a policy choice). A reasonable conclusion is that the slow growth in fiscal decentralization is a primary factor holding back increased reliance on the property tax. Additional important factors include the availability of other sources of revenue for local governments that might crowd out the property tax, and the government's lack of success in finding ways to address the difficult administrative problem of valuation.

In the commentary following the chapters in part II, Gregory K. Ingram agrees that fiscal decentralization is an important determinant of the intensity of use of the property tax. However, he stresses that fiscal decentralization is a policy choice as well as a result of economic development, and that OECD and transitional countries have been more willing to decentralize than have developing countries. This leads him to conclude that it is very difficult to predict the future course of property tax revenues.

In chapter 2, Joan Youngman reminds us that the property tax might be unique among taxes in terms of its ability to adapt. She argues: "Within the specific confines of real property taxation, transition is a fact of life." Ingram sees the recurring transition as endemic to the nature of the tax (i.e., its high degree of visibility draws the eye of taxpayers, which leads to administrative and policy changes that are highly visible, and so on). Youngman tracks through some important changes in property tax practice—administrative as well as political—to demonstrate that many of the important transitions in the tax have arisen in the industrialized countries. This experience is used to make the case that the obstacles to future development of the tax, and the new opportunities to be captured, are not as different as those among industrialized, developing, and transitional countries.

Youngman describes two major twentieth-century upheavals to the property tax in industrial countries where property taxes have long been a mainstay. The introduction of a poll tax with the succeeding Council Tax in the United Kingdom and Proposition 13 in the United States were sea

changes in the practice. If such major changes arise in the United States and the United Kingdom, where the property tax is long established, then the fits and starts we observe in developing and transitional countries should be no cause for alarm. In fact, the Youngman thesis concerning transition is a theme that runs throughout this book. Part VII of the book reports on the experience in the Baltic countries as they make the transition to a system of private ownership, and considers how the property tax is a part of this transition. In chapter 7, John L. Mikesell and C. Kurt Zorn describe the experience of Russia and Eastern Europe in developing a cadastral system as an adjunct to the privatization of land ownership, and in chapter 8, Joseph K. Eckert details how computerized mass appraisal can function as part of the transition process. In chapter 9, U. A. Vasanth Rao shows how area-based systems of valuation in India can be a step in the transition to market value systems.

THE ROLE OF PROPERTY TAXATION

There has always been debate about the appropriate objectives for the property tax. At one extreme is the standard taxman position: “Design it to be primarily a revenue raising instrument, and design it in a way that it has minimal effects on economic choices.” The other view, most often taken by planners, is that any instrument that taxes land has a great potential to influence social policy and economic decisions (i.e., everything from stimulating a more efficient use of land, to creating a better environment for economic development, to improving the equity of the distribution of overall tax burdens).

In chapter 5, Richard M. Bird and Enid Slack give a good account of the “taxman” position in considering the property tax as an instrument to provide funds for the development of rural areas in developing countries. They recommend a strong focus on empowering rural populations to raise revenues to finance badly needed local public services, rather than fine tuning to accomplish nonfiscal objectives. Top-down fiscal policies, they argue, have not worked in rural areas in developing countries, and it is time for a bottom-up approach to fiscal decentralization. A locally controlled property tax could become a key element of this strategy.

“Getting it right” is no easy matter in the case of rural property taxation. Issues such as unclear or inadequate assignment of expenditure responsibilities and difficult administrative structures are major impediments, and there is usually scant administrative capacity to implement a local property tax. There seems little choice but to design the tax centrally and to mandate

its imposition by local governments at some minimum level. Otherwise, local politicians will be loath to impose a property tax that likely will be unpopular with the local elite, and would much prefer to rely on intergovernmental transfers. Once the tax is established and the administrative infrastructure is in place, the control of the tax should shift to the local government level.

Bird and Slack raise two other particularly thorny issues concerning rural property taxation. On the politically charged question of taxing agricultural land, they come down on the side of an area-based approach, taking account of land productivity if possible, with some indexing or annual adjustment for inflation. In the case of farmland at the urban fringe, a reasonable approach may be to treat it as a transitional case and allow taxable land values to rise as urbanization creeps closer and as better information on land values becomes available. There is much international precedent for this practice.

Some policymakers have been influenced by the view that the property tax might play a role in making the tax system more fair. Although few would argue that property tax reform should be led by vertical equity considerations, it would be unthinkable to exclude questions of fairness from the reform discussion. In fact, one school of thought is convinced that the property tax is regressive because it falls primarily on consumers of housing, and argues that this feature makes it a bad choice for low-income countries where the supply of housing is short. Others take the “new view” of property tax incidence and see it as a tax on capital and, therefore, one that can add to the progressivity of the tax system. In chapter 4, Edward B. Sennoga, David L. Sjoquist, and Sally Wallace revisit the theory of property tax incidence with a computable general equilibrium model including structural features representative of developing and transitional countries, such as the presence of a large informal sector and less than perfect mobility of capital.

Under these assumptions, they show that the burden of property taxes is borne primarily by owners of land and capital. This would suggest a progressive distribution of the tax burden, with the incidence of the tax falling most heavily on middle-income and upper-income taxpayers. Interestingly, they show that their results are not significantly influenced by different assumptions about the mobility of capital. Their work supports those who would argue that the property tax will not likely add to the regressivity of tax systems in developing countries.

Indira Rajaraman also believes the property tax to be progressive in its incidence, but in her commentary (following the chapters in part III), she calls for an expanded analysis to substantiate this conclusion. In the developing

country case, she does not see the informal and the government sectors as self-contained, as Sennoga, Sjoquist, and Wallace assume, but rather as sectors that trade in intermediate goods with the formal sector. If trade occurs between the informal and formal sectors of the economy, this opens a transmission mechanism for the shifting of property tax burdens to likely poorer groups in the economy. However, it is not clear that this change in the underlying assumptions of the model would alter the main conclusion of the analysis concerning the progressivity of the tax, but Rajaraman's comment suggests a fruitful area for future research.

The property tax levied in Taiwan dates back to ancient China. In chapter 6, Steve Waicho Tsui studies the efficiency of the property tax and land administration fees in Taiwan both as a revenue source for local governments and in their other assigned role: to influence the pattern of land use and to capture "unearned increments." The land value tax is a strong revenue producer for local governments, collection costs are low, and revenues are fairly stable. However, it does not reach its potential as a revenue-raising instrument because of poor assessment practices. Despite the long history of property taxation in Taiwan, assessments are only a rough approximation of market values. Assessment ratios in Taipei City can be as low as 38 percent.

Of more interest is Taiwan's land value increment tax, which is one of the few examples of a capital gains tax on land. In recent boom years on land values, this tax yielded as much as 4 percent of GDP, a level that would rival that of Canada, the country with the highest level of property taxation in the world. But the tax is unstable in its yield, and recently the government has rolled back the rate to relieve the burden. Moreover, it does not work well in capturing land value increments, again because of a flawed assessment process. If we look to Taiwan for an example of a successful capital gains tax on land, we will not be encouraged by the results. Taiwan has had more success with value capture using land use regulations that require owners to contribute a portion of their land being developed. Tsui attributes the better success of land administration measures to greater transparency and a perception of more fairness. Natalia V. Takhtarova, reflecting on this experience, speculates in her commentary (following the chapters in part III) that the results would be quite the opposite in Russia, where land administration mechanisms are viewed as unfair and "corruption risky." Apparently, culture and history matter greatly in designing schemes to recapture land value increases from the real estate sector. Of course, the property tax and practically all other explicit taxes are new institutions to Russia and most other transitional countries. Takhtarova provides a rich perspective on the difficulties of introducing a market-based property tax in Russia

and other transitional countries; in particular, she properly emphasizes the importance of getting the political economy of the property tax right before moving forward with the reforms.

INFORMATION SYSTEMS

The principal administrative impediment to the heavier use of the property tax in developing and transitional countries is the challenge of determining market values for land and structures. The failure to establish a creditable tax base erodes taxpayer confidence, dampens compliance rates, and limits revenue performance. Lower revenues mean poorer services, and poorer services stiffen the resistance to higher taxes. The underlying problem is the absence of accurate sales data on property transactions. The source of the problem might be the limited involvement of the private sector in property markets, particularly in transitional countries. The more likely problem in developing countries is that reported sales values for traded property are not accurate. The latter might be due to the combination of a high property transfer tax rate that encourages underreporting of a sales values and a transfer tax office that lacks adequate resources to monitor the accuracy of sales price declarations.

In chapter 7, Mikesell and Zorn describe these data problems and report on how this issue is being addressed in five transitional countries: Russia, Ukraine, and the three Baltic countries. All these countries seem to recognize the need for assembling accurate land value data, either for taxation or for other purposes such as privatization negotiations or dispute adjudication. Progress in building a database of sales transactions that can be used for valuation varies widely among these countries, with Russia and Ukraine lagging behind the Baltic countries. In all cases, however, there has been an effort to build a modern cadastre that includes relevant land characteristics.

Mikesell and Zorn provide some useful lessons. First, even in countries where private ownership and property markets are only now emerging, and where the property transfer administration is fraught with problems, the process of developing a comprehensive database on land records and land transactions can begin. These case studies show that long before the database is complete, it can be used to support the valuation of land for tax purposes. In the case of the Baltic countries, valuation is informed by market data but done by expert opinion. However, the growing database of sales values in the Baltic countries has encouraged the use of mass appraisal techniques. Second, the effort invested in assembling a good database may be directly related to the importance of the property tax as a revenue source

or to expectations about reliance on the property tax in the future. The reliance on the property tax by local governments for revenues in Latvia (18 percent) and of local government revenues in Lithuania (12 percent) may not yet be high enough to serve as a disincentive to underassessing the tax base.

There is a long way to go, however. The land value information systems are incomplete, and so their use in inferring values for all properties can be challenged. The quality of the data itself is suspect, given the likelihood of underreported sales amounts. None of these countries has established a test of assessment quality. Valuation systems based on comparative sales data can never be fully accepted unless taxable values are independently verified in assessment ratio studies.

In the commentary following the chapters in part IV, Paul Smoke observes that institutional arrangements matter greatly in setting the stage for a successful property tax. He notes from Mikesell and Zorn's chapter that in the Baltic countries, where more progress has been made toward the creation of cadastral records, that the process has been centralized in single agencies. In Russia responsibility has been shared among many agencies. Although the door is still open on centralized versus decentralized administration, the merits of single agency seem very persuasive. In her commentary Takhtarova makes the interesting point, with reference to Russia, that it took agency consolidation of responsibilities for records management to attract the necessary funding to get the job done.

Even in countries where the beginning of a land value system is in place, the valuation is still market assisted in that assessors use the data plus judgment (e.g., the judgment of real estate agents) to arrive at a tax liability for each parcel. In chapter 8, Eckert argues that we can do better, even in transitional and developing countries, by moving to a more developed method of establishing values. He describes the use of computer assisted mass appraisal (CAMA) to establish values for each parcel, based on reported sales values, individual property characteristics, and location. This method has appeal in that it can take into account the influence of a wide variety of factors on land values, and it can do this in a systematic way. It is also attractive because it offers a relatively inexpensive means of establishing a cadastre of property values, and it can be done in a short period of time (e.g., 18 months for 30 cities in Kosovo). Both Latvia and Lithuania have moved quickly to establish mass appraisal systems. Even so, there is some subjectivity in the mass appraisal approach, for example, in the choice of variables to be used in determining the hedonic index and in establishing boundaries to help identify location values.

Are developing and transitional countries ready for CAMA? Perhaps not. The biggest problem is that available data on property transactions, on

which the hedonic index is based, may be an inadequate record of sales values in both absolute and relative terms. And, as Mikesell and Zorn point out, most countries do not conduct assessment equity studies that would allow us to identify the degree of error in these data. On the other hand, both Eckert and Smoke think that systematic “market informed” mass appraisals can lay a foundation for moving toward a true market valuation approach. Short-run errors in valuation might not be such a high price to pay, and in any case they are no worse than the errors introduced by present methods of valuation. Takhtarova underlines this by noting that valuation design forces governments to make choices on broader issues relating to information requirements and intergovernmental fiscal relationships.

VALUATION

In the commentary following the chapters in part V, Gary Cornia argues correctly that property tax design requires an early answer to the question, “What will be the base of the tax?” Most students of property taxation think of the “proper” tax base as being market value, in the form of sales or rental data. Scholars and advisers regularly urge the adoption of standard methods of valuation, in particular the comparative sales approach. As those who must implement the property tax know, these standard methods of valuation do not travel well to the developing country setting. The paucity of information available on market transactions makes good estimates of value extremely costly. As a result, policymakers in low-income countries often turn to shortcut methods to estimate the tax base.

One method that has been gaining acceptance in developing countries is the area-based approach to valuation. The method appears simple and involves only two steps. First, every property is assigned a value zone based on factors such as location, service available, and quality of the structure. Second, the taxable area of the property is multiplied by a notionally determined value per square foot to arrive at the property tax base. In chapter 9, Rao discusses the merits and shortcomings of this approach as it has been used in India in recent years. On the one hand, this method of determining the tax base has gained favor with both taxpayers and local governments. Taxpayers appreciate the simplicity and transparency of the resulting valuation/tax tables. Urban local governments in India also were enthusiastic because they saw significant revenue increases in the aftermath of the introduction of area-based property taxes. Moreover, the area-based approach is a way for local governments to circumvent the harmful Indian court ruling that controlled rents are the appropriate tax base in the rental value system.

However, Rao also acknowledges some significant flaws with the area-based approach. First, it does not avoid the problem of determining values because the notional values per square foot still must be determined for each zone, and this is done on the basis of expert judgment. The area approach, no less than the comparative sales approach, faces the perennial problem of a lack of reliable data on comparative sales. In India the rates of property transfer tax exceed 10 percent in some states, offering a major inducement for understating sales prices. A second problem is that the area-based system can be quite complicated because it requires that each property be weighted by value coefficients for location, land use, and building type, and there can be subcategories for each coefficient. The data requirements here resemble in some ways those associated with the more sophisticated CAMA approach discussed by Eckert. The transparency of a simple table is undermined by the great complexity of the computations for the values the table presents. Rao reports that for some Indian cities there can be as many as 240 different combinations of coefficients. Third, area-based systems are characterized by fixed values per square foot between valuation periods; hence, they exhibit no growth in response to property value increases. Thus, this method suffers from the same revaluation problem as the traditional market value approach. In fact, no Indian city that adopted the area-based system has revalued (i.e., updated coefficients). Cornia makes the further important point that local governments may become comfortable with the area-based approach, and the property tax reform process could end at that point.

Another solution to the problem of valuation would be to eliminate improvements (structures) from the tax base (i.e., tax only the land). Surely this would reduce the difficulty of the valuation job. In chapter 10, Riël C. D. Franzsen and William J. McCluskey report on experience with site value taxation in both industrialized and developing countries. In general, the results of their analysis square with expectations. Land is more easily valued because it tends to be more homogeneous than improvements; its physical characteristics do not change as much as improvements; and, other things being equal, its implementation does not require as much staff as does a tax base that includes both land and improvements. In addition, the celebrated economic advantage of the site value tax is that it does not discourage investment in improvements.

On the other hand, Franzsen and McCluskey acknowledge some significant problems with site value taxation. The most important is the limited availability of evidence on sales of vacant properties within urban areas to make creditable estimates of land values in the entire city. As Cornia notes, this data problem has led many property tax analysts to conclude that a site

value tax is infeasible. Even advocates of site value taxation, such as Franzsen and McCluskey, cannot find good evidence that this valuation problem can be overcome for urban areas. One possibility to make headway would be to use a CAMA approach to find “residual values” (not explained by other hedonic variables) for land area and its location. But, to our knowledge, so far this has not been tried.

A second problem lies in the data itself. As in the case of all value bases, property sales values can be understated to avoid full payment of transfer taxes. Finally, there will be important political issues if land value taxation requires a higher rate of tax than does a capital value tax on land and improvements to raise a given amount of revenue.

These shortcomings, plus the perception by many that exemption of high-value structures is socially wrong, are powerful. Franzsen and McCluskey’s list of countries, including developing and transitional countries, using land value taxation is short and getting shorter, and it includes none of the world’s largest countries.

PROPERTY RIGHTS AND ENFORCEMENT

The absence of reliable data is only one impediment to creating a valuation roll in developing and transitional countries. Another is that private ownership of property may be limited, and the concept of an arm’s-length property market may be completely new. Can a property tax succeed in such an environment? The case of the Baltic countries suggests that the property tax can succeed even if it is introduced while land markets are developing. The two other case studies of the feasibility of land taxes without land markets lead to the same conclusion.

In chapter 11, Yu-Hung Hong tries to answer this question with a study of land taxation in ancient China. He has identified tax systems that operated in various periods—some quite ingenious in their structure—and were revenue productive, proved sustainable over long periods of time, and minimized transaction costs. None of these systems was based on taxing the value of the land, largely because the cost of establishing land values would have been prohibitive in the absence of functioning land markets. All of these systems taxed output from the use of the land or extracted in-kind contributions, were transparent, and seemed to find acceptance from taxpayers. The nominal tax rates were significant (e.g., 10 percent of total output). The lesson here for developing and transitional countries is that the absence of a market in land transactions that would provide easy evidence of values is not an insurmountable constraint to effective property taxation.

In the commentary following the chapters in part VI, Claudia M. De Cesare makes the interesting observation that some of the ancient Chinese practices described by Hong are relevant to contemporary property tax policies. Penalizing inefficient uses of land and keeping the tax structure and administration as simple as possible continue to be central advice in the development of property tax systems. And, as described by Tsui in chapter 6, the Taiwan practices of taxing land value increments and covering development costs by requiring contributions from benefiting landowners find their origin in ancient Chinese tax policy.

In chapter 12, Michael E. Bell and John H. Bowman study a more recent situation to ask the same question: Can there be a successful property tax in a case where there are no good records of ownership and no clearly defined system of property rights? They study the case of South African townships and in particular the informal settlements (multiple untitled dwelling units occupying a single tract of land on the outskirts of an urban area) and tribal lands under communal ownership. In the former case, there were no ownership records for the apartheid period, and in neither case was there a valuation list or reliable tax maps.

Nevertheless, Bell and Bowman are optimistic about the prospects for developing the property tax in this environment and argue that local governments should both register new properties and be aggressive about developing market values for property tax purposes. They argue for a simple area-based system during a transitional period, with a high threshold that will exempt low-income taxpayers. Bell and Bowman stress the need to keep the concept of market prices in the public eye to stimulate the development of a property market. The link between such actions and the establishment of property rights is less clear. De Cesare probably has it right: the implementation of a property tax in newly urbanizing areas is more likely to organize the records on property rights than to define or modify them.

Even if property rights are in place, it is necessary to overcome the problems of enforcement. Most developing countries fail to collect the full amount due. For this reason Sally Powers argues in chapter 13 that the nature of the collection process is one of the early decisions to be taken in structuring the property tax. She stresses the need for public information campaigns to encourage voluntary compliance. These campaigns should emphasize both the fairness of the tax and the idea that the revenues are paying for valuable services. Note, though, that such campaigns can have an effect only if the tax is, in fact, fair and if it really does buy significant amounts of services that are demanded by the potential taxpayers. Powers sees the tax-paying public as the target for such public information campaigns, but De Cesare sees local politicians as an equally important audience.

Powers also argues for teeth in the legislation (e.g., treating the tax as a lien on property, imposing sanctions on nonpayers, and imposing heavy penalties). Such sanctions might be most effective if they produced inconvenience (e.g., denial of vehicle license plates) but stopped short of draconian seizures of property, particularly residences, which carry enormous administrative and political costs. The idea of sanctions is a good one and would put the property tax on the same enforcement footing as other taxes. However, such sanctions do exist in many developing countries and are not enforced, mostly because local politicians are too wary of penalties on local voters and too intimidated by local elites. Moreover, there is the possibility that such sanctions may not even be constitutional, as De Cesare suggests may be the case in much of Latin America.

THE PROPERTY TAX IN A TRANSITIONAL SETTING

In some cases national governments find a window of opportunity for property tax reform so comprehensive that it amounts to introducing a new tax. Such was the case in the three Baltic countries in the period following the fall of the Soviet Union. We can learn interesting lessons from these major reforms. One is that the property tax can be part of a larger reform agenda and need not be postponed on grounds that bigger changes have a higher priority. To the contrary, the potential for successful property tax reform might be enhanced if it is packaged with other important changes in national policy. After the fall of the Soviet Union, the Baltic countries began a program of restitution of ownership rights and privatization of real property that required establishing property rights and identifying ownership for every parcel in the country. At the same time, the Baltic countries were preparing to apply for membership in the European Union, reducing company income taxes to attract investment, and seeking greater fiscal decentralization. In all three countries, property tax reform was structured to fit this context.

The Estonian case, as reported in chapter 14 by Tambet Tiits, is interesting in several respects. First, the choice of the tax base was land value. Second, the property tax was an integral part of a decentralization strategy. Local governments were given the authority to set the tax rate within prescribed limits, with the goal of providing an important source of local government revenue. Third, assessments were to be based on market value, using traditional comparative sales methods to establish values. So, unlike many nations that took a cautious approach to property tax reform, the Estonians jumped directly to a market value basis for taxation. A major

enabling factor was a companion reform under which the property transfer tax rates were brought down to less than 1 percent. It is reported that, as a result, actual transaction values are now accurately disclosed.

In many ways, the Estonian reform was exemplary, but it also had important failings. Its most serious shortcoming is its lack of any prescribed period within which revaluation must take place, with the result that assessed values have fallen to levels well below market. The stage has been set for a significant revaluation shock, which is always a major challenge to the political acceptability and revenue yield of the property tax. In his commentary Ingram also notes that taxpayer backlash can lead to a major restructuring of the property tax. Without revaluation, revenue growth in Estonia has slowed, and this has compromised the goal of using the property tax as a significant local revenue source. The property tax share in GDP is 0.34 percent, which is below the international average of about 0.7 percent estimated by Bahl and Martinez-Vazquez in chapter 3 for nonindustrial countries.

The situation in Lithuania is similar in that a property tax was introduced at a time of significant privatization of real estate and the development of a property market. The reform has gone more slowly than it has in Estonia. The restoration of ownership to the private sector is not scheduled for completion until 2009. In chapter 15, Albina Aleksiene and Arvydas Bagdonavicius describe and analyze the development of the property tax system and its unusual approach to a transition from area-based to market value assessments. The present system uses an area method with notional assessments for the land tax, and this has resulted in major undervaluation in urban areas. The tax on structures, which is a separate levy, is assessed using traditional methods of valuation and comes closer to being a tax on market values. Perhaps the most distinguishing feature of the Lithuanian tax is its exemption of residential properties.

In the commentary following the chapters in part VII, Vytautas Šulija points out that the property tax has been slow to develop in Lithuania. One reason for this is that as recently as 1999 only 13 percent of urban land was private property. Moreover, it takes time to develop a value-based tax, and it is not clear that the population had the taxpaying capacity to absorb a significant increase in tax burdens in the 1990s.

CONCLUSION

There is much to be learned from the chapters in this volume about whether the property tax can be made to work. The underlying theme that runs through most of these chapters is that the property tax is in a perpetual

transition, and its policies and administration are always changing. Yet the feeling one gets from these analyses is optimism that the transitions are moving in the right direction.

Four general conclusions might be drawn from these chapters. First, during a transition second-best approaches can be the right strategy. Market-assisted information for valuation can be an acceptable substitute for actual sales transaction data, until the latter become available. However, we must avoid second-best methods such as area-based assessments becoming permanent substitutes for a tax based on actual sales transaction data.

Second, institutions matter greatly. Paying attention to the political economy of the tax, investing records management in single rather than multiple agencies, identifying the right collection machinery, and finding a way to gather reliable data on sales transactions are all essential to developing a workable property tax.

Third, accurate valuation of the tax base is the key to success with the property tax.

Finally, and most significantly, with careful design and administration, the property tax can be a key to strengthening local government finance, promoting rural development, and improving the fairness of the distribution of tax burdens.