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Financing Rural Local Governments**

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The Role of the Property Tax in Financing Rural Local Governments¹

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1. Why This Topic?

Why write a paper on rural local government finance in developing countries? Cities, particularly large cities, are where the action is these days. International competition is increasingly between cities, not countries (Bennett 1997). The concentration of people and firms increases social and economic interaction and results in greater exchange of ideas among people working in different fields in the same location. Large metropolitan areas can achieve the critical mass required to attract and support high degrees of specialization in labour, knowledge, businesses, services, infrastructure, institutions, and media. To be globally competitive, cities need to provide a wide range of services from transportation, water, sewers, garbage collection and disposal, police and fire protection to parks, recreation and culture, affordable housing, and social assistance.

For these reasons, how metropolitan areas are governed and financed is important (Bird and Slack 2005). Money matters: who has it, where does it come from, and under

¹ Paper prepared for the conference: “Making the Property Tax Work in Developing and Transitional Countries” Andrew Young School of Policy Studies and Lincoln Institute of Land Policy October 15-17, 2006

what conditions can it be spent, and by whom? How public expenditures are financed is always a key issue in any city or metropolitan area strategy (World Bank 2002). In particular, experience demonstrates that the ability to self-finance – that is, to be free of the whims and wishes of others – is a critical factor in determining which metropolitan institutions live and thrive and which fade away or die in bickering between contending financial supporters.² The role of the property tax in the rapidly expanding urban areas of the developing world – an issue well discussed in Bahl and Linn (1992) – is thus a subject that clearly warrants close attention from those concerned with development, decentralization, and the efficient, effective, and equitable provision of local public services.

Can the same be said of the property tax in rural areas? We think so, for at least two reasons. The first and most important reason is simply because billions of people, most of them very poor, still live in rural areas around the world – about 1.2 billion in India and China alone – and the path and effects of development in different countries may be much affected by how those thus, as it were, ‘left behind’ are treated. In particular, how and to what extent these people can be provided with at least a modicum of local public services is an important issue. Since, as we note below, the property tax is likely to be the only way in which rural local governments can ever hope to become viable, accountable, and at least moderately effective, how to make the rural property tax ‘work’ in developing countries is thus an important issue in terms of improving human welfare.

A second reason is that, although the world may be globalizing, national politics are generally still largely shaped by local and regional concerns. How the rural sector fares in development matters both for economic and political reasons. The economics of the relationship between agricultural and general development have long been explored in the literature.³ As Mellor (1967) and Hymer and Resnick (1969) noted long ago, a critical aspect of agricultural development is how agricultural and other activities interact in the context of the broader rural economy. In this context, we stress that there is more

²For example, as Davis and Raich (2003) show with respect to various attempts made over the years to ‘institutionalize’ some metropolitan structure in the Mexico City region, the only one that had even limited success was the only one that gave the region any real control over its own finances.

³ For a summary of the classic literature, see e.g. Bird 1974, chap. 2.

to rural property taxation than just taxing agricultural land. Most discussion of the property tax in rural areas has understandably focused on the taxation of agricultural land. Taxing agricultural land effectively, efficiently and equitably is clearly an important topic. Indeed, one of us wrote a book on this issue some years ago (Bird 1974) and of course many authors have since continued to till these fields.⁴ In reality, however, much of the rural property tax base often consists of residential and non-residential buildings and land devoted to non-agricultural pursuits. The taxation of non-agricultural property in rural communities may thus sometimes be as important as the taxation of agricultural land from both revenue and economic perspectives.

In this paper we thus take a broad approach to the role of the property tax in rural areas in developing countries and view it in the context of the developmental case for developing more effective rural local government. The role that sound local rural property taxes may play in developing the institutional social capital within which the needs and knowledge of local peoples may be more effectively combined to improve both their well-being and economic development more generally may also be important, as Sokoloff and Zolt (2005) have argued in historical perspective.⁵

In the next section we develop further some aspects of the argument as to why it is critical to improve rural local government in most developing countries, and why a more effective property tax may in many countries be a critical component in this process. We then turn in section 3 to review some aspects of agricultural land taxation briefly, noting especially that insufficient attention seems to have been paid to the important ‘local’ dimension of such taxation. When this consideration is taken into account, we argue that even more weight is added to the argument made in Bird (1974) to the effect that to make such taxes work in the circumstances of most developing countries, they must be kept as simple as possible.

In section 4, we discuss three particular facets of rural property taxation. The first such matter is the appropriate treatment of rural land in what we have elsewhere (Bird and Slack 2006a) called ‘the land between’ the urban and rural areas – that is, the urban fringe. The second is the importance of taxes on property transfers in many countries, and

⁴ See, for example, Strasma et al. 1987; Newbery 1987; Skinner 1991a, 1991b; Hoff 1991; Khan 2001; Rajaraman 2006.

⁵ For a distinct, but related, argument, see Hoffman and Gibson (2005).

the generally undesirable effects of such taxes. Finally, a third issue we consider briefly is the attempt in a few countries to affect land use patterns – and even to effectuate land redistribution and reform -- through ‘special’ taxes such as those on ‘idle land.’ In Section 5 [as yet incomplete], to lend a little verisimilitude to what might otherwise seem a somewhat bald and unconvincing argument, we review briefly some aspects of several episodes of actual - or attempted, or contemplated - rural tax reforms around the world. We suggest that in all cases one important problem has been inadequate attention to the inherently ‘local’ nature of rural property taxes. Finally, in Section 6 we conclude with a few reflections on the critical question of how one might ‘market’ sound rural tax reform.

2. Getting Rural Local Public Finance Right

How to finance adequate public service provision in rural local governments is a problem in rich and poor countries alike. We mentioned above the importance and difficulties of developing adequate metropolitan governance and finance structures. Diverse and context-specific as the ‘best’ solutions to such problems invariably turn out to be (Bird and Slack 2005), it is much simpler to talk about ‘the’ metropolitan finance problem than ‘the’ rural finance problem. No two big cities are alike -- but all are big cities. No two rural areas are identical either, but the variation within this sector across and within countries – from densely populated (and sometimes astonishingly big) ‘villages’ within walking distance of other equally large villages to scattered huts across remote and desolate terrain is enormous. A ‘remote’ community may be defined as one that is sufficiently far removed from the nearest community, particularly a larger urban centre, such that out-commuting on a daily basis is impossible, and access to services, especially emergency social and medical services, is difficult or impossible (Slack, Bourne and Gertler 2003). On the other hand, rural communities within (say) a day’s commuting distance of a major city face a completely set of challenges and opportunities. As usual, therefore, all simple statements, including many of those made in this paper, are likely to be wrong when applied to any concrete case.

While the precise circumstances may vary considerably from place to place, in general the problem is simply that billions of people around the world live in places that

do not have sufficient resources to supply even minimal public services. This simple dilemma has many variants. Sometimes, a potential resource base may exist but cannot be tapped for local purposes owing to pre-emptive actions by higher-level governments. Natural resources provide an obvious illustration in some countries.⁶ In other cases, local governments are so restricted in their revenue-raising authority that they cannot raise enough to do anything. In still others, there may simply be no effective government structure that is responsible for providing such services – and almost never is the (nominally) responsible authority accountable in any meaningful sense to those for whom they are supposed to provide. Many countries either have no effective government structure – central or local - in rural areas or have structures that are largely totally inappropriate for such areas.⁷

In yet other cases the physical circumstances in rural areas are so adverse that one wonders how people survive in such conditions, let alone receive any government services. Desert regions in Africa and elsewhere, the tundra in Russia, villages perched on mountain tops in countries all over the world – many such instances of remote communities exist. The question in such cases may sometimes be whether it may not be more desirable to encourage those living in such regions – often as a result of past conflict and persecution – to move rather than to facilitate their continued marginal existence.⁸ The political acceptability of such a ‘solution’ is generally negligible, but the price paid by all concerned under the prevailing situation is seldom either transparent or much discussed.

Although there are no universal characteristics of remote areas, there are some common themes (Dougherty et al. 1999). Remote areas tend to be characterized by their small size in terms of population, market, and labour supply. Communities tend to be sparsely populated and physically isolated from each other. They are generally non-contiguous. Often, there is no publicly provided overland transportation system such as roads or rail and at best a limited range of other public and private services. Remote areas are often subject to harsher climatic conditions than exist in the more populated and

⁶ McLure (2003) provides a useful overview of this issue.

⁷ Paradoxically, as Bird and Slack (2005) discuss, much the same may also be said of the very different case of large and growing metropolitan regions in many countries.

⁸ One author (Graham 1963) memorably labelled this approach “The Ghost Town as an Objective.”

urbanized parts of the country. Many such communities have higher unemployment rates because of fewer job opportunities, a weak and declining economic base and a lack of economic diversification. Such small, rural and remote communities often have relatively few individuals in the prime working age group and a larger proportion of children and older people. Since young adults tend to migrate out of such communities, these characteristics tend to become self-perpetuating. In some regions and countries, much of the 'native' (indigenous) population often ends up in remote communities, in part because over the years they have been pushed further and further out into the hinterland.

As Kitchen and Slack (2006) note, in many countries the relatively small size and low concentration of the rural population in remote areas means that the per capita costs in providing services are high while at the same time the fiscal base in such areas is generally low. Remote communities with small populations are unable to take advantage of economies of scale in service delivery. Expenditures on roads, water and sewers are often higher because of the harsh climatic conditions and difficult terrain. Even such large and rapidly growing countries such as India and China face such problems. More sparsely populated and slowly growing countries like those in much of sub-Saharan Africa are often in even worse shape in this regard.

How may the difficult and intractable problems facing such extreme cases be solved? The answer of course depends on many factors. It depends, for example, upon the precise objectives of policy objective – a matter that itself largely depends in practice upon the often contested question of 'who decides' (Bird 2004). Is the aim to 'empower' local people?⁹ Is it to improve service delivery in accordance with central policy objectives? Or is it simply to download some troublesome responsibilities from the center? In India, for example, World Bank (2004) demonstrates that central (and state) attempts to provide rural services have seldom been effective. Efforts at 'decentralization' to date have not, for the most part, as yet produced demonstrably much better results in India (or elsewhere). Nonetheless, in the long run the results are indeed likely to be 'better' in the sense of providing local citizens with more of what they want

⁹ Can people be 'empowered'? Or must they (in effect) empower themselves (Breton 2004)? We return briefly to this issue at a later point.

and are willing to pay for (at least in part) -- if not necessarily more of what those 'up there' think they should have.

In the end the 'best' answer depends to a considerable extent upon the circumstances of the country. Is the problem that there are too many small, remote, and essentially unsustainable settlements? Is it that even potentially viable local governments are unduly constrained from tapping local resources? Or is it that the governments that exist are neither adequately responsible for nor sufficiently responsive to their residents?

One way or another, it seems fair to say that most countries face major problems in financing rural local public services, that these problems are hard to solve, and – of course – that the precise nature of both the problem and feasible solutions is generally quite context-sensitive. Right. Given all this, however, the real question is, as always: what is to be done?

Ideally, as Bahl and Martinez-Vazquez (2006) suggest, to approach this (or any) issue in intergovernmental finance one should first develop a coherent strategy. To do so, one has first to decide clearly the objectives of policy. After all, if one does not know what one is trying to do, it is hard both to do whatever it is and to know if one has succeeded in doing it. Unfortunately, such clarity is hard to achieve in the real world in which there are usually many relevant actors with many different ideas of what can and should be done, and who should pay for what. The difficulty of obtaining any substantial degree of agreement on an issue such as financing rural public services is clear in the many developed countries in which significant groups of citizens seem to view the continued existence of a picturesque rural sector as close to the national self-image. Issues such as the extent to which people should be encouraged (or at least not discouraged) from migrating to richer areas seem unlikely ever to be fully resolved in most countries. Nonetheless, intractable though such issues may be, in principle they need to be brought out into the open and discussed explicitly if a sensible strategy to achieve whatever goal is agreed is to be developed.

Designing and sustaining a strategy for financing rural local public services thus seems likely to be a long-term perhaps interminable, process. In the interim, however, much could be done in most countries both to improve the evidential basis of discussion

and to improve life in rural communities. For example, some poor rural areas manage much better than others that are in apparently similar circumstances, as Fiszbein (1997), Faguet (2004), Zhou (2006) demonstrate with respect to the cases of Colombia, Bolivia, and Sierra Leone, respectively. It is obviously important to study such relative successes closely and to figure out how they have done it. Equally, it is important to think of ways to spread this knowledge around the country and to get others on what seems to be the “right path” to success, for example when it comes to running a property tax. One might think of establishing a competition, with prizes for the best performing region or village as well as encouraging and facilitating forums in which local officials can learn from each other.¹⁰ As Lefevre (2006) has stressed in a different context, when it comes to building sustainable institutional capital getting the ‘process’ right is often more critical than specifying the desired ‘product’ in detail.

When it comes to the design stage, however, Bahl and Martinez-Vazquez (2006) are clearly correct that one needs to work on the intergovernmental transfer system and the local revenue system at the same time in order to achieve the difficult twin objectives of making sure that even the poorest areas get the resources they need to provide the services that the national interest requires – something that is considerably easier to say than it is to measure objectively! -- while simultaneously ensuring that local decision-makers face an adequately hard budget constraint at the margin. The basic idea in designing an effective intergovernmental structure in general is simple. At present, three groups are now, all too often, distinct in many countries -- those who decide, those who pay, and those who benefit. Good sustainable policy design requires creating a substantial degree of overlap among these groups (Bird et al 2004). Of course, how this can be done in a sustainable fashion in any particular country is seldom easy or obvious.

Another common precept urged on those dealing with intergovernmental finance issues is ‘unction before finance’ (Bahl 2002). Before discussing rural finance, one needs a view as to what rural local governments should be doing. On the whole, in most cases they probably should not do all that much. Nonetheless, the critical point is that that they do *something* – specifically, something that they (those who live there) want done -- and

¹⁰ The recent experience with the RRI (rapid results initiative) program in Sierra Leone is particularly interesting in this respect (Zhou 2006).

do it well. Circumstances differ from country to country and place to place within countries, but such things as farm-to-market roads, local markets, and basic primary education and health centers often appear to be high on the “to do” list of both rural people and ‘experts’ in the capital, though not necessarily with the same relative priorities (Fiszbein 1997).¹¹

Poor communities are obviously unlikely to be able to finance much of “social service” costs out of their own resources. Nonetheless, experience suggests strongly that it is better for all if they do so to any small extent possible (Estache 1995). A community that pays only 5 percent of the cost of an educational or water system has a much greater stake in the effective operation of that system than one that gets whatever it gets for ‘free.’ More directly “economic” services -- such rural infrastructure as roads, irrigation systems, possibly village phones and/or radios, for example -- should, like the bare-bones administrative structure needed in such communities, be financed from local resources to at least some extent. If a community cannot do even this, one wonders if it has, or should have, a future -- though this, as already mentioned, is invariably a politically exceptionally contentious point. To put this point most strongly, the correct watchword for sound rural decentralization and development policies should be not ‘no taxation without representation’ but rather its obverse -- ‘no (real) representation without taxation.’ That is, unless local governments have to pay for what they get at least to some extent it is all too likely that neither they nor others will take their role sufficiently seriously to ensure that, over time, it gets done right.

All this, not by chance, takes us back to the property tax. Most property tax revenues in all countries are raised in urban areas: that’s where the base is. But urban areas also have many other possible revenue sources, at least potentially, and property taxes seldom account for as much as half their own-source revenues (including borrowing) in practice. In many developing countries, however, the property tax often accounts for all their ‘own source’ revenue.

In theory, the sources of revenue available to rural local governments in most developing countries are usually the same as local governments elsewhere: taxes, user

¹¹ William Easterly (2006) recently noted that the ‘last refuge’ of central planners was in foreign aid agencies. He obviously has not worked much with those responsible for rural development, decentralization, or local government in most countries.

fees and intergovernmental transfers. In reality, however, the characteristics of the population and the tax base in remote areas restrict the use of many of these revenue sources. It is difficult, for example, for some communities to levy a property tax because the tax base is limited relative to local needs. One reason may be the lack of private ownership of properties in remote areas so that there are fewer properties to tax. Furthermore, the values of properties in remote communities tend to be lower than in urban areas. There is often little or no information on property ownership or the characteristics of the property to provide an estimate of the tax base.

In the end, however, about all that many rural local governments can likely do on their own behalf is to tax land and property and perhaps to impose a limited range of user charges (market fees, etc.). This may not amount to much in aggregate, and may at times get lost in the rounding error at the national level, but they matter a great deal to the communities in question. Nonetheless, both to provide services to rural people and also to build up the institutional social capital needed for development in general, local communities need to be encouraged and enabled to do these things to the limits of their ability.

Rural local governments often face administrative difficulties because they are unable to find suitably qualified full-time staff and have limited training opportunities to develop and maintain qualified personnel. Some municipalities operate with a part-time staff; in others, officials are required to have a wide range of expertise. Specialization is virtually impossible. Some such problems may be overcome, however, by contracting out to other governments or the private sector or by sharing expertise among municipalities, when required. Technology can also improve efficiency and provide easy access to needed expertise. Of course, support and encouragement from higher-level governments may often be essential to facilitate and promote such 'work-around' solutions.

If rural communities are to be maintained as viable places to live and work, they should be as financially self-sufficient as is possible. This means that, to the extent that it is possible, users should pay the full costs of local services and property taxes should be closely related to the actual benefits received those services. Rural property taxes at the local level are more likely to be acceptable to taxpayers than central government property taxes where the proceeds are used to finance local services rather than services in other

communities. Such taxes are likely to be more feasible the simpler they are. Simple land taxes -- perhaps based simply on unit value (perhaps with some variation by irrigation and a few other factors) -- may often be the best one can do in some areas.¹²

3. Taxing Rural Property

Recently, many developing and transitional countries have become more interested in land and property taxes. From a purely fiscal perspective, the extent to which real estate taxes can produce revenue to finance local services is especially important in countries that are decentralizing as many emerging economies have been in recent years. When public funds are as hard to find as they are in most such countries, additional revenues from property taxes are obviously desirable. Moreover, at least in some countries attention is again beginning to be paid to the potentially beneficial allocative effects that properly structured and implemented land taxes might have in both rural and urban contexts. Finally, and in some ways perhaps most importantly, a good local finance system may play a critical role in helping develop the institutional social capital necessary for good governance and sustainable economic development (Sokoloff and Zolt 2005).

Taxes on land and property exist everywhere (Bird and Slack 2004). The revenue such taxes produce is especially important for local governments in rural areas where there is little else that can be taxed. The extent to which local governments have control over property taxes is an important determinant of the extent to which they are able to make autonomous expenditure decisions, and the degree of such autonomy is in turn an important element in improving the delivery of local public services.¹³ The level, design and control of rural property taxation are thus critical elements in determining the effectiveness of decentralization policy in many countries.

¹² Given the limited tax base and high unit costs of service provision in many rural areas, it is very likely that some level of subsidization may be needed to provide even the most basic local public services. We do not discuss this issue further here, however, except to note that a critical element in designing an efficient and equitable transfer system is the existence of some 'truly local' revenue source: see e.g. Bird and Smart 2002.

¹³ See Hoffman and Gibson (2005) for a recent case study, and Sokoloff and Zolt (2005) for a historical perspective.

Some have also suggested that land taxation may be used purposively to foster rural land reform. Colombia, for example, is considering a major reform of rural property taxes as part of its attempt to ‘reincorporate’ parts of the countryside long dominated by various guerrilla and anti-guerrilla forces into the ‘normal’ governance system (Garzón and Vázquez-Caro 2004). In principle, rural land taxes may thus have two distinct roles in emerging economies -- as a source of local revenues and as a tool to affect land use. Unfortunately, at least as we see it, perhaps too much attention has been paid to the theoretically more intriguing second role and not enough to the boring but critical first role of rural property taxes as a source of local government revenue.¹⁴

At present, in most developing countries property taxes provide only a small, though sometimes significant, share of the revenue available for local governments. As a rule the coverage of the tax is not comprehensive, and both assessments and nominal tax rates are low, as are collections. The prevailing low tax rates are often imposed by higher-level governments but even when local governments can set rates, they usually find rate increases in this most visible of taxes difficult to sell politically. Despite such problems, as de Cesare (2002, 9) recently noted, “...the property tax remains the predominant option for raising revenues at the local government level in Latin America” – and not only there. The potential yield of land and property taxes may not be all that large, revenues from this source are unlikely ever to be very elastic, and administrative costs are often substantial (especially when a market-value assessment system has to be put into place).¹⁵ Nonetheless, expanding the rural property tax remains both a logical and a desirable objective for many countries, particularly those in which many people still live in rural areas and in which local governments are expected to play an increasing role in allocating public sector resources.

Taxes on land and property are appropriate local revenue source in part because real property is immovable: it is unable to shift location in response to the tax. Not only are taxpayers more aware of the property taxes they pay than they are of other taxes, the

¹⁴ Portions of this and the next section of the paper follow closely parts of Bird and Slack (2006).

¹⁵ As Evans (2003) notes, the compliance costs of real property taxes are likely to be relatively low. The other side of this coin, however, is that the administrative costs (per dollar of revenue) are likely to be relatively high. As Dillinger (1991) stresses, from a revenue perspective far too much effort has been spent in many developing countries on improving assessment systems and not nearly enough on improving the ‘sharp end’ of the tax system – effective collection: see also Kelly (1995).

property tax usually finances services which are also very visible, such as local roads. Visibility is clearly desirable from a decision-making perspective because it makes taxpayers aware of the costs of local public services. Awareness enhances accountability, which is obviously a good thing from both an economic (hard budget constraint) and political (democratic) perspective. But it does not make the property tax popular.

A particular problem with property taxes arises because they 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. Unfortunately, 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. One way or another 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 seldom cheap. Indeed, to administer a property tax at the same level of fairness (non-arbitrariness) as most other major taxes is both a relatively costly operation and one that, no matter how well it may be done, is not easily accepted as fair by many taxpayers.¹⁶

Still, despite such problems, local property taxes clearly support local autonomy. The extent to which such autonomy is either desired or attained is of course country-specific. In most developing countries, local government autonomy is often heavily constrained when it comes to taxation. Central authorities are reluctant to grant such autonomy to local governments (Ebel and Taliercio 2005). Central governments either do not trust local governments to exercise their taxing authority appropriately or they are afraid local autonomy will impinge on their own ability to levy property taxes or other taxes.

¹⁶ In a pioneering study of the Malaysian land tax (which is based on area, location and use and not on value), Manaf, Hasseldine and Hodges (2005) find that the low and decreasing compliance rates observed (especially with respect to agricultural land) reflected many factors including the perceived fairness of the system and taxpayer knowledge of the system. Unfortunately, no variables reflecting perceptions of local (state) expenditures were included in the study.

For a local government to make efficient fiscal decisions, it must weigh the benefits of the proposed services against the costs of providing them. If local governments do not finance services themselves, then the link between expenditures and revenues is lost and the choice of services will not be based on an accurate perception of their cost. Setting tax rates at the local level places accountability for tax decisions at the local level, and increased accountability leads to better local services (Hoffman and Gibson 2005) and perhaps even to a sounder development path over time (Sokoloff and Zolt 2005). An essential ingredient of responsible local autonomy – or, if one prefers, of a ‘hard’ local budget constraint (Rodden, Eskeland, and Litvack 2003) – is thus that tax rates be set locally (and not by a senior level of government). The property tax systems existing in most emerging countries fall far short of this standard.

An additional question is whether the property tax is to be levied at a flat or graduated rate. In many countries, some graduation is introduced by exempting low-value properties. In a few instances (for example, some provinces in Argentina) the tax rate increases with the value of the taxed property. In Thailand, the tax rate also increases, although in a way that results in regressive rates. Many countries impose higher taxes on “idle lands” -- though seldom with much effect (Bird and Slack 2004). Particularly in rural areas, some countries have occasionally attempted to use progressive land taxes as, in effect, proxy income taxes by attempting first to aggregate all land owned by a single person and then to impose a graduated tax. Such schemes have generally failed, however, owing both to the administrative difficulty of assembling the information – particularly when properties are located in different jurisdictions – as well as the political unreality of attempting to accomplish “land reform by stealth” in this way (Bird 1974).

A striking feature of most property taxes around the world is how low the tax rates are. Even in countries such as Argentina in which progressive rates are imposed, the top rate (on assessed value) seldom exceeds much more than 1 percent, and it is often lower. In Indonesia, the centrally-set land tax rate is only 0.5 per cent. Moreover, as a rule, the effective rate of property taxes is, owing to low assessment ratios and poor enforcement, much lower than the nominal or statutory rate. Other factors resulting in low effective tax rates in many countries are lags in reassessment and the inadequacy of

adjustment for value changes. In the Philippines, for example, although the nominal rate was as high as 2 per cent, the effective rate was estimated to be only 0.07 per cent (Guevara, Gracia, and Espano 1994).

Both education and incentives are needed for successful mobilization of local revenue from property taxes. Taxpayers need not only to receive improved local services but also to perceive that taxes are being administered fairly (Manaf, Hesseldine and Hodges 2005). To achieve this goal requires improved tax administration -- property identification and management, valuation and assessment, billing and collection, enforcement, and adequate taxpayer service. Few, if any, emerging economies can manage to do all of these things well.

In the end, the only way to achieve successful property tax reform in any country is to secure sufficient support from a significant proportion of taxpayers. Support is more likely if taxpayers both feel that they are receiving adequate services for the property taxes that they pay and perceive that the process of taxing property is fair and accountable. In most emerging countries local governments have a long way to go before these preconditions are satisfied. On the whole, and perhaps especially in rural areas in which fiscal relations are inevitably more ‘personal,’ an approach that couples property tax reform with significant decentralization may have a better chance of success than a ‘stand-alone’ reform of either alone.

In general, agricultural properties tend to be treated favourably, as shown in Table 1. Rural and especially farm properties are favoured in a variety of ways – for example, through lower assessments, exemptions for part or all of the farm property, lower tax rates on farms, or farm tax rebates. In some countries (for example, China) much agricultural land is simply not taxed at all. In others, rather than assessing farms at their market value (which presumably reflects the highest and best use), farms are assessed at their value in current use. Even in market-value systems the value of a farm for tax purposes is often determined by its selling price if it were to continue to be used as a farm. Alternative uses of a farm (e.g. as a housing subdivision), or its speculative value, are not considered in the determination of value.¹⁷ Such favourable treatment of

¹⁷ This outcome is even more likely when, as is common in many countries (Bird 1974), agricultural land is taxed on an area basis, adjusted by crop utilization and, perhaps, by average crop prices.

agricultural land is usually designed to preserve it from conversion to urban use but, as will be noted below, it rarely succeeds in achieving this land use objective.

How should agricultural land be taxed? Under a pure area-based tax, the tax is levied at a uniform rate on each unit of land area, without regard for the income-generating potential of the land. The amount of assessment is determined by multiplying the tax rate, expressed as a flat amount per hectare (or other unit of land) by the number of units in each taxable tract. A variant of a land area tax would take account of differences in the potential of the land to generate income by adjusting the tax rate or tax base by factors such as irrigation, soil type, and distance from the market. Although an area-based tax is inelastic, tax rates or assessments may of course be adjusted to reflect inflation (as in Colombia) or productivity improvements.

Land taxes assessed on the basis of land area are the simplest in terms of structure and administration. The information requirements are minimal and include: the area of the property, its location, its classification, and the name of someone to whom the bill can be sent. Since the tax is lump sum and not based on output, it may force owners to improve the use of their land.

There are some disadvantages to a tax on land alone, however (Skinner 1991b; Khan 2001). First, the tax could be regressive because the burden of a tax on land as a percentage of the land value would be negatively related to the productivity of the land. The relative tax burden on poor farmers would be higher than on rich farmers if the former own less productive land. Second, revenue potential is limited by the maximum acceptable burden on the least productive land. Third, the tax bears no relation to the circumstances of the landowner. Nevertheless, as Bird (1974) notes, if the burden distribution of an area-based tax is roughly consistent with prevalent equity norms, then its overwhelming administrative advantages favour this type of tax. Although an area-based tax is inherently crude, it would probably be tolerable in most countries if taxed at a fairly low rate. Even a crude area-based tax at a low rate would be an improvement over the present situation in countries that collect little if any taxes from agricultural land. Moreover, if the cadastral records are incomplete and tax rates are fairly low, taxpayers may prefer to pay the tax because doing so may help to establish ownership (Skinner, 1991b).

Table 1. Property Tax Treatment of Farm Land in Selected Countries

Australia	Rates often reduced at local discretion
Canada	Assessed as farm; lower tax rates in some provinces
Germany	Base includes machinery/livestock; no business tax
Japan	Assessed as agricultural if outside urban area
United Kingdom	Exempt
Hungary	Some exemptions
Latvia	Rural land value proportional to average cadastral value
Poland	Separate taxes on agricultural land and forests
Russia	Tax rates are different for agricultural land
Ukraine	Tax rates depend on use of land and fertility
Argentina	Value based on location, area, fertility, alternative uses
Chile	Value in current use
Colombia	Assessed same as urban; tax rates must be the lowest
Mexico	Land value depends on land use; buildings on unit value of construction; sometimes lower tax rates
Nicaragua	Exemptions may include up to 1 hectare of land
China	Separate tax on farm land occupation based on area
India	Rural similar to urban; lower rates and some exemptions
Indonesia	Rural (& low-valued urban) housing mostly exempt
Philippines	Taxed at higher % of assessed value than residential
Thailand	Lower rate for land used for annual crops
Guinea	Agricultural land not taxed
Kenya	If taxed, typically on the basis of area not value
South Africa	Rural and agricultural properties included in tax base but not taxed
Tanzania	Rural property not taxed
Tunisia	Agricultural land not taxed

Source: Bird and Slack (2004), pp. 34-5

Value-based taxes can be levied on the annual rental value or the capital (market) value of the farm. Under the rental value approach, in principle property is assessed according to estimated (not actual) rental value or net rent. When landowners do not keep adequate accounting records of their annual rental receipts, the tax could be imposed on actual rental payments of tenants to landlords (net of expenses). In the case of owner-cultivated land, the assessment could be determined with respect to rentals and expenses of similar properties cultivated by tenants. The problem with this method is lack of reliable information on rental payments and high costs of verification. Even with this system, a satisfactory land classification is needed to establish appropriate rental rates and allowances on a standardized basis for all the different grades and uses of land in each local area.

Another assessment method used for taxes based on rental value requires tax officials to estimate the income-producing capacity of each class of land, presumably following standardized land classification and assessment procedures, and then to separate out the part representing rental value, or to estimate the latter on the basis of an assumed rate of return on the capital value. The result in either case, much as under an area-based tax, is a presumptive assessment, rather than an assessment based on any record of individual experience.¹⁸

As with a tax on rental value, a tax on capital value captures both the land as well as the improvements to the land. Since only a small portion of taxable landholdings in most rural areas is actually sold in any assessment period, it is doubtful that the selling prices can be accepted as true indexes of capital value since they are usually influenced by a host of institutional forces and market imperfections. As a result, tax officials once again need to rely on land classification procedures and other indirect methods of valuation.

In theory, there should be no difference between a tax on market value and a tax on rental value. When a property is put to its highest and best use and is expected to continue to do so, rental value will bear a predictable relationship to market value – the discounted net stream of net rental payments will be approximately equal to market value. This relationship does not always hold, however.

¹⁸ For a general discussion of presumptive taxes, see Bird and Wallace (2003).

First, gross rents are often used rather than the economically relevant “net” rents that build in an allowance for maintenance expenditures, insurance costs, and other expenses. Second, most countries tend to assess rental value on the basis of current use. A property that is under-utilized – that is, currently used for a purpose less productive than other possible uses -- would be assessed at a much lower value under the rental value approach than under the market value approach. From a land use perspective, a tax based on value in highest and best use is more efficient than a tax based on current use because it stimulates use to its highest potential by increasing the cost of holding unused or under-used land (as compared to developed land). The difference between highest and best use and current use is particularly relevant in the case of idle land, especially when it borders on an expanding urban area or is in an agricultural area which is expected to experience rapid development (land on the urban fringe is discussed further below).

Whether the value-based assessment uses rental value expressed as the rate of payment for use of the land (annual value) or the present discounted value of the annual payments (capital value), the information and administrative requirements are high (Ott 1999). In many countries, assessment practices are poor, the number of trained assessors is usually small, and techniques such as scientific soil mapping, productivity surveys, and assessment manuals are rare. Because the cadastral information needed to determine market value is often not available at reasonable cost, a simple uniform tax on a classified area basis that includes some measure of market value by creating zones that reflect distance to the market, soil conditions, etc. is probably the best form of agricultural land tax for most developing countries.¹⁹ Annual readjustments for inflation would reduce the need for annual or regular reassessments.

One possible approach might be to use an initially simple area-based system as a starting point to move to a market-value based system over a period of years. For example, as urbanization creeps closer and information on sales of properties increase, the tax based on area might be adjusted by zones to reflect different market values. A zone located closer to recently urbanized land would have a higher factor than a zone

¹⁹ An interesting model that incorporates coefficients designed to reflect market pressures into an area-based system has been recommended for lands in traditional tribal areas of South Africa (Bell and Bowman, 2006). A workshop with community residents helped to identify the characteristics that make land “good.” The three most important factors were: access to water, soil fertility or quality, and services.

located further away. As the prospect of land conversion (rural to urban) came closer, zones could be defined more and more narrowly until at some point the 'zone' becomes an individual property. At that point, the area-based system will in effect have become a market value system.

In many developing countries, however, even a simple area-based classified system would be a substantial improvement. In principle, as the intriguing South African experiments described in Bell and Bowman (2006) suggest, it might be possible to build up such a tax base 'from the bottom.' Some other examples in both rural and urban areas of what is essentially an iterative process of determining appropriate relative property values to serve as the basis for allocating a pre-determined tax target are discussed in Rhoads and Bird (1969). When potential taxpayers are intimately involved in determining the tax base, the process is likely to be, as one might expect, convoluted and slow and to have any chance of success taxpayers really have to be keen on getting the services to be paid for through the taxes. At the end of the day, however, the results should be both economically and politically more 'efficient' than in the usual top-down process. Moreover, a 'club'-like form of rural local democracy financed along these lines would presumably provide a sounder and more sustainable form of local government over time.

Despite such potential virtues, however, building a rural property tax from the ground up is likely to be a step too far in most countries. First, and most obviously, the various 'club members' do not start out as equals and they are of course most unlikely to end up as equals. If the rich few control, they control, and the institutional structures within which they exercise control are a secondary issue. But one cannot redress basic inequalities or alter fundamental political realities by wishing things were different than they are, so this problem is not really fundamental in this context. Nor is the likely objection that such 'idealistic' approaches will work only in some and not in all areas. The same may of course be said of any feasible approach. More important is the simple fact that many rural communities in developing countries lack the resources and know-how to do the job. As usual when it comes to making decentralization effective, in reality what is usually needed is thus a strong central (or state) supporting, encouraging, facilitating, training, and capacity-building role. Central governments cannot, as Breton

(2004) has put it, 'empower' local governments because in a fundamental sense people cannot be 'empowered' by anyone: they must empower themselves. But they can often do so only if the conditions are such that it can be done. In this case, what this means is that , providing local communities with good land maps and reliable crop price information is as essential to their imposing sensible taxes on agricultural land as the same information is to any effective centrally-directed land tax.

4. Some Special Issues

Taxing on the Urban Fringe

Farmland on the urban fringe often faces pressure for urban development. Rapid urban development on the urban fringe can lead to urban sprawl and the high costs associated with providing infrastructure and services to new developments on the outskirts of cities. From the perspective of property taxation, the issue is whether local taxation can or should be used to encourage (or discourage) urban development of farmlands on the urban fringe.

The difference between value in current use and value in highest and best use is particularly significant in the case of farmland on the urban fringe. A common approach in developed countries to assess farms is at their value in current use rather than their market value (which reflects the highest and best use). The value of a farm for tax purposes is thus determined by its selling price if it were to continue to be used as a farm. Alternative uses of the farm (e.g. as a housing subdivision), or its speculative value, are not considered in the determination of value.

Taxing agricultural land on the basis of its value in current use was originally designed to reduce development pressure. Current use remains popular because of the widespread perception that it is unfair to tax farmers for non-farming uses such as real estate development (Youngman 2005). Indeed, almost every US state had some form of preferential treatment for agricultural land, usually in the form of current use

assessment.²⁰ Although the protection of family farms is the main justification for current use assessment, the provisions generally do not differentiate between family farms, hobby farms, corporate farms, or land being prepared for subdivision. The result is that many of these tax breaks end up benefiting land developers (Youngman 2005).

How well does current use assessment work in practice in preserving farmland? The provision of tax relief to farmers is designed to affect the timing of land development at the urban fringe. The extent to which development will be delayed depends on two factors (Anderson 1993): first, the difference between value in current use as a farm and the market value in its developed use and second, the rate of property tax. The greater the difference between value in current use and market value, the greater will be the impact on delaying development. The higher the property tax rate, the more effective will be value in current use in terms of delaying development.

The evidence suggests that value in current use does not benefit farmers in truly rural areas because the difference between value in current use and market value assessment is insignificant for farms for which there is no development pressure. Where farming is the most profitable use of the land, such as in truly rural areas, the value in current use is the same as the value in highest and best use. Although there may be some difference in value if current use is based on variables such as crop prices, an artificially low assessment will not benefit a farmer in a rural jurisdiction. Moreover, tax rates are likely to be lower in truly rural areas than in areas on the urban fringe.

Even in areas where agricultural owners are free to sell their land for development at any time, current use assessment by itself will not ensure the long term preservation of farmland. Theoretical research (England and Mohr 2002) suggests that current use assessment can defer but not permanently prevent development of land on the urban fringe. Preferential property tax treatment is not sufficient to preserve farmland because

²⁰ Similar practices exist in Canada: In Ontario, farmland is assessed and taxed at lower rates although the farm residence and one acre of land surrounding the residence is normally part of the residential property class (not the farm property class) and is therefore taxed at its current (market) value. In BC, farmland is assessed at its value in current use. Buildings on farm land are assessed at market value. All farm structures, including the farmer's dwelling, are classified as residential. In Manitoba, farmland, farm outbuildings and farm residences are assessed on the basis of their most probable market value. Owners of farmland on the urban fringe can apply for a "farm use" assessment. A change in use of the property results in a tax payback on the difference between the two values for a period of up to 5 years.

the resulting tax differential is unlikely, given the generally low effective tax rates on land, to be large enough to compensate for the much higher prices that would be paid if the land were converted to urban use (Maurer and Paugam 2000).²¹

Efforts to preserve farmland on the urban fringe can also result in unintended consequences (Youngman 2005). For example, favourable treatment of rural land can increase speculation at the urban fringe and hence end up increasing urban land prices. Reducing taxes on land under the greatest development pressure (close to the urban fringe) may result in leapfrog development. In other words, land further away from the urban fringe will be developed in the short term and the protected land will be developed at a later date. Leapfrog development requires infrastructure expansion and can be costlier than developing the land on the urban fringe.

Taxes on Property Transfers

A variety of other taxes -- transfer taxes, stamp taxes, capital gains taxes, value-added taxes, inheritance taxes – are often applied, sometimes at high rates, to land and property in many countries (Franszen and McCluskey 2005). The most common alternative form of land tax is one on land transfers. Land transfers may sometimes be subject to various taxes and charges – land transfer taxes, stamp duties, notarial fees, registry charges, value-added taxes, and, in some instances, succession and gift taxes.²² While it is beyond our scope to discuss these taxes in detail here, it should nonetheless be noted, as David Ricardo pointed out two centuries ago, that taxes on the transfer of property are in a sense the ultimate “anti-market” and indeed anti-development tax.²³

Land transfer taxes are levied at the time of sale of a property and are calculated as a percentage of the value of the property transferred. The tax, which must be paid before the transfer can be registered, is like a sales tax payable by the purchaser and

²¹Some states impose a penalty when farmland is withdrawn from use value assessment programs. The penalty reflects the difference between agricultural use taxes and the amount that would otherwise have been due (based on market value assessment) for some number of years preceding the sale. But these penalties are small relative to the potential profits from farmland conversion.

²² The treatment of land and real property under a VAT is a complex issue: for a recent discussion, see Bird and Gendron (2005).

²³ For an early analysis of such “market-discouraging” transfer taxes, and references to the literature, see Bird (1967).

calculated as a percentage of the purchase price. The tax rate sometimes increases with the value of the property; in some cases, taxes are higher on non-residents.

Land transfer taxes may be imposed centrally or locally. When levied at the local level tax rates have to be fairly low to avoid distortions (people moving in response to the tax). When rates are set low, however, the administrative costs at the local level end up being high relative to the amount of revenues collected.²⁴

In principle, a heavy tax on land transfers may provide an undesirable deterrent to asset transfers, including those which would facilitate more efficient resource utilization, since its effect is undoubtedly to reduce the average volume of transactions. Transfer taxes may work against one of the alleged main benefits of taxes on real property, namely, the pressure they exert either to utilize land more efficiently (in order to produce income to pay the tax) or to sell the land to someone who will use it efficiently. On the other hand, it may be argued that high land transfer taxes will deter fraudulent property transfers intended to avoid high property taxes, especially those levied at progressive rates. On the whole, however, such taxes discourage the development and formalization of land markets. Their popularity, often at surprisingly high rates, is presumably attributable primarily to administrative convenience. Something happens that comes to the attention of the authorities: the “taxable event” – the recorded exchange of title – is visible, even if the true value of the transaction usually is not.

The revenues generated from a land transfer tax depend on activity in the real estate market. As land values rise and activity in the market grows, the yield of the tax will increase. A lull in the real estate market, however, will result in a lower yield from a land transfer tax. Land transfer taxes discourage full reporting of transaction amounts and thus reduce the reliability of this source of data for property tax administration (Bahl 1998).

The purchaser pays the land transfer tax to the government. In terms of incidence, individuals have little ability to pass on the tax, although consideration of the tax may lower the price a buyer is willing to pay for property. Because the tax is usually small, however, the effect on price is not likely to be significant. In the case of businesses, the

²⁴ To the extent that the collection of land transfer taxes provides an opportunity to collect other unpaid taxes on the property being transferred, the administrative burden as a percentage of the total tax revenues may be lower.

tax is a capital cost that is likely to be recovered over time through higher prices for goods and services. Although the tax is probably borne relatively more by high-income people, the value of real property relative to income tends to decrease as incomes increase so that the land transfer tax tends to be regressive relative to income for those who pay the tax.

Land transfer taxes have also been introduced to dampen speculation, although not successfully. In the 1970s in Ontario, Canada, for example, the provincial government levied a land speculation tax on the gains realized on the disposition of real property, including buildings and fixtures. The stated purpose of this tax was to restrain the rate of increase of land and housing prices by curbing speculation and also to recover for the public a major share of the windfall gains from land speculation. The tax rate of 20 per cent applied to realized capital gains, with some important exceptions.²⁵ Although the tax did result in a temporary reduction in the price of houses, it left the upward trend in house prices unaffected (Smith 1976). Furthermore, the tax increased concentration in both the construction industry and in the ownership of residential investment properties, thus reducing competition. The tax was also said to encourage the deterioration of residential investment properties and to reduce the availability of funds for investment in real property. Finally, the tax was found to be costly to administer and it was not clear if it generated sufficient revenue to cover its administrative costs. Since the tax was found to eliminate most taxable transactions, revenues were small. (At the extreme, of course, if the tax succeeded in eliminating “speculation” there would be no revenues at all.) For all these reasons, the tax was eventually eliminated.

In principle, countries concerned with efficient land use in which land transfer taxes are imposed at high rates, however, would seem well advised to consider lowering such taxes and to make up any revenue loss by, for instance, strengthening basic property taxes. In practice, however, the administrative ease and political popularity of taxing transfers seems almost always to outweigh the (less visible) economic costs of doing so.

²⁵ Exceptions included principal residences, developed industrial and commercial property sold to government, residential investment property owned by the transferor for at least ten years and containing a structure worth at least 40 per cent of the total value; farm property owned by the transferor at least ten years, included in a registered plan of subdivision and wholly or partially serviced by the transferor.

Special Taxes on Land

There are two dimensions to the non-fiscal impact (e.g. on land use patterns) of land and property taxes. On one hand, such impacts clearly occur and ought therefore to be taken explicitly into account in designing and evaluating property tax systems. For example, taxing land alone is more favorable to investment and growth than taxing land and improvements (Netzer 1998). Ideally, sensible fiscal (and land) planning should take such effects into account, for example by placing a heavier burden on land than on improvements when it is feasible to do so.

Going further than this, however, and imposing special land taxes explicitly to achieve desired non-fiscal outcomes is a temptation that should generally be resisted. From Britain to Colombia, from the Philippines to Tunisia, instances of land tax design intended primarily to achieve such objectives are easy to find. What is considerably more difficult to find is evidence that such tax gadgets have produced net beneficial results. The effort devoted to designing land taxes intended primarily to achieve non-fiscal purposes may at times have detracted from the more important task of implementing an effective and efficient revenue source for local governments (Bird 1974). Rural land reform, the control of land speculation, reaping land value increments for public purposes are worthy objectives. But attempting to achieve them indirectly through the clever design of fiscal instruments may at times be counterproductive and has almost always proved not to be worth the effort.

For example, the plusvalía or land value increment tax found in a number of Latin American countries (Smolka and Furtado 2001) is no doubt a good idea in principle. But no one, anywhere, has been able to get very far with this approach in practice: witness the account in Hood (1976) of Britain's futile attempts to tax land value increments in the 1950s and 1960s. Similarly, attempts to adjust rural land taxation in part to, as it were, achieve land reform by stealth, as has frequently been proposed in India, for example – where the issue is especially salient because of the unfortunate constitutional exclusion of agricultural income from the central income tax -- seem doomed. As Hirschman (1963) noted, what cannot be done openly for political reasons can seldom be accomplished indirectly either, especially when it is adverse to the perceived interests of the landowning elite.

In the end, the only 'non-basic' property tax that really seems worth exploring in most countries is likely some form of special assessment or betterment tax. Countries such as Colombia have had considerable success in recouping some of the benefits to adjacent property owners from certain public investments through such means. However, it is neither easy nor costless procedure to establish and operate such a system in the conditions of a developing country (Rhoads and Bird 1969). Perhaps for this reason, few countries have managed to do much with this potentially useful fiscal instrument and its use in rural areas is, at best, limited.²⁶

5. Rural Property Taxes in “Action” – Some Cases

*China*²⁷

China's prolonged economic boom began in the rural sector – first in agriculture and then with small industries. Although the growth impetus has clearly now shifted to urban areas, China remains to a surprising extent a rural country: indeed, there are actually now more people in the rural sector than when the boom started – and many of them are very poor and getting older. The rural sector remained at the periphery of the Chinese fiscal system throughout the 1980s and 1990s – lightly taxed, but also receiving few subsidies or budgetary expenditures. At the same time, however, the state steadily increased its reach into the rural sector with policies mandating family planning, the provision of free universal education through junior middle school, and the standards under which services are to be provided, all of which increased the costs of government at the grassroots levels of townships and villages. In addition, local officials expanded their demands for resources in part simply to pay for their own salaries. But no new revenue sources were provided to 'grassroots' governments to pay for such activities. The result was an explosion of levies and fees, an increased burden on poor rural taxpayers, and increasing political unrest (Jin and Shen 2006). One recent response was to abolish the long-standing 'agricultural tax'; another was to announce that a new rural property tax would be introduced. But what kind of tax? Does it make sense in China to

²⁶ See e.g. the account of the lengthy Colombian experience in Bird (1984a).

²⁷ This section is based largely on Wong and Bird (2005).

think of introducing a ‘conventional’ market value tax in rural areas? Any viable form of rural property tax in China, as in many countries, seems more likely to be along the lines of a classified area-based tax – that is, close in some ways to the old agricultural tax -- than the sort of modern computer-assisted market appraisal (CAMA) based tax generally recommended by experts these days. However, in all likelihood politics likely rules out any quick return to any form of sensible property tax in China’s rural areas.

[to be completed – Colombia, South Africa]

5. Selling Local Property Taxes

A question sometimes asked is “Can the property tax effectively reach agricultural land in developing countries?” Much ingenuity has been devoted to working out systems of taxation to achieve this objective in an economically desirable and administratively feasible way. The real problem in most countries, however, lies less in the nature of the tax than in the failure to ‘sell’ it to those who matter – the people who have to pay it. To do so, we suggest, a key prerequisite is that potential taxpayers must be convinced that they will get something for their money. In countries in which the main experience with government is the need to cope with bureaucratic regulations and arbitrary impositions, the prospects that the central government will be able to be very successful with such marketing seem slim. We think the only real chance for effective local property taxes in rural areas in developing countries is to emphasize the ‘local’ and especially to emphasize the direct and visible benefits that can accrue to local communities when and if they collectively decided upon, and pay for, local public works and services. Some may consider this idealistic and naïve. We think, on the contrary, that it is not only realistic but even essential to forgo the misconceived attempts to ‘centrally plan’ the lives of the rural poor (and their richer, and often dominant, neighbours) and instead to develop and foster an institutional structure within which those communities that wish to do so can work together to develop themselves.

In this scenario, the role of the central government is to guide (but not to direct), to support (but not control), and to facilitate (but not to mandate). Proceeding along these lines never be easy. Nor will the results be evenly (or perhaps equitably) distributed.²⁸ But at least there seems some prospect of results from following this path. Given the abysmal and virtually worldwide failure of alternative ‘top down’ policies, it seems more than time to give people a chance. It may take a very long time indeed for a state that has so visibly failed to deliver the goods to win sufficient trust (build up sufficient social capital) to be able to succeed in doing so in some completely new way. One way to do so may perhaps be to retrench at the centre and to let services be delivered more and more – albeit no doubt still imperfectly (in some sense) – by more accountable local governments, thus building up social willingness to support a stronger state that now really delivers the goods.²⁹ This painful institution-building process usually gets neglected in such reports because it just takes so long and its results are so obviously uneven in any heterogeneous context, but there may be no alternative. On the other hand, a considerably more optimistic approach is that if one creates the right incentives at the bottom and gets the centre sufficiently out of the way, service delivery to the poor can improve amazingly quickly even in initially very unpromising circumstances. The problem in many countries, however, is not that this may not happen but rather that it is unlikely to be given a chance to happen given the prevailing power structures.

²⁸ To illustrate, in most societies, some groups are not seen as part of the local ‘community’ and may as a result simply be excluded, or even specifically penalized, if more decisions are made locally. It is not an accident that the ‘inclusive welfare state’ was essentially driven from above, and not below.

²⁹ This is essentially the analysis of Gladstone’s 19th century fiscal reforms in Britain offered by Daunton (2001)

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