

Taxing Land and Property in Emerging Economies: Raising Revenue...and More?

Richard M. Bird and Enid Slack¹

Bird - Professor Emeritus and Co-Director, International Tax Program, Joseph L. Rotman School of Management, University of Toronto, 105 St. George Street, Toronto, Ontario, Canada M5S 3E6. Tel. 416-978-8627. Fax 416-978-0002. email - rbird@rotman.utoronto.ca

Slack - Director, Institute on Municipal Finance and Governance, Munk Centre for International Studies, University of Toronto, 1 Devonshire Place, Toronto, Ontario, Canada M5S 3K7. Tel. 416-946-0328. Fax 416-946-8915. enid.slack@utoronto.ca

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Recently, many developing and transitional countries have become more interested in land and property taxes. 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). China too is considering the role of land and property taxation in its burgeoning urban areas (Bird 2005). For various reasons and with varying degrees of urgency, property taxation keeps popping up on the policy agenda in countries around the world.

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.² Finally, and in some ways perhaps most importantly, some recent literature suggests that local property taxes may play a critical role in helping develop the institutional social capital necessary for good governance and sustainable economic development (Sokoloff and Zolt 2005).

These are broad themes, and the discussion in this paper is for the most part in equally broad terms, although much of what we say is based on our recent study of land and property taxes in 25 countries around the world (Bird and Slack 2004).³ That study did not yield simple general conclusions: the appropriate role played by taxes on land and real property and the design and implementation of such taxes are likely both to differ in different countries and to change over time in any one country. The dictum that ‘no one size fits all’ is especially relevant when it comes to land and property taxes because the level, structure and effects of these taxes depend both on the nature, development and distribution of property rights and on the extent to which local governments have real decision-making power.

The paper is organized as follows. First, we set out in brief the roles that real property taxes may potentially play in developing countries. We then note how very far reality diverges from this prescription. Those who would change the situation must, we suggest, first think through carefully the underlying policy problems in some depth. As with any political institution, the role played by land taxes in any country is critically dependent on the variety of political, social, historical, and economic factors that shape public policy. Significant policy reforms are more likely to reflect changes in the balance of the factors underlying any existing ‘equilibrium’ than to induce such changes (Bird 2003). We do not argue this case in detail here, however. Instead, we simply note some reasons why it may prove more difficult to reform property taxes than other taxes.

Experience suggests that to move forward with property tax reform one must not only be modest with respect to the real potential for change but also careful to get some critical details right. We therefore consider next a few aspects of how to do it right -- specifically, whether the usual argument for moving quickly to a modern ‘market value’ system in less developed countries always makes sense. We conclude that it does not. Next, we look briefly at the arguments for utilizing taxes on land and property to achieve broader land policy goals and argue that experience suggests that emerging countries should focus primarily on developing a sound local property tax rather than venturing down this path. Finally, to make some of these points a bit more concrete, we conclude by using the case of China to stress the need to pay much more attention to the quite different rural and urban situations in developing countries in designing and implementing land and property taxes as an effective source of local revenue.

The Potential Role of Land Taxes

Taxes on land and property exist everywhere. In both principle and practice, such taxes may have important fiscal and non-fiscal effects. The revenue they produce is often an important source of finance for local governments. 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.⁴ The level, design and control of property taxation are critical elements in determining the effectiveness of decentralization policy in many countries. Many have also suggested that land taxation may be used purposively to shape urban development patterns and foster rural land reform, and some countries have tried to do some things along these lines. In principle, then, land taxes have, at least potentially, two distinct roles in emerging economies: the first is as a source of local revenues and the second is as a tool to affect land use.

Providing Local Revenue

The property tax generates a significant proportion of local government revenues in relatively few countries, mainly developed countries influenced by British experience. In most developing and transitional countries, the property tax provides only a small, though sometimes significant, share of the revenue available for local governments. Property tax revenues are relatively low in many developing and transitional economies in part because of the way in which the tax is administered. As a rule the coverage of the tax is not comprehensive, assessments are low as are nominal tax rates and 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. In any case, simply raising the legal tax rate seldom seems appropriate in emerging countries because doing so would place the burden of the increase on “those few individuals whose properties are on the tax rolls, accurately valued, and from whom taxes are actually collected” (Dillinger 1991, 5).

Despite its many problems, however, 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 just there. The potential yield of land and property taxes is unlikely to be huge, revenues from this source will never be very elastic, and administrative costs are often substantial, especially when a market-value assessment system has to be put into place.⁵ Nonetheless, an expanded property tax remains both a logical and a desirable objective for many

countries, particularly those in which local governments are expected to play an increasing role in allocating public sector resources.

Assisting Land Policy

The instruments used by local governments to raise revenues impact the nature, location, and density of development. In urban areas, for instance, local governments can affect urban form not only with planning tools but also with such financial tools as the property tax. For example, increases in property tax should result in a reduction in density, other things being equal. The nature of the tax base is also important. Where the tax is levied on the assessed value of property (land and improvements), any investment such as a building that increases the value of the property increases assessed value and tax.⁶ Higher property taxes thus provide an incentive for less densely developed projects – for example, scattered single-family houses rather than apartment buildings. A tax on land only provides an incentive for greater density relative to a tax on both land and improvements. The choice of highest and best use (rather than current use) as the tax base is also likely to result in higher densities.

To the extent property tax differentials are matched by differentials in expenditures on public services, they should not result in a distortionary impact on location or land use. When public services provided to the property owner enhance the value of the property and result in higher property taxes, the property tax may be thought of loosely as a benefits tax. Where such 'matching' does not occur, however, there will be a pattern of positive and negative subsidies that will influence urban development patterns, usually in a way that worsens it. As Oldman et al. (1967) argued decades ago in the context of an early analysis of Mexico City's finances, such misallocations may be especially damaging in the case of the rapidly urbanizing cities of the developing world. This concern seems equally valid today in countries such as China (Bird 2005). Taxes on land and property are seldom matched by service benefits in developing countries. In particular, non-residential properties are often over-taxed relative to benefits received compared to residential properties; tax competition among municipalities often does not reflect differential service benefits; and the common practice of providing favorable tax treatment for farm properties creates further distortions.

Several key policy choices may have an impact on land use: what is included and excluded from the tax base, how property value is defined for different classes of property, what percentage of value is taxable for each class, and how effective tax rates vary within and between classes of property. The information available on many of these points in most developing countries is inadequate to permit analysis of the effects of the existing – almost certainly non-optimal – tax systems on land use. In view of the very low effective tax rates generally applied, any resulting distortions may not be great. Nonetheless, given current pressures for further decentralization and the likelihood of increased reliance in at least some countries on land and property taxation as a source of local finance, property taxes reforms should be designed properly from an economic perspective. In practice, however, in most developing countries what is most important is simply to develop more effective local property taxes. Attention should be paid to potentially undesirable fiscal incentives for land use, but as a rule the task of putting a good property tax into place should not be complicated by attempting, as it were, to do land-use planning through fiscal instruments.

The Real World of Property Taxation

In a recent book we reviewed property taxes in a number of countries around the world (Bird and Slack 2004). The diversity in land and property taxes across countries is striking. There are differences in the determination of the tax base, the setting of tax rates, and the ability to levy and collect the tax. In some countries, one property tax covers all types of property. In others, there are different taxes for different components of real property. Countries may, for example, have separate taxes on land and buildings; separate taxes on residential and non-residential property; or separate taxes in urban and rural areas. Moreover, there are often significant differences within countries. The greater the degree of local discretion in establishing the tax base and setting the rates, the greater the diversity within a country particularly in federal systems, in which the state or provincial government often provides the legal framework under which municipalities can operate. Summarizing this reality is made even more difficult by the lack of internationally comparable information.

Providing Local Revenue

It is clear, however, that land and property taxes are not big revenue producers in any country. As Table 1 shows, at the turn of the century such taxes accounted in developing countries for only about one-half of one percent of GDP (and only about 2 percent of total tax revenue), up a bit from earlier decades.⁷ The equivalent share for the OECD (industrial) countries remained at a bit more than 1 per cent of GDP (and about 4 per cent of all tax revenues) throughout the period.⁸ On the other hand, property taxes are often important sources of local revenue in many countries, especially in developing countries. In the 1990s, for example, property taxes accounted for 40 percent of all sub-national taxes in developing countries and 35 percent (up from 30 percent in earlier decades) in developed countries. These taxes financed a bit more than 10 percent of sub-national expenditure in both groups. As the country information shown later in Table 2 indicates, the relative importance of local property taxes as a share of both GDP and local revenues varies widely from country to country, within both developing and developed country groups.

Table 1

**Local Property Tax as Share of GDP and Local Revenue
(percent)**

	1970's	1980's	1990's	2000's
Developed Countries	1.24/17.4	1.31/17.0	1.44/17.9	1.46/13.0
Developing Countries	0.42/27.6	0.36/24.3	0.42/19.1	0.53/18.3
Transition Countries	0.34/6.7	0.59/8.5	0.54/8.8	0.72/7.2
All Countries	0.77/22.8	0.73/20.4	0.75/15.6	0.95/11.9

Note: The first number in each cell is share of GDP; the second is share of local revenue. Numbers are not directly comparable either between groups or periods owing to differing coverage in each cell. Data shown for '2000's' is usually 3-year average for 2002-04 and include all 55 (21 developed, 17 developing, and 17 transitional) countries for which necessary data are available in IMF (2005)

Source: Bahl (2002) and additional calculations by Roy Bahl and Bayar Tummennasan, as reported in Bird and Slack (2004). Figures for 2000's calculated by authors from data in IMF (2005).

The Economics of Land and Property Taxes

The property tax has historically been associated with local government in most countries. Interestingly, recent studies suggest that the greater extent to which local governments are financed by local property taxes in North America compared to Latin America is one reason for the differential developmental paths followed by the two regions (Sokoloff and Zolt 2005). Taxes on land and property are an especially appropriate local revenue source in part because real property is immovable: it is unable to shift location in response to the tax. Although a change in property tax may be capitalized into property values in a particular community, and in the long run tax differentials may affect where people locate, these effects are of a smaller magnitude than those that would occur with income and sales taxes at the local level.

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

Of course, this analysis is based on a number of assumptions such as that local property taxes in fact finance services that benefit property values, that the incidence of such taxes is on local residents, that both tax rates and service levels are decided by local residents, that those who wish to 'buy' other combinations of services and tax rates are free to move to other jurisdictions, that – impelled by their sensitivity to property values – people will act rationally in response to such signals, and that local governments do what voters want them to do. The strength and validity of many of these links is obviously suspect in the context of many developing countries. Moreover, this argument becomes particularly tenuous when it comes to explaining the commonly found phenomenon of higher taxation on non-residential property.

In contrast, some see the property tax as essentially a tax on capital or, to the extent it falls on housing, as a tax on housing services. Zodrow (2001), for example, argues that the property tax in the United States results in distortions in the housing market and in local fiscal decisions. In particular, taxes like the US property tax that are based on market value discourage building and result in the underutilization of land. The result is that the country ends up with less capital per unit of land than is economically efficient. Homeowners who improve their houses, for example, face higher taxes as a result and will thus be discouraged from doing so. As George (1979 [1879]) said, a tax on land values alone would avoid this economic inefficiency and would stimulate efficient land use.

A tax on land value taxes only location rents (the returns from a particular location regardless of the improvements to the site). Since improvements to land (such as structures) are not taxed, the owner has an incentive to develop the land to its most profitable use. Compared to a property tax on land and buildings that discourages investment in property, a site value tax thus encourages building and improvements. Assuming land is in fixed supply, a tax on land falls on landowners and cannot be shifted to others. Increased site value taxes will thus be capitalized into lower property values. Since the tax is borne proportionately more by owners of land and land ownership is unequally distributed, such a tax should be more progressive than a tax on land and improvements. Site value taxation thus scores well in terms of both equity and efficiency. Indeed, taxes on land are generally regarded as one of the least distortionary taxes, while more general taxes on property do of course distort decisions about improvements (investment) to property. So why, as Table 2 shows, do most countries levy property tax is levied on both land and 'improvements' (a term that includes structures, buildings, irrigation systems, and other man-made features)?

Table 2: Selected Characteristics of the Property Tax in 25 Countries

	Local Property Taxes as % Local Govt Revenues 2002-04*	Basis of Assessment	Local Discretion over Tax Rates	Different Tax by Property Class
OECD:				
Australia	37.6	Market value or rental value or both	Yes for local tax; limits on annual revenue increases	Yes
Canada	38.7	Market value	Yes; some restrictions	Yes
Germany	5.6	Market value; area in former GDR	Central base rates; local leverage factors	Yes
Japan	--	Market value	National standard and maximum rates	No; assessment differentials
U.K.	0.1	Market value (residential); rental value (non-residential)	Residential tax only; centrally-determined tax ratios for bands	Two separate taxes
Central and Eastern Europe:				
Hungary	4.0	Area or adjusted market value	Yes, within legal limits	Yes
Latvia	8.8	Market value	No; local governments can grant relief	No
Poland	9.2	Area	Yes; subject to minimum and maximum rates	Yes
Russia	8.0	Area; inventory of structures; value of assets	Yes, within narrow range set by senior governments	Yes
Ukraine	4.7	Area	No	No
Latin America:				
Argentina	--	Market value	Yes	Yes
Chile	22.4	Area by location for land; construction value for buildings	No	No
Colombia	--	Market value	Yes; subject to central government limits	Yes
Mexico	1.9	Market value	Yes	Yes
Nicaragua	--	Cadastral value	No	No
Asia:				
China	2.4	Area; market value or rental value	No	No
India	--	Mostly annual rental value; some area and market value	Yes, subject to state restrictions	Yes
Indonesia	--	Market value	No; can change valuation deduction	No

Philippines	--	Market value	Yes, subject to maximum and minimum rates	No; assessment differentials
Thailand	12.2	Rental value; market value	No	Yes
Africa:				
Guinea	--	Rental value	No	Yes
Kenya	--	Area or market value or both	Yes	Yes, but rarely differentiated
South Africa	18.4	Market value	Yes	No; relief mechanisms used
Tanzania	--	Market value or replacement cost	Yes	Yes
Tunisia	--	Area; rental value	No	No

*Three-year average: 2001-03 for China, Hungary and Poland, and 1998-2000 for Mexico.

Source: Bird and Slack (2004); property tax share in local revenues calculated from data in IMF, Government Finance Statistics 2005.

One reason may be because the valuation of land alone can be difficult, especially in urban areas where most real estate sales combine the value of land and improvements so that the value of improvements needs to be subtracted to derive an assessed value for land. On the other hand, others argue that valuation of land alone is probably easier than valuation of property (Netzer 1998) and can often be estimated directly from sales and demolition records. The original arguments for site value taxation (George 1979 [1879]) were made in a context in which cities such as San Francisco were growing rapidly. Land that was worthless one day was worth a fortune the next, owing largely to the rapid influx of population. Valuing land separately may be less of a problem when urban areas are growing rapidly, as in most developing countries (Bahl 1998). In many countries, land and improvements are in practice assessed separately in any case, with land value being estimated on the basis of a land value map and building value in accordance with construction cost tables – and both set of values being often long out of date. Another problem with taxing land only, however, is that since the tax base is considerably smaller than the value of land and improvements combined a higher (and hence politically more difficult) rate is needed to generate comparable revenues.

Who Pays the Property Tax?

Quite apart from the question of taxing land only, why has so other good advice bestowed for so many years by experts in so many countries about the desirability of relying more heavily on property taxes had so little apparent effect? One reason, we suggest, is simply because property taxes are particularly difficult taxes in a number of important respects. To illustrate, what one thinks of the present and possible future of any tax inevitably depends in part on what one thinks its incidence is. Who pays the property tax, and is it an equitable tax? There appear to be as many answers to these questions as there are views about the property tax. Those who view taxes on residential real property as essentially taxes on housing services tend to think that property taxes are inherently regressive, since housing usually constitutes a relatively larger share of consumption for poorer people. Those who view property taxes as essentially a tax on capital tend to think that such taxes are inherently progressive, since generally income from capital constitutes a relatively higher share of income for richer people. Those who view the

portion of the tax that falls on land as being paid out of economic rent consider it to be inherently equitable to tax such 'unearned increments' arising (often) from public actions. Those who view property tax as essentially a benefit tax tend to think that there is no more sense in asking if the 'price' of local public services (the property tax) is regressive than in asking if the price charged for anything else is regressive: voluntary exchange (imposing property taxes as generalized user charges for services) does not, in their view, raise any question of incidence. Although hardly conclusive, the empirical evidence on capitalization on the one hand and 'tax exporting' on the other, at least in the United States and Canada, suggests that there may be something in all of these views.⁹ In the end, it seems, beliefs concerning the equity or inequity of the property tax appear to depend largely on what one thinks of the property tax in the first place.

Political and Administrative Aspects

Of course the property tax is hardly the only tax for which incidence is a black box. But at least four additional characteristics of the property tax differentiate it from other taxes: its visibility, its inelasticity, its inherent arbitrariness, and, in at least some countries, the extent to which it reflects local autonomy. First, as usually applied the property tax is a very visible tax. Unlike the income tax, it is not largely withheld at source. Unlike the sales tax, it is not paid in small amounts with each daily purchase. Instead, the property tax generally has to be paid directly by taxpayers in periodic lump sum payments. This means that taxpayers tend to be more aware of the property taxes they pay than they are of other taxes.¹⁰ Moreover, the property tax usually finances services which are also very visible, such as roads, garbage collection, and neighbourhood parks. 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. It does not, however, make the property tax popular. On the contrary, as we discuss below, it appears often to be harder to raise (or reform) property taxes than other taxes.

A second important characteristic of the property tax is that reform efforts are unlikely to have big revenue payoffs simply because the base of the tax is invariably relatively inelastic.

Bahl (2002), for example, notes that the GDP elasticity of the property tax in general has been close to unity for decades (see Table 1). Property values generally respond more slowly to annual changes in economic activity than do incomes, and even when values do rise rapidly few jurisdictions – and almost none in emerging economies - update property values for taxation purposes on an annual basis.¹¹ As a result, in order to maintain property tax revenues in real terms (let alone to raise property tax revenues) it is generally necessary to increase the ‘headline’ tax rate. As with visibility, inelasticity may mean greater accountability (taxing authorities have to increase the tax rate to increase tax revenues), but it also almost always results in greater taxpayer resistance.

Thirdly, most taxes are based on flows – income or sales. The tax base may sometimes be the source of argument between taxpayer and tax authority, but there is a measurable economic activity on the basis of which the tax is levied. In contrast, taxes on land and property are (generally) based on stocks – asset values. Unless the asset subject to tax is sold (by willing buyers to willing sellers) in the tax period, someone has to determine the value that serves as the basis on which to assess the tax. 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.¹²

Finally, to the extent property taxes are levied only by local governments, they support local autonomy. However, the extent to which such autonomy is either desired or attained is very country-specific. In most developing countries, local government autonomy is often heavily constrained when it comes to taxation. One explanation is simply that 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. It may sometimes be sensible for central government to set limits on property tax rates (for example, to restrict the export of taxes to other jurisdictions) but the degree and nature of the control observed in many countries goes well beyond this purpose.

Another explanation for restrictions on local autonomy is that there is sometimes confusion on the part of both central and local government officials between revenue sharing and own-source revenue autonomy (Bird, Ebel and Wallich 1995). With revenue sharing, although the proceeds of the tax accrue in whole or in part to local governments, it is the central government that sets the tax rates and assesses and collects the tax. Shared tax revenues may be distributed among local governments on the basis of where the revenues were collected or on the basis of a formula (for example, on a per capita basis). Revenue sharing is essentially a transfer in which local government revenues are tied to specified revenues of the central government. It is not the same as authority to levy one's own taxes.

A third explanation is that local governments are generally reluctant to take advantage of the legal authority they do have (Ebel and Taliercio 2005). One reason might be because individuals and businesses can easily move between local jurisdictions so that a differential property tax rate could encourage migration to jurisdictions with lower tax rates. Such tax competition may create an environment in which municipalities become more efficient in their use of resources and more accountable to taxpayers. But it may also result in 'harmful' competition, resulting in a less than optimally-sized local public sector. A more likely reason for the reluctance of local officials and politicians to use property taxes, however, is simply that they are unwilling to face the political fallout from levying taxes and would prefer to have the central government bear that responsibility.

An essential ingredient of responsible local autonomy – or, if one prefers, of a 'hard' local budget constraint (Rodden, Eskeland, and Litvack 2003) – is 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. In many transitional countries, one result of the lack of

local control over property taxes is a disincentive to privatize properties. Local governments are unwilling to dispose of properties if they can control the revenue they receive from leasing them but have no control over property tax revenues.¹³ To avoid such distortions, local governments need better control over local tax sources if they are to get out of the land development business, for which they are generally ill suited.

Reforming Property Taxes

Many countries have introduced property tax reforms of varying degrees and varieties. The reasons for undertaking such reforms vary. In some countries, property tax reform was part of an overall reform of local government structure and finance. In others, it was part of a reform of the overall tax system. In still others, property tax reform has been carried out on its own without being part of other government initiatives. Most reforms have focused on either updating assessments or moving from some other base (such as an area-based system) to a value-based system. As Kelly (1995) shows, however, in most emerging countries not only is it not enough to reform assessments but concentrating on assessment reform may in the end subvert the entire reform effort.

An important conclusion drawn from a recent review of property tax reforms in countries such as Indonesia, Colombia and Kenya is that in order to implement property tax reform successfully – where success is defined as raising more revenue in a relatively efficient, equitable and sustainable way – several basic elements need to be in place (Bird and Slack 2004). The preconditions for reform depend, to some extent, on the type of reform that is being implemented. If the reform focuses on the assessment base, for example, a precondition for the successful implementation of that reform is the availability of adequate technical expertise. Other preconditions include the existence of a cadastre, a land registration system, adequate local government capacity, and a solid administrative infrastructure. In addition, considerable and sustained political will is needed to ensure that the reform is implemented. For example, in the case of the relatively successful property tax reform in Indonesia the key was sustained political will. In Kenya, the primary obstacle to implementing property tax reform has been lack of political will and weak administration. Both education and incentives are needed for successful

revenue mobilization. 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 addition, if reform is expected to result in major tax shifts within or among property classes, some form of phase-in mechanism is almost invariably politically necessary in order to cushion the impact. Failure to allow adequately for transitional problems and to cushion burden shifts is often fatal. No matter how economically desirable the long run outcome of property tax reform may be in terms of the equity and efficiency of the tax, its transitional effects may be sufficiently undesirable in political terms to kill it. Some ways of dealing with this problem seem better than others. For example, tax limitations (or tax capping) such as Proposition 13 in California should be avoided.¹⁴ Although the Californian system has been successful at providing certainty and stability for those taxpayers who stay in their homes, such ‘freezes’ break the link between taxes and market values and hence make property taxes less uniform and more arbitrary. Equity is sacrificed because properties with similar market values do not pay the same taxes. Moreover, because there is no incentive to review one’s assessment, assessment errors may never be corrected. Perhaps most importantly, “once a freeze is imposed, the process of thawing may be too painful to bear” (Youngman 1999, 1395).

A simple phase-in of tax increases over a relatively short period of time is a better way to cushion the impact of property tax reform. There is always a conflict between moving to a fairer system as quickly as possible and lessening the impact on those whose taxes would increase. Nonetheless, phase-ins are often needed when reform has been delayed for a long time owing to the size of the tax shifts required. One needs to be careful, however, that transitional or remedial measures such as phasing in tax increases do not take on a life of their own and extend beyond the time required for the transition.

Tax reform is always as much or more a political as it is a technical exercise. The visibility of the property tax and the inherent subjectivity of determining its base mean that it is especially vulnerable to criticism if it is not well administered. It is a complex and expensive task to set up and run a decent property tax. If too much pressure is put on the tax, the system may break down. We noted earlier that many factors need to be in place for a successful reform: clear goals, strong commitment from all levels of government, careful and detailed plans with respect to legislation, valuation, administration, training, collection, and adjudication, and – perhaps most important – political acceptance of the need for the reform. Who can argue? On the other hand, how likely is it that all -- or sometimes any – of these conditions will be satisfied in most developing and transitional countries? How much cost in terms of time and effort must be incurred to secure them, and will the expected benefits justify this use of scarce political, technical, and economic resources? Such questions can be answered only by detailed consideration of the circumstances of each individual country.

To cut to the chase, 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. An approach coupling property tax reform with significant decentralization may have a better chance of success than a ‘stand-alone’ reform than either alone.

Increasing the fairness of the property tax does not often seem to have been a stated objective of reform in any country. It is in any case an elusive goal. Moving to a fairer system is difficult because it invariably means shifts in taxes among taxpayers. Even if reform improves not only equity but also the efficiency and administration of the tax and there are phase-in mechanisms to ease the impact, there will still invariably be winners and losers. Those who benefit from reform usually remain silent. Those who lose tend to be vocal. With a highly visible tax such as the property tax, increasing taxes on more affluent – and usually politically influential -- residential homeowners (as sensible reform would often require) is not likely to prove easy anywhere.

The politics of successful property tax reform thus are not propitious in most countries. Such reform is seldom easy, usually difficult technically, and has often been not too rewarding in either revenue or political terms. In these circumstances, it is thus encouraging that some emerging countries like Indonesia and Colombia have nonetheless achieved some success. It may be difficult to improve land and property taxes substantially in a short time, but it is, it seems, not impossible to improve them to a meaningful degree in most countries, provided – and it is a major proviso – that the will to do so is really there.

Getting it Right

Successful property tax reform is thus possible, if it is done right. But what is ‘right’ when it comes to property taxation? Essentially, one has to decide how to determine the tax base, at what rate to tax it, and how to keep the system, once established, functioning properly. While there are of course many options at each stage of this story, for simplicity we focus here on a ‘mainline’ version of the story.

Determining the Tax Base

What should be taxed? Two distinct assessment methodologies are commonly used for property taxation: area-based assessment and value-based assessment (see Table 2), with the latter being divided into capital and rental value approaches (Youngman and Malme 1994). A few countries use some variant of self-assessment. The conventional consensus is that capital (or market) value taxation is best, for several reasons. The benefits from services are more closely reflected in property values than in the size of the property. For example, properties close to transit systems or parks enjoy higher property values. Market value also has the advantage of capturing the amenities of the neighbourhood, amenities that have often been created by government expenditures and policies. Finally, any assessment system that fails to take account of changes in relative values over time will result in inequities. In practice, most countries use a mixture of systems. For example, a country employing market-value assessment may actually tax single-family residences on the basis of values estimated by what is called the comparable

sales method, commercial properties on the basis of values estimated by capitalizing some income stream, industrial properties largely on the basis of their estimated depreciated cost method, and rural properties on the basis of a more or less refined area (value per unit) method.

Many transition countries use area-based systems of taxation because the absence of a housing market has meant that they lack the necessary information and expertise to determine market values. An area-based system may gradually be shifted to a market-value based system over a period of years as the housing market develops by weighting the area by indicators of quality and location. For example, a tax based on the number of square meters of a structure could be adjusted to reflect the quality of the unit and its location. Quality might reflect the age of the unit and whether it has been renovated. For location, each municipality could be divided into zones to reflect different market values. A zone located in a desirable neighbourhood would have a higher factor than a zone located in a less desirable neighbourhood. Over time, zones could be defined more narrowly from entire neighbourhoods to sections of neighbourhoods to individual blocks. Eventually, the narrowing of zones would come close to each zone being virtually an individual house and the unit value system would, at that point, approximate market value (Slack, LaFaver and Shpak 1998).

Some countries use variants of self-assessment, under which property owners place an assessed value on their own property. In Hungary, for example, the local tax system is based on the principle of self-identification. Taxpayers are obliged to register and report their tax obligations to the local tax administration. In Thailand, self-declaration are made to local assessors who assess the self-declared value and identification in terms of how well it matches their data. Self-declaration of properties by landowners is also required in the Philippines once every three years. The local assessor then prepares the assessment roll. Self-assessment is an appealing procedure to poor countries with little administrative capacity. It does not appear to require expert assessment staff, and it seems to be easy to implement. Indeed, in some cases, such as Bogotá, Colombia, self-assessment has been relatively successful in terms of increasing revenues from property taxes, albeit at a time of rapidly rising property prices. A recent report recommended, largely on the basis of the Bogotá experience, that self-assessment should be

utilized to a considerable extent in Colombia's rural areas also (Garzón and Vázquez-Caro 2004).

In some countries the taxing authority has the right to buy the property at the self-assessed value. Such a system is only credible if it actually can and will buy the property. In practice, this right seems to have been exercised only rarely, presumably because of the political and budgetary impossibility of large-scale property purchases. Tanzi (2001) recently proposed that people should assess their own property and then make the self-assessed value public. Anyone who wanted to buy the property could make an offer at a price that exceeded the declared price by some margin (such as 40 percent). If the owner refused the offer, the bid price plus a penalty would become the new assessment. Although appealing to economists, and frequently recommended in the past, on closer examination such ideas seem much less attractive on a number of grounds (Holland and Vaughan 1970) and have not proven viable in practice.¹⁵

In general, self-assessment seems likely to lead to inaccurate estimates of property values, with a tendency toward under-estimation. It violates the principle of fairness on the basis of ability to pay because people with comparable properties will not necessarily pay comparable taxes. Since lower-valued properties generally have a lower rate of under-estimation than do higher-valued properties, this approach is regressive (i.e. taxes are relatively higher on low-valued properties). Under-estimation obviously erodes the size of the tax base with the usual detrimental effects on tax rates and/or on service levels. In the end, there is no easy way to get people to tax themselves in the absence of a credible verification process.¹⁶ To minimize the obvious problems of under-statement associated with self-assessment, governments must be prepared to obtain (costly) expert assessments of individual properties in cases where it believes self-assessment is inaccurate.

Do Not Give the Tax Base Away

Local governments are often tempted to provide tax incentives such as reduced tax rates or even complete tax forgiveness for some taxpayers to attract businesses to their jurisdiction. The usual arguments for such incentives are that they will result in job creation, investment in

the local area and increased local output (Brunori 2003). Often local governments engage in such tax competition to attract and keep taxpayers who are believed to contribute more in local revenues than they consume in government services. Property taxes, at least at US levels, do appear to have a small but significant influence on business location (Bartik 1991), but there is little or no evidence that property tax incentives are an effective strategy to achieve economic growth. Tax incentives often lead to a deterioration of the tax base and are accompanied by lower levels of public services.

Lower taxes for specific firms mean higher taxes for all other taxpayers. Generally, lower taxes are offered to new businesses locating in the municipality at the expense of existing residents. Tax incentives are often wasted on firms that would have located there anyway. Tax incentives may lead not only to unfair competition among businesses but also to corruption. All in all, local governments would seem well advised to stay out of the business of giving away their potential tax base. Certainly, when they choose to do so, they should not be rewarded with increased intergovernmental transfers to compensate for the lack of own-source revenues and poor quality services. Nor should one government (the centre) give away the tax base of another government (municipality).

Setting the Tax Rate

Three major issues arise with respect to tax rates. Who sets them? Are they differentiated, and, if so, how? And, finally, at what level should they be set? Sometimes rates are set by the central government. Sometimes there is some local discretion, within centrally-set limits. Sometimes there is complete local discretion. Even where rates are locally determined, they are often limited by the central government. Table 2 shows the extent of local discretion in the setting of property tax rates in 25 countries.

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).

Local determination of tax rates is particularly important in countries in which a senior level of government determines the tax base. Local tax rates may have to be set within limits, however, to avoid distortions. A minimum tax rate may be needed to avoid distorting tax competition. Richer local governments may choose to lower tax rates to attract business. With their larger tax bases, they can provide equivalent services at lower rates than poorer competing regions. The resulting location shifts may not be allocatively distorting but they are generally politically unwelcome. A maximum rate may also be needed to prevent distorting tax exporting, whereby local governments levy higher tax rates on industries in the belief that the ultimate tax burden will be borne by non-residents (Boadway and Kitchen 1999). Such tax exporting severs the connection between payers and beneficiaries and renders decentralized decision-making about taxing and spending inefficient.

Whether directed from above or left on their own, many local governments levy rates that differ by property class (see Table 2).¹⁷ Different rates may be imposed for different classes of property (residential, commercial, and industrial, for example). Through this approach local governments may attempt to manage the distribution of the tax burden across various property classes as well as the size of the overall tax burden on taxpayers. Generally, where variable tax rates are applied properties are assessed at a uniform ratio (100 percent or some lesser percentage) of market value. Another way to differentiate among property classes is through a classified assessment system, as in the Philippines. Under this system, types of property (residential, commercial, etc.) are differentiated according to ratios of assessed value but a uniform tax rate is applied. Variable tax rates are more visible and easier to understand for taxpayers than a classified assessment system -- which may, unfortunately, be one reason that differentiated rates seem to be less common than differentiated assessment ratios. Often, assessment ratios differ substantially among classes of property more as a matter of practice than of law and are hence virtually invisible.

Variable tax rates (or other differentiation of property taxes among property classes) may be justified on a number of grounds. For example, it can be argued that the benefits from local public services are different for different property classes. In particular, a case can be made on benefit grounds for taxing non-residential properties at a lower rate than residential properties (Kitchen and Slack 1993). No examples of such differentiation come to mind. On efficiency grounds, property taxes should be heavier on those components of the tax base that are least elastic in supply. Since business capital tends to be more mobile than residential capital, efficiency arguments again lead to the conclusion that business property should be taxed more lightly than residential property. In reality, however, lower rates are generally applied to residential properties for obvious political reasons (Thirsk 1982). Variable tax rates can also be used to achieve certain land use objectives. Since higher property taxes on buildings tend to slow development, if the aim is to develop some neighbourhoods instead of others differential taxes in different locations may be desired.

However one looks at it, however, there is little economic rationale for the most common of all property tax differentials – the higher taxation of non-residential property. Differentially higher taxation distorts land use decisions and favors residential use over commercial and industrial use. A similar rate on both uses would ensure that the choice is based on the highest and best use (Maurer and Paugam 2000). Special taxation of one factor of production (real property) may also distort productive efficiency by inducing a different choice of factor mix in producing goods and services.¹⁸

In some countries much agricultural land is simply not taxed. 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.¹⁹ Such favourable treatment of agricultural land is usually designed to preserve it from conversion to urban use. Basing the property tax on value in current use, however, is probably not sufficient to preserve farmland because the resulting tax

differential is unlikely 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). Furthermore, favourable treatment of rural land can increase speculation at the urban fringe and hence end up increasing urban land prices.

An additional question is whether the property tax is 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).

Such details pale in most developing countries next to what is perhaps the most striking features of their property taxes -- 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, for example, 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, when 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).

Running the System

“Tax administration is tax policy” is a common observation in tax discussions in developing and transitional countries. No form of taxation is more dependent on administration than property taxation. How well land and property taxes are administered impacts not only on their revenue but also their equity and efficiency. In many countries, poor tax administration is an impediment to implementing the property tax. Often, local authorities simply do not have the capacity to administer the tax. Many administrative functions are performed manually rather than being computerized. The revenue base does not include all taxable properties, collection rates are low, and enforcement is almost non-existent. Even countries with relatively good property tax administration often have problems updating values on a regular basis. Recognizing the difficulty of local administration, many countries involve higher-level governments in some aspects of property tax administration, notably assessment. Even then, however, the results often leave much to be desired, since higher-level administrations often have little incentive to respond to the needs of local governments for up-to-date and accurate tax base information.

Three key steps are involved in the process of taxing real property: (1) identification of the properties being taxed, (2) preparation of a tax roll (which contains a description of the property and the amount of assessment) and responding to assessment appeals, and (3) issuing tax bills, collecting taxes, and dealing with arrears. The first step in levying a property tax is to identify the property and to determine the owner (or other person responsible for tax liability). A fiscal cadastre requires the following minimal information for each property: a description, a definition of its boundaries (using cadastral maps), ownership, and the value of land and improvements. A cadastre is an inventory of all properties with a unique property identification number for each parcel to allow for the tracking of all parcels. Property identifiers allow for the linking of assessment, billing, and property transfer records. A good property identification system also requires that information on properties within the jurisdiction is updated and made consistent. In many developing countries much of the needed information is simply not available to anyone in the “official” information system. De Soto (2000), for example, argues that in Latin America the relevant information is not fully legally recorded for 80 per cent or more of land and property.²⁰ For a property tax to work properly, the information that needs to be collected for each property includes, for example: an assessment roll number of the property, the address, the owner(s) of the property, the area in square meters, the age of the unit, and whether it has been

renovated.²¹ The information collected has to be reported in a consistent way and a process needs to be established to update it on an annual basis (Slack, LaFaver, and Shpak 1998).

The simple process of property identification is often difficult in emerging economies. Revenue base information is generally neither up to date nor complete. In Kenya, for example, the fiscal cadastre and valuation rolls include only between 20 and 70 per cent of the total taxable land; in Guinea, the tax roll in 1999 covered only about one third of taxable property. The information to support a fiscal cadastre on a consistent nation-wide basis is sometimes fragmented between the central and local governments. In Hungary, for example, the Land Offices of the Ministry of Agriculture manage the legal cadastre but have no information on property values, while Duty Offices at the local level keep transactions records. Tax departments within local governments keep information on residential units, and local technical departments maintain information on building permits, local master plans for land use zoning and information on public utility infrastructure. These databases are not integrated.

Another common problem is the lack of an adequate system for monitoring and recording land transfers. In the Philippines, for example, the law requires the Register of Deeds, Notaries Public, and Building Officials to submit documents on property transfers to the assessors. In practice, however, assessors generally rely on taxpayers for this information. As is not uncommon in developing countries, it is often easier in the Philippines to get (unreliable) information from taxpayers than (probably no more reliable) information from other agencies. In many countries property records are not computerized. In Kenya, for example, property records are kept manually and maintained in an ad hoc manner. Because it is too expensive for local governments to keep a good record of property identification data in Thailand, taxes are simply not collected on some properties. Thailand is hardly unique in this respect.

For the costs of local government to be shared fairly among taxpayers, property taxes must be based on assessments that are uniform within each jurisdiction. Uniform assessments are easier to achieve where the assessment function is centralized. One US study, for example, found that the use of county rather than local assessors resulted in more uniform residential assessments (Strauss and Sullivan 1998). Another study suggests that any economies of scale in the

assessment function are more likely to be achieved at the central (state) government level (Sjoquist and Walker 1999). One way to achieve economies of scale while maintaining local assessment is by contracting out the assessment function (Bell 1999).

Fair and productive property taxes require not only a good initial assessment but also periodic revaluation to reflect changes in value. Frequent valuations maintain the legitimacy of the tax and reduce the risk of sudden, dramatic shifts in tax burdens from large increases in assessed values. In a value-based system where property values are changing, a shorter time frame for reassessments would obviously be better at reflecting current market conditions. Indexing (e.g. by the rate of inflation) as is done in some countries (for example, Colombia) is not as good as reassessment because property values change at a different rate in different neighbourhoods and for different property characteristics. Fairness is not achieved when property assessments are merely increased by a common factor on an annual basis. Nonetheless, where financial resources are insufficient to do regular reassessments, indexing may be useful. Indexing (over a three to five year period) that reflects relative price changes among locations and property markets can both ameliorate taxpayers' discomfort with large assessment changes and improve information about market trends for assessment administrators.

No matter how well designed and implemented it may be, any property tax system may make mistakes. An essential component of a good system is thus an error-correction mechanism, and one critical element of such a mechanism is to allow taxpayers to appeal their assessment if they think it is wrong. Such appeals processes usually include an informal review by the valuation office to correct factual errors and differences in views of the assessed value. If differences are not resolved at this stage, they proceed to a valuation review board comprising experts in valuation. In some countries, there is a third stage whereby taxpayers can appeal the decision of the valuation review board to a specialized tax court. An appeal system is both desirable and necessary: in reality, however, its outcome may sometimes be to reduce equity, simply because appeals are invariably most utilized by better-off taxpayers who both have more to gain and can better afford to pursue legal redress. In most developing countries, such concerns are more theoretical than real since in practice assessments are seldom appealed – perhaps because the taxes imposed are so small that appealing them is not worth the while of

those most likely to do so, perhaps because the same (well-off) people may have other, less formal, ways of seeking relief (corruption), or perhaps because the formal system is so cumbersome and difficult to use that it is not worth pursuing.

Alternatively, in some countries, appeals may be infrequent simply because there is no effective collection of unpaid taxes in any case. Tax arrears as a proportion of taxes collectible are low in most developed countries (for example, 3 to 4 percent in Japan and the U.K). But they are very large in some developing and transitional countries (for example, 50 percent in parts of Kenya and the Philippines and up to 70 percent in Russia). In principle, if the property tax is not paid within a specified time period after the due date, interest (and a late fee) should be charged with the ultimate enforcement measure being the sale of the property. Such sales almost never occur in developing countries. A more effective enforcement mechanism (at least for properties transferred within the formal legal system) may be not to permit property transfers unless property taxes are up to date.

Other Taxes on Land and Property

A variety of other taxes -- transfer taxes, stamp taxes, capital gains taxes, value-added taxes, inheritance taxes – are also applied to land and property in most countries. Such taxes may generate more revenue than property taxes but they often have undesirable economic effects. Such taxes deserve closer attention than they normally receive. On the other hand, a few countries also apply ‘special’ land taxes intended to achieve explicitly non-fiscal objectives. Such taxes perhaps deserve less attention than they have attracted.

Taxes on Property Transfers

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 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.

In principle, countries concerned with efficient land use would seem well advised to lower land transfer taxes and to make up any revenue loss by 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.

Special Taxes on Land

A few countries appear to have listened more closely to the experts when it comes to introducing special land taxes for essentially non-fiscal purposes – to reap “unearned increments” (*plusvalía* in Colombia, for example), to recoup the costs of public investment expenditures (development charges in Canada, special assessments and betterment levies in various countries), or to discourage the holding of “idle land” (Philippines and penalty rates in some Latin American countries). Such non-fiscal objectives of land taxation have received considerable attention in the literature over the years.

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. Taxing land alone is more favorable to investment and growth than taxing land and improvements (Netzer 1998). The uneven way in which property taxes are often applied within urban areas – with differential taxes on housing and business, for example, and different impacts in older and newer areas – may affect the pattern of urban growth (Slack 2002). Rural development patterns may also be affected by land taxation (Bird 1974). 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 urban land speculation, reaping land value increments for public purposes – all these 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 (1967) 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.²⁴ Similarly, although development charges, exactions, and other forms of “value capture” have been increasingly employed in some U.S. states and Canadian provinces, and some useful lessons for other countries may perhaps be learned from this experience (Slack 2002), the role of such devices also seems likely to be very limited in the circumstances of most developing and transition countries.

Conclusion: The Case of China

One way to conclude a general survey paper such as this is to consider some of the issues raised in the context of a particular country. China is of course hardly a typical developing country but it is an important one, and its circumstances bring out clearly one of the central problems facing property tax designers around the developing world – namely, not only does ‘one size not fit all’ when it comes to designing policies for particular countries but one size may often not fit all even within any one country. Consider, for example, how China might deal with what might perhaps be called its three property tax problems: what to do in rural China, what to do in urban China, and what to do in the ‘land between.’²⁵

Rural China

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 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. But politics likely rules out any quick return to any form of sensible property tax in China’s rural areas.

Urban China

The other side of the Chinese coin is that its cities are growing so rapidly that within a decade half or more of its population will be urban. So far, however, the pattern of urban growth in China has not followed that found in other countries. In particular, contrary to experience in most of the world, its largest urban centers have on the whole grown less rapidly than the urban sector as a whole (Au and Henderson 2002). Moreover, in some critical respects the internal pattern of growth within Chinese cities has also deviated from what economic logic would suggest is sensible – although in this respect at least its experience is not too different to what has been seen elsewhere. The present urban finance system in China is clearly far from rational (Hong 2003). Up to now, many Chinese cities seem to have divided their efforts between attempting to keep unsuccessful businesses in operation through protectionist measures and attempting to attract new businesses by distorting land and capital markets. Unless cities are given sufficient ‘good’ fiscal instruments to finance their expansion, they are likely to continue, as in the past, to cope with the problems facing them by recourse to ‘bad’ ones such as extra-budgetary funds (Wong, 1999), arbitrary and illogical fees (Hong, 2003), and distorted ‘public-private’ schemes (Wong 2003).

In some cities, much investment in both infrastructure and housing has been financed by bank loans, in many cases with repayment capacity estimated on the basis of expected sales of

appreciated land leases. Many urban local governments throughout the country have been dependent on the sale of such leases for a considerable fraction of their revenues and have been heavily involved in land and real estate development. Local government's role is critical to the acquisition of land for development, especially when the conversion of farmland is involved. A lot of money can be made in these activities, and governments have not been slow to move into not only developing serviced land but even building shopping complexes and housing developments. Unfortunately, exactly what has been done, by whom, and who bears how much risk are all unclear since most such activities are conducted through companies and corporations in which various governments are involved in ways that are murky and completely hidden from public scrutiny.

Despite the obvious risks in such involvement, arguably local governments in expanding urban areas have had little choice but to take the gamble because they are responsible for financing infrastructure but have neither the tax resources to do so nor the authority to borrow. However, 'off-budget' financing of urban growth in China seems also at times to have been used to exploit government's monopoly of land acquisition and information about development plans, not necessarily for the benefit of the public. The system has facilitated the provision of urban infrastructure in some Chinese cities. However, it has also exacerbated the lack of transparency in local fiscal matters, reduced the effectiveness of budgetary procedures, created considerable opportunities for both waste and corruption, and distracted government officials from their primary task of providing public services and hinders market reform.

An alternative approach to financing urban development is to think of cities as in effect 'enterprises' that provide services of various sorts both to urban residents and to the country as whole.²⁶ As with any enterprise operating in a (globally as well as nationally) competitive environment, success depends on both obtaining sufficient resources and using them in the right combinations to produce goods and services that potential customers are willing to pay for. For the success of an 'urban enterprise' to improve society's welfare, the prices that all relevant decision makers face must be 'right' in the sense of correctly representing social opportunity costs. The main condition that needs to be satisfied to get urban development right is thus that decision-makers must both face correct input prices and charge correct prices for their outputs.

For China to avoid replicating the experience of too many cities in other countries and ending up with what a famous early paper on this subject in the United States provocatively – and accurately - called “The City as a Distorted Price System” (Thompson 1976), it needs to get urban prices right. In particular, both public and private decision-makers should face correct prices for land which requires both an appropriate regulatory structure and, importantly, an appropriate land tax system so that the best use is made of scarce urban space.²⁷ Excessive decentralization, for instance, already appears to be arising in some cities. Rapid rises in land prices frequently signal large shifts in land use reflecting underlying fiscal regulatory distortions. Unfortunately, as Hong (2003) shows in detail, the basis on which to build a decent land tax system in China still seems some distance away.²⁸ The road to such a tax in China is clearly dependent on the extent to which a ‘normal’ land market is established (or at least simulated). Only then will local governments be willing (or forced) to give up their present reliance on selling land leases for revenue – essentially trading off a future income stream for a current revenue that is all too often spent on current expenditures, thus building up problems for future sustainability. In the long run the way to go in urban China does indeed seem to be to follow conventional wisdom and move towards a good ‘modern’ property tax based on market appraisals.

The ‘Land Between’

But if China’s path ahead is indeed a ‘two-track’ reform, towards a classified area-based rural tax and a market-value-based urban tax, an obvious problem looms. What happens to the ‘land between’ – the actual (and potential) urban fringe? One solution may be, as discussed earlier, to use the 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 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 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 and the area-based system has in effect become a market value system.

Of course, when that point is reached everywhere in the country – a time that seems likely to be many, many years in the future -- China's three property tax systems will have become one, and that one will look like the 'best practice' system commonly advocated everywhere. To get to this point from the very different conditions that now exist not only in China but in developing and transitional countries around the world, would-be property tax reformers need both to spend much more time working out many more difficult details than seems generally to be recognized and also to pay much more attention to the important political economy issues that shape land tax policy and practice. It will not be a simple process.

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² For references to earlier discussions of this question, see, on urban land, Oldman et al. (1967) and, on rural land, Bird (1974).

³ Other useful cross-country comparative studies of land and property taxes in emerging economies include Strasma et al. (1987); Bahl and Linn (1992); Youngman and Malme (1994); Municipal Development Programme (1996); Rosengard (1998); McCluskey (1999); Brown and Hepworth (2000); Andelson (2000); Malme and Youngman (2001); and McCluskey and Franzsen (2005).

⁴ See Hoffman and Gibson (2005) for a recent case study, and Sokoloff and Zolt (2005) for a historical perspective.

⁵ 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).

⁶ This assumes that an increase in the value of the property will be reflected in the value assessed for taxation purposes, which is by no means always the case in developing countries.

⁷ All statements made in this section are based essentially on data drawn from the International Monetary Fund’s Government Finance Statistics, the only comparable source available for non-OECD countries. These data are subject to many qualifications, as noted in that source: see e.g. IMF (2005). In addition, since the coverage of local finance in this source is both patchy and varies considerably from period to period, all comparisons must be taken with a large helping of salt.

⁸ These data do not include taxes on land and property accruing to central governments. Since in most countries property taxes basically accrue to local governments, we shall often simply refer to them as local taxes.

⁹ This literature is reviewed in most textbooks. For one example, see Bird and Slack (1993).

¹⁰ In some cases, however, mortgage institutions include property tax payments with monthly mortgage payments. This procedure reduces the visibility of the property tax for taxpayers who pay their taxes along with their mortgage payments.

¹¹ For instance, as a result of the well-known “bubble” in asset prices in Japan in the 1980s, at one point the effective rate of the fixed property tax in Tokyo was estimated to have fallen to 0.05 per cent (Ishi 2001).

¹² 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.

¹³ It is of course possible to subject leaseholds to property taxes, but our point relates to the difference in the degree of local control over lease and tax revenue.

¹⁴ Under Proposition 13, property tax rates cannot exceed 1 percent of a property’s market value and valuations cannot grow by more than 2 percent per year unless the property is sold (this provision is known as time-of-sale reassessment). Proposition 13 also required that state tax rate increases be approved by a two-thirds vote in the legislature and that local tax rate increases be approved by a referendum.

¹⁵ For a brief review of the past history of this idea, and the problems with it, see Bird (1984).

¹⁶ Few seem likely to match the high standards set out over four centuries ago by, of all people, Machiavelli, who once wrote that “In the province of Germany....When these republics have need to spend any sum of money on the public account...each person presents himself to the tax-collectors in accordance with the constitutional practice of the town. He then takes an oath to pay the appropriate sum, and throws into a chest provided for the purpose the amount which he conscientiously thinks that he should pay; but of this payment there is no witness save the man who pays” (Machiavelli 1983, 244-45).

¹⁷ Property tax rates can also vary according to the services received. In some jurisdictions, there is a general tax rate across the city and a special area rate or additional surcharge in those parts of

the city that receive services only provided to them e.g. garbage collection, street lighting, transit etc.

¹⁸ For a proposal for a more neutral form of local business taxation, see Bird (2003a).

¹⁹ 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.

²⁰ For analysis of land titling and other key questions of land policy in developing and transitional countries, see World Bank (2003).

²¹ The cost of collecting the information could be added to the tax bill. In some Canadian provinces, for example, the assessment function is performed by a corporation that represents municipalities in the province. The cost of the assessment function is passed on to municipalities who add this cost onto property tax bills.

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).

²⁴ See e.g. the account of the lengthy Colombian experience in Bird (1984a).

²⁵ For a broader treatment of China’s fiscal and intergovernmental problems, see Wong and Bird (2005).

²⁶ Of course, there are many other possible approaches to urban finance – for example, focusing on reducing urban poverty through using local finance for redistributive purposes. As discussed elsewhere (Bird 2001), however, the benefit approach taken here provides a sounder analytical structure within which to consider urban finance issues and is not necessarily inconsistent with poverty-alleviation concerns. For an interesting alternative approach to the ‘benefit’ model with a Chinese twist, see Deng (2003).

²⁷ See Bahl and Zhang (1989) for a prescient early recognition of the importance of this point for China’s sound urban growth, and Hong (2003) for a recent appraisal.

²⁸ Deng (2003) makes an interesting argument to the effect that to at least some extent the land leasing, land user fees, and even the murky ‘public-private’ arrangements characterizing most land use decisions in Chinese cities may approximate the effects of a decent land tax, but he also

concludes that at most the present system may constitute a transitory stage on the way to the necessary improved land tax system.

Tax policy can indirectly contribute to equity by raising enough resources to allow a level of expenditures on public services that is adequate to promote social goals without creating any impediment on economic growth. An efficient and effective tax administration may generate more revenue, which may help a government reduce budgetary deficits and curb inflation. The differences in the various national tax systems and in the tax burdens combined with the progressive elimination of obstacles to the movement of persons and property, as well as the Vito Tanzi and Howell H. Zee, "Tax Policy for Emerging Markets: Developing Countries" International Monetary Fund, 2000. Working Paper:WP/00/35. 3. Property taxes and virtual currencies. 3 Common tax policy challenges and emerging issues. 3.1. Common challenges in taxing virtual currencies 3.1.1. the tax evasion risks raised by virtual currencies had previously been explicitly mentioned in the communiqués of the G20 Finance Ministers' meetings in March and July 2018. However, in most countries, and in the emerging academic literature, there is often a lack of comprehensive guidance or a framework for the treatment of these assets for tax purposes, with any guidance generally being partial or incomplete. This lack of guidance may be driven in part by the complexity of defining the tax treatment for these assets in a way that covers their different facets, as well as their rapidly changing nature. In most cases, the title is registered in the Unified State Register of Real Estate. There are, however, several particular cases when there may be no such registration of the title: if the real estate was acquired by the current owner before 1998. Moreover, even if the buyer has signed the statement of transfer without raising any objections at that time, he nonetheless subsequently may still claim the defects of the real estate if he proves that such defects had arisen before the transfer. Russian law is based on a system of separate ownership of the land and of the building. Therefore, the land plot and the building erected on it may be owned by different persons. A transition economy or transitional economy is an economy which is changing from a centrally planned economy to a market economy. Transition economies undergo a set of structural transformations intended to develop market-based institutions. These include economic liberalization, where prices are set by market forces rather than by a central planning organization. In addition to this trade barriers are removed, there is a push to privatize state-owned enterprises and resources, state and collectively. Property tax revenues are relatively low in many developing and transitional economies in part because of the way in which the tax is administered. As a rule the coverage of the tax is not comprehensive, assessments are low as are nominal tax rates and collections. Assisting Land Policy. The instruments used by local governments to raise revenues impact the nature, location, and density of development. In urban areas, for instance, local governments can affect urban form not only with planning tools but also with such financial tools as the property tax. Taxes on land and property are an especially appropriate local revenue source in part because real property is immovable: it is unable to shift location in response to the tax.