The Role of the Property Tax in Financing Rural Local Governments in Developing Countries

ITP Paper 0608

December 2006

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Abstract

We argue in this paper that better rural local governments are needed to improve the lives of billions and that a good property tax is the key to improving rural local governments. Moreover, we suggest that only by giving local governments both the incentive and the ability to levy a property tax can effective rural local government and a meaningful rural property tax be achieved in most countries. Such a tax would often likely be a simple area-based levy, and the central government may not be too happy either with the way communities run the tax or how they spend the proceeds, but the critical role of the central government is to support and facilitate local action on this front, not to supplant it.

JEL Codes: H11; H71; R51

Key words : property tax, rural local government

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Big cities are where the action is today. 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 labor, 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. How metropolitan areas are governed and financed is thus important (Bird and Slack 2005). Money matters: who has it, where does it come from, under what conditions can it be spent, and by whom? How public expenditures are financed is the key to any city or metropolitan area strategy (World Bank 2002). 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.[1] The role of the property tax in the rapidly expanding urban areas of the developing world 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 – over 1.2 billion in India and China alone. Both the path and consequences of development clearly depend upon how those who are, as it were, 'left behind' in these areas are treated. The extent to which rural people are provided with local public services is important. How to make the rural property tax ‘work’ in developing countries is thus also important since, as we argue below, this is likely to be the only way in which rural local governments in most developing countries can ever hope to become viable, accountable, and at least moderately effective.

A second reason is because national politics are largely shaped by local and regional concerns. How the rural sector fares matters for both economic and political reasons. The economics of the relationship between agricultural and general development have long been explored in the literature.[2] 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. More recently, the role that sound local rural property taxes may play in developing vital institutional social capital has attracted some attention.[3]

There is more to rural property taxation than taxing agricultural land. Taxing agricultural land effectively, efficiently and equitably is of course important. Indeed, one of us wrote a book on this issue some years ago (Bird 1974) and many authors have since continued to till this field.[4] But much of the rural property tax base consists of residential and non-residential buildings and land devoted to non-agricultural pursuits, so the issues relevant to financing rural local government overlap only partially with the agricultural tax literature.

In the next section we discuss further why it is critical to improve rural local government in most developing countries, and why a more effective rural property tax is a critical component in this process. We then turn in the following section to some aspects of rural property taxation, noting especially that insufficient attention seems to have been paid to the important ‘local’ dimension of such taxation. We also touch on the appropriate way to assess rural property, the appropriate treatment of rural land in what we have elsewhere (Bird and Slack 2006) called ‘the land between’ urban and rural – that is, the urban fringe -- and the weak case for using rural property taxes to affect land use patterns (let alone land redistribution and reform) through special taxes such as those on ‘idle land.’ Finally, we conclude with a few reflections on the critical question of how best to ‘market’ sound rural tax reform.

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. It is 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 even within countries is enormous – from densely populated (and sometimes astonishingly big) ‘villages’ within walking distance of other equally large villages to huts scattered across remote and desolate terrain. ‘Remote’ communities may be sufficiently far removed from the nearest urban centre so that not only is daily out-commuting impossible but also ready access to medical and other services (Slack, Bourne and Gertler 2003). Rural communities within a day’s commuting distance of a major city face a completely different set of challenges and opportunities.

Despite this diversity, the general problem of rural local finance in developing countries is clear: billions of people live in places that do not have sufficient resources to supply even minimal public services. Of course, this simple dilemma has many variants. Sometimes, a potential resource base cannot be tapped for local purposes owing to pre-emptive actions by higher-level governments, as illustrated by natural resources in many countries.[5] In other cases, local governments are so restricted in their revenue-raising authority that they cannot raise enough to do anything. In most developing countries, local government autonomy is heavily constrained. Central authorities are reluctant to grant any significant tax autonomy to local governments (Ebel and Taliercio 2005). Either they do not trust them to exercise taxing authority appropriately or they are afraid local autonomy will impinge on their own ability to levy property taxes or other taxes.

In still other countries, there may simply be no effective government structure – central or local – in rural areas. Even when there is such a structure, almost never is the (nominally) responsible authority accountable in any meaningful sense to those for whom they are supposed to provide. 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 exist. Sometimes the question is whether it may not be more desirable to encourage those who live in such remote regions – in some instances as the consequence of past conflict and persecution – to move rather than to facilitate their continued marginal existence.[6] Such a 'solution' is seldom politically acceptable but the price paid by all concerned under the prevailing situation is equally seldom either transparent or much discussed. As Kitchen and Slack (2006) note, the relatively small size and low concentration of the rural population in remote areas means that the per capita costs of providing services are high. Such communities 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. At the same time the fiscal base in such areas is generally low. Rural people even in large and rapidly growing countries such as India and China face such problems. Those in more sparsely populated and slowly growing countries like those in most of sub-Saharan Africa are even worse off.

How may these difficult problems be solved? The answer depends in part upon the precise objectives of policy – 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?[7] Is it to improve service delivery in accordance with central policy objectives? Or is it simply to download some troublesome responsibilities from the center? The answer depends also on 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?

In the eyes of some, efforts at 'decentralization' to date may not have yet produced demonstrably much better results than the prior system. Others disagree and argue that 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 and are willing to pay for (at least in part) -- if not necessarily more of what those 'up there' think they should have. The evidence is not clear. In India, for example, while World Bank (2004) demonstrates that central (and state) attempts to provide rural services have seldom been effective, some evidence suggests that more decentralized provision is better (McCarten and Viasaylu 2004): the issue is far from resolved. The same is true in the much-studied case of Latin America.[8]

What *is* clear is that most developing countries face major problems in financing rural local public services, that these problems are hard to solve, and 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, to approach this (or any) issue in intergovernmental finance one must first develop a coherent strategy (Bahl and Martinez-Vazquez 2006). To do so, however, one must first decide the objectives of the policy. If one does not know what one is trying to do, it is hard to do it, let along to know if one has succeeded in doing it. Unfortunately, there are many relevant actors with different ideas of what can and should be done and who should pay for what. Designing and sustaining a strategy for financing rural local public services is a long-term, perhaps interminable, process. Nonetheless, more could be done in most countries to improve not only the evidential basis of discussion but also, more importantly, 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), and Zhou (2006) demonstrate with respect to the cases of Colombia, Bolivia, and Sierra Leone, respectively. It is important to study such relative successes closely and to figure out how they have been achieved. It is also important to think of ways 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, for instance, facilitate forums in which local officials can learn from each other or establish a competition with prizes for the best performing region or village.[9] As Lefèvre (2006) stressed in a different context, when it comes to building sustainable institutional capital it is often more critical to get the 'process' right than to specify the desired 'product' in detail.

The basic idea in designing an effective intergovernmental structure is simple. Too often three groups are now distinct in many countries -- those who decide, those who pay, and those who benefit. Sustainable policy design requires creating a substantial degree of overlap among these groups (Bird et al 2003). How this can be done in practice in any particular country, however, is seldom obvious. Bahl and Martinez-Vazquez (2006) are correct that the intergovernmental transfer system and the local revenue system need to be considered together in order to achieve the difficult objective of making sure that even the poorest areas get the resources they need to provide the services national interest requires – something that is easier to say than to measure objectively! -- while simultaneously ensuring that local decision-makers face an adequately hard budget constraint at the margin.

In most cases rural local governments in developing countries should probably not do all that much (Litvack, Ahmad and Bird 1998). But they should do *something* – something that is, that they (those who live there) want done -- and do it as well as possible. 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 priority (Fiszbein 1997).[10] Poor communities are unlikely to be able to finance much out of their own resources. Nonetheless, experience suggests strongly that it is important that 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 it free. To put this point strongly, perhaps the watchword for sound rural decentralization and development policies should be not 'no taxation without representation' but 'no (real) representation without taxation.' That is, unless local governments are able and willing to pay for what they get at least to some extent neither they nor others are likely to take their role sufficiently seriously to ensure that, over time, whatever it is they do is done right.

Not by chance, this takes us back to the property tax. Most property tax revenues in all countries are raised in urban areas: that's where the tax 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 (Bahl and Linn 1992). In contrast, about all that most rural local governments can do is to tax land and property and perhaps impose a limited range of user charges (market fees, etc.). Rural property tax revenues may not amount to much in aggregate and may get lost in the rounding error at the national level. But they matter a great deal to the communities in question. To provide services to rural people and to build up the institutional social capital needed for development in general, local communities need to be encouraged and enabled to do what they can do to tax themselves rather to rely on the always unreliable 'kindness of strangers.' If rural communities are to provide meaningful services to rural people and to be maintained as viable places to live and work, they need to be as financially self-sufficient as is possible. In many countries, the only way to make any progress towards this goal is by taxing rural land and property.

Taxing Rural Property

Some developing countries have recently become more interested in land and property taxes.[11] 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). Similarly, South Africa is thinking about how to make land taxation more effective in rural areas (Bell and Bowman 2006). Of course, taxes on land

and property already exist almost 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. Rural property taxes imposed locally are more likely to be acceptable to taxpayers than similar central taxes because 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 may often be the best one can do in some areas.[12] The level, design and control of rural property taxation are critical in determining the effectiveness of decentralization policy in many countries.

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. Sometimes there may be little private ownership of properties in remote areas so that there are fewer properties to tax. The values of properties in rural 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. The prevailing low tax rates are often imposed by higher-level governments. Even when local governments can set rates, they usually find rate increases in this most visible of taxes difficult to sell politically. 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).

De Cesare (2002, 9) recently noted that, despite its many problems "…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).[13] 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 sources 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 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.

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). Property taxes in most emerging countries fall far short of this standard (Bird and Slack 2004).

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. Such support is more likely if taxpayers both feel that they are receiving adequate services for the property taxes that they pay and also 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 seems likely to have a better chance of success than a 'stand-alone' reform of either alone.[14]

Agricultural Land Taxation

Agricultural properties tend to be treated favorably, as shown in Table 1. Rural and especially farm properties are favored 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.[15] Such favorable treatment of agricultural land is usually designed to preserve it from conversion to urban use although, as noted below, it rarely succeeds in achieving this land use objective.

[Table 1 near here]

How should agricultural land be taxed? The simplest approach is a tax 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 simple in terms of structure and administration. The information requirements are minimal: 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 may be regressive because the burden of a tax on land as a percentage of the land value is negatively related to the productivity of the land. The relative tax burden on poor farmers is 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 administrative advantages favor this type of tax. Although an area-based tax is inherently crude, it would probably be tolerable in most countries if the tax rate is low. 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. If cadastral records are incomplete and tax rates are fairly low, taxpayers may even be glad to pay the tax because doing so may help to establish ownership (Skinner, 1991b).

Value-based Taxation

The alternative usually favored by experts is a value-based tax. Such 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 may 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, similar to an area-based tax, is a presumptive assessment, rather than an assessment based on any record of individual experience.[16]

As with a tax on rental value, a tax on capital value captures both the land as well as the improvements to the land. 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, 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. 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 -- is 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. However, 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. In practice, tax officials charged with taxing rural land usually rely on land classification procedures and other indirect methods of valuation, no matter what the law may say.

Whether 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), information and administrative requirements are high (Ott 1999). In many countries, assessment practices are poor, the number of trained assessors is 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, and so on is probably the best form of agricultural land tax for most developing countries.[17] Annual readjustments for inflation would reduce the need for annual or regular reassessments.

An important conceptual and political problem arises when property taxes are based on market 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.[18]

Taxation at the Urban Fringe

A possible approach might be initially to use a simple area-based system but with the long-run goal of moving to a market-value based system. 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 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.

Farmland on the urban fringe often faces pressure for urban development. Rapid development on the urban fringe can lead to sprawl and the high costs associated with providing infrastructure and services to new developments on the outskirts of cities. Can local taxation be used to encourage (or discourage) urban development of farmlands on the urban fringe? Should it be used? A common approach in developed countries is to assess farms 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 determined by its selling price if it were to continue to be used as a farm. Taxing agricultural land on the basis of its value in current use was originally designed to reduce development pressure, reflecting the widespread perception that it is unfair to tax farmers for non-farming uses such as real estate development (Youngman 2005). Almost every US state has some form of preferential treatment for agricultural land, usually in the form of current use assessment.[19] Although the protection of family farms is the main justification for current use assessment, these provisions seldom differentiate between family farms, hobby farms, corporate farms, and land being prepared for subdivision: these tax breaks in practice thus often benefit land developers (Youngman 2005).

The extent to which development will be delayed depends on the difference between value in current use as a farm and the market value in its developed use and the rate of property tax (Anderson 1993). The greater the difference between value in current use and market value, the greater the impact on delaying development. The higher the property tax rate, the more effective is value in current use in terms of delaying development. Value in current use does not benefit farmers in truly rural areas because where farming is the most profitable use of the land the value in current use is the same as the value in highest and best use. 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 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).[20]

Efforts to preserve farmland on the urban fringe can also result in unintended consequences (Youngman 2005). For example, favorable 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: 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. Since leapfrog development requires infrastructure expansion it can be costlier than developing the land on the urban fringe.

In many developing countries 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 up'.[21] Of course, when potential taxpayers are intimately involved in determining the tax base, the process is likely to be convoluted and slow. Moreover, to have any chance of successful outcomes, taxpayers must be keen to obtain the services to be paid for through the taxes. Nonetheless, at the end of the day the results of such a process should be both economically and politically more 'efficient' than in the usual top-down process. 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 may prove a step too far in most countries. Since potential 'club members' do not start out as equals they are unlikely to end up as equals. If the rich few dominate, the precise institutional structure within which they exercise control is a secondary issue. However, since one cannot redress basic inequalities or alter fundamental political realities by wishing things were different than they are, this problem is not fundamental in this context. Nor is the likely objection that such 'idealistic' approaches will work only in some and not in all areas, since the same may 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. To make decentralization effective the central (or state) government usually needs to play a strong supporting, encouraging, facilitating, training, and capacity-building role. Central governments cannot ‘empower’ local governments because in a fundamental sense people cannot be ‘empowered’ by anyone: they must empower themselves (Breton 2004). But they can do so only if conditions permit. Providing local communities with good land maps and reliable crop price information is as essential to their imposing sensible taxes on agricultural land as is the same information to any effective centrally-directed land tax.

‘Non-fiscal’ Rural Land Taxes

Finally, there are two dimensions to the non-fiscal impact (e.g. on land use patterns) of land and property taxes.[22] On one hand, such impacts clearly occur and ought therefore to be taken explicitly into account in designing and evaluating rural 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.

However, 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 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 equally unlikely to succeed. 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.

A related question is whether the rural property tax should 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. Some countries impose higher taxes on "idle lands" -- though seldom with much effect (Bird and Slack 2004). Particularly in rural areas, 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, owing both to the administrative difficulty of assembling the information – particularly when properties are located in different jurisdictions – and the political unreality of attempting to accomplish "land reform by stealth" in this way (Bird 1974).

In the end, the only 'non-basic' property tax that 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 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.[23]

Selling Rural Property Taxes

Much ingenuity has been devoted to working out systems to tax agricultural land in developing countries in an economically desirable and administratively feasible way. The real problem in most countries, however, is not so much how to design a rural property tax, including a tax on agricultural land, but how to 'sell' such a tax to those who matter – the people who have to pay it. Potential taxpayers must be convinced that they will get something for their money. In countries in which the main experience rural people have with government is coping with bureaucratic hassles and arbitrary impositions, the central government is unlikely to have much success with such marketing efforts. The only real chance for effective local property taxes in rural areas in most developing countries is to emphasize their 'local' character and the direct and visible benefits that can accrue to local communities when and if they collectively decide upon, and pay for, local public works and services.

Some may consider this approach idealistic and naïve. We think that it is not only realistic but even essential to forgo misconceived attempts to 'centrally plan' the lives of the rural poor (and their richer, and often dominant, neighbors). Instead, what needs to be done is to develop and foster an institutional structure within which those communities that wish to do so can work together to develop themselves. In such a scenario, the role of the central government is to guide (but not to direct), to support (but not to control), and to facilitate (but not to mandate). Proceeding along these lines will never be easy. Nor will the results be evenly (or perhaps all that equitably) distributed.[24] But at least there is a prospect that some results will ensue if this path is followed. Given the abysmal and virtually worldwide failure of alternative 'top down' policies, it seems more than time to give rural people a chance to help themselves. It may take a very long time for states that have so often visibly failed to deliver the goods to win sufficient trust (build up sufficient social capital) to be able to persuade people to tax themselves, but the effort needs to be made.

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 stronger governmental institutions that can and will deliver the goods.[25] To facilitate this process, central governments need to do a lot. They must ensure that local people and governments have both the ability and the incentive to act on their own behalf by, for example, structuring transfers to encourage local resource mobilization and providing local people with local governments that they 'own' (e.g. through democratic processes) and that have access to fiscal resources they control (e.g. by setting tax rates). They must also encourage such powers to be used wisely by providing essential information (e.g. on tax bases) as well as training and support. Education of both local leaders and rural people in general is an essential and continuing task. As Zhou (2006) put it in discussing the surprising initial success of local government development efforts in Sierra Leone, the secret lies in three words: "Communicate. Communicate. Communicate." Rural property taxation rests on the communication both of facts (e.g. on tax base) and especially of ideas such as linking local tax efforts and local access to public services. People need to believe that taxes are necessary, that the taxes they are asked to pay are fair, and that the money taken from them is put to good use and provides real benefits to them. This is not the world in which most rural people in developing countries now live, and it will take a long time before it can be fully realized, if it can be. But unless countries are willing and able to make serious moves in this direction, they are unlikely to have either effective rural property taxation or effective rural local government.

Such institution-building takes a long time, and in any heterogeneous context its results will be uneven, but there may be no alternative. A more optimistic view, for which there is some evidence (Faguet 2004), is that if one simply creates the right incentives at the bottom and gets the centre sufficiently out of the way, service delivery to the poor may improve amazingly quickly even in initially very unpromising circumstances, though this may in part reflect the relative ease of moving from zero to a small positive outcome and not be a good indicator of long-run prospects in the absence of more fundamental changes. Whether discernible improvements would come quickly and easily or slowly and with difficulty, the real problem blocking effective local government and taxation in many countries is often simply that those who have power do not want to give up even a little to those without, no matter how much better off a bit more autonomy may make everyone in the long run. In the end, whether one lives in Washington DC or in rural Bangladesh, taxation is always and everywhere more about politics than economics.

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

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Notes

[1]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 also the only one that gave the region any real control over its own finances.

[2] For a summary of the classic literature, see e.g. Bird (1974), chap. 2.

[3] See Sokoloff and Zolt (2005) for an historical perspective and Hoffman and Gibson (2005) for a distinct, but related, argument.

[4] See, for example, Strasma et al. (1987); Newbery (1987); Skinner (1991a, 1991b); Hoff (1991); Khan (2001); Rajaraman (2004).

[5] If the local community has privileged access to such resources, other problems arise: for discussion, see McLure (2003).

[6] One author (Graham 1963) memorably labelled this approach "The Ghost Town as an Objective." Dougherty, Klase and Song (1999) provide a review of some common themes in 'remote' areas.

[7] Can people be 'empowered'? Or must they (in effect) empower themselves (Breton 2004)? We return to this issue later.

[8] Indeed, the Inter-American Development Bank recently (November 30, 2006) held a workshop on the conflicting views held by different experts on the design and effects of decentralization reforms in Latin America.

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

[10] William Easterly (2006) recently noted that the 'last refuge' of central planners was in foreign aid agencies. He apparently has not worked much with those in central governments who are responsible for rural development, decentralization, or local government.

[11] Some parts of this section are based on Bird and Slack (2006).

[12] Given the limited tax base and high unit costs of service provision in many rural areas, some subsidization is usually 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] 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).

[14] An urban case in Colombia illustrates the point: Bogotá managed not only to reform its property tax significantly but also to combine the tax change with spending changes that mobilized taxpayer support to a surprising extent (Acosta and Bird, 2005).

[15] 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.

[16] For a general discussion of presumptive taxes, see Bird and Wallace (2004).

[17] 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.

[18] 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.

[19] 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 but 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.

[20]Some 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.

[21] Other examples in both rural and urban areas of an iterative process to determine appropriate relative property values to serve as the basis for allocating taxes are discussed in Rhoads and Bird (1969).

[22] 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). Land transfer taxes are popular with governments because they are administratively simple and often produce substantial revenue – sometimes as much or more than property taxes. They may also deter fraudulent property transfers intended to avoid high property taxes. On the other hand, 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. Such taxes discourage the development and formalization of land markets. Countries with high land transfer taxes should consider lowering such taxes and to make up any revenue loss by strengthening basic property taxes, provided the economic gains of such a substitution are sufficient to compensate for the greater administrative costs.

[23] See, for example, the account of the lengthy Colombian experience in Bird (1984).

[24] In many countries, 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.

[25] This is essentially the analysis of Gladstone's 19th century fiscal reforms in Britain offered by Daunton (2001)