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The Taxation of Urban Property in Less Developed Countries

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Introduction

Taxes on property are the single most important source of locally raised tax revenue for urban governments in less developed countries. Moreover, since central and state governments have generally pre-empted the sales and income tax bases, and since urban government expenditure needs continue to press, it seems likely that the role of urban property taxes will become even more important. This increase in importance should heighten concern about those features of the property tax which affect the elasticity as well as the level of revenue yield. But while revenue considerations almost always dominate the concern when property tax reform is contemplated, potentially significant allocative and distributive effects must also be considered. Indeed, much of the variation in urban property tax structure in less developed countries is due to aggressive use of the tax to achieve desired equity and allocative effects.

Yet with this importance and potential, surprisingly little is known about the practice of urban property taxation in less developed countries. All too often the frame of reference for property tax reform is the past experience in a particular city or the advice of an outside "expert" whose comparative experience is limited and whose biases are likely to be in the direction of the system he understands best. Comparative norms, qualitative or quantitative, are not available, and

there has been little transfer of information about successful and unsuccessful experiences. The greatest shame of this absence of comparative analysis is that there is a rich history of experimentation with urban property taxation in developing countries, particularly with the use of the tax to influence the use of urban land.

The objective of this volume, and the TRED conference from which it came, is to take a first step toward filling this gap in our knowledge about the practice and impacts of urban property taxes in less developed countries. In truth, it is a small step in that relatively few countries are discussed in the essays below and consideration of many important questions of collection and assessment are conspicuously absent. Still, these essays break new ground by describing and analyzing a far greater range of practices than has been considered before, and by applying the conventional theory of incidence and allocative impacts to the LDC setting.

My chapter, in Part I, is intended as a summary of the current practice—a perspective, I hope, in which to consider the more analytic and country specific essays which follow. If there is any striking conclusion from this survey, it is that the trichotomy of property tax systems into annual value, capital value, and site value grossly oversimplifies because most countries/cities have by now developed systems which combine elements of all three basic forms. So varied have become assessment practices that it is not clear whether the application of any two systems in any given city would yield a similar valuation pattern. In terms of common problems, two stand out: (a) the idea of a property tax system is not adequately recognized, hence piecemeal rate structure and assessment reforms often have offsetting impacts, and (b) revenue growth is inelastic with respect to income, due primarily to the inability (administrative and political) to maintain an assessment roll at current market values.

Three chapters examine the distributional effects of the property tax in developing countries. Charles McLure has studied the relevance of the new view of property tax incidence in the developing country case and argues that the proper approach in incidence studies is likely to be far different from anything done in the past, theoretically more difficult, and empirically more demanding. In reconciling the new and old views, he makes the case that the answer to the incidence question requires a disaggregation in the economy between locally and industrially immobile capital versus other capital, an assumption about the international mobility of capital, and a distinction between total consumption and consumption of nationally produced goods. Most important, however, is his point that the incidence answer depends exactly on the incidence

question—e.g., the effect of a uniform increase in a nationwide property tax versus that of an isolated local government property tax increase.

Johannes Linn carefully considers the intra- and international capital mobility assumptions in analyzing the incidence of the property tax in Colombia. He concludes that the incidence of a uniform, nationwide property tax increase worsens from being quite progressive in the short run to being approximately neutral in the long run. For a localized tax increase, a similar progressive impact is found in the short run, but in the long run the localized increase is likely to be regressive. Linn argues that the traditional view of incidence is reasonable for analysis of the long run effects of nationwide increases due to international capital mobility, but it must be amended to allow for burdens on land and labor.

Daniel Holland's proposal for reform of the property tax system in La Paz, Bolivia, illustrates the relationship between equity and allocative effects. He demonstrates that even without accurate income data, a progressive effect might be obtained by cross-classifying properties according to location and quality of construction and allowing the tax rate to vary by these characteristics. Both Holland and Linn describe the favorable equity effects of not including the lowest income families in the property tax base.

Part III of this volume is concerned with land use effects of property taxes and with betterment levies. Roger Smith surveys the use of site value, vacant land, land value increment, and land transfer taxes and analyzes the effect of each on the level and rate of growth of land prices and on land development timing. If one objective in using these tax measures is simultaneously to lower land prices, slow the growth in land prices, and bring forward the time of development, Smith is pessimistic about the possibilities of success. He argues persuasively that a single fiscal instrument will not likely achieve all of these objectives, and suggests that best results will come from a combination of site value taxes, vacant land taxes, and direct governmental land use regulation.

William Doebele describes and analyzes the workings of one of the most successful of the betterment recovery methods, South Korea's land readjustment system. Under the system, agricultural land is taken from an owner and returned in the form of fully serviced lots. In the process, portions of the original holdings are deducted as payment in kind with the result that urbanization may be completely self-financing. While there remain problems of valuation, a virtue of the system is that no money changes hands; hence the system may be more efficient than expropriation and can avoid the collection problems of betterment recovery through taxation.

Lowell Harriss examines the use of the land value increment tax and the annual land value tax in Taiwan. These taxes appear to have been designed primarily to induce particular land use effects and only secondarily as revenue-raising measures. But while the land value increment and vacant land taxes are structured properly to discourage land speculation and encourage redevelopment, inadequate enforcement may have resulted in only a marginal effect on investor decisions.

The chapters in Part IV consider administrative aspects of urban property taxation in developing countries. Appropriately for a TRED volume, all are concerned with the workability of site value taxation. Oliver Oldman and Mary Teachout present an administrative evaluation of site value taxation with reference to the issues of the definition of unimproved land, the identification of an appropriate valuation technique, and the design of a proper review process for taxpayer objection. They clearly identify the administrative problems which raise these basic issues and offer a number of proposals for implementation of site value taxation. Oldman and Ching-mai Wu make the case that the elasticity of property tax yield is an irrelevant measure of potential revenue growth. They point out that administrative and assessment features confound attempts to measure accurately the responsiveness to urban economic growth and that an appropriate index of urban economic growth is not available in any case. They also suggest that because of administrative imperfections the desirable features of a site value tax are not sure to be captured by the more intensive use of that tax, hence a high elasticity may be a mixed blessing.

O. St. Clare Ridsen, Jamaica's Commissioner of Valuation, gives a fascinating account of the history of Jamaica's eighteen-year experience in implementing site value taxation. In detailing the administrative, political, and cultural issues which influenced the transition to a land value system, he gives considerable insight into the compromises necessary to bring about such a change in property tax practice. He concludes that the site value approach is not only feasible but probably ideally suited for a developing country such as Jamaica. John McCulloch, City Valuer of Johannesburg, also argues for the feasibility and virtues of a site value system. Though South Africa is not a low income country, its experience with land value taxation is instructive, particularly in terms of the apparently successful residual method of land valuation.

Carl Shoup concludes this volume with an overview of the essays and issues. Basing his analysis on the eleven essays, he considers the reasons underlying so modest a use of real estate taxes and the potential for increasing reliance on the property tax through changes in structure and administration.