

IS [RURAL] PROPERTY TAX RELEVANT?

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Abstract

The present document presents the general notions and the definition of property taxation and, as part of it, the working definition of rural property taxation emphasizing that property taxation is a matter of “property” and rural property taxation is linked with rural property, specifically with land ownership. In addition, the document presents some facts about the performance of property taxation based on a secondary source of cross-country analysis. In order to give a definition of rural property tax, I will explain the logic of taxation linked to property and then present the nature and logic behind property taxation in theory.

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I. Introduction

*"Death and taxes may be inevitable,
but they shouldn't be related"*
J. C. Watts, Jr.

Property tax is an impost levied upon property by reason of ownership. Property tax can be defined as "generally, a tax imposed by municipalities upon owners of property within their jurisdiction based on the value of such property". There are three types of properties to consider in order imposing a tax: land, land improvement (immovable man-made things, e.g. buildings) and personal properties (movable things). Real estate or *realty* is the combination of land and improvements to land. It is sometimes called a real estate tax, especially when assessed against both improved and unimproved land.

Property taxation has existed since the very early stages of civilization. Historically, according to Carlson (2004), property taxes were used in Egypt, Babylon, Persia, and China, as well as throughout the ancient world. The primary focus of early property taxation was land and its production value. For instance, in Ancient Egypt, taxes were levied against the value of grain, cattle, oil, beer and land (production and land value). From the existing records, the most common taxpayers were the farmers, from whom assessors coerced collection. In ancient Greece, there is evidence of land taxation. For example, Athenian citizens complained that property taxes were too high and demanded that the government lower expenditures. Ancient Romans also paid taxes on the value of land, buildings, livestock, trees, vines and other personal property. In Medieval times, where current England exists, land taxes had existed for hundreds of years, and although the lords and king owned the land, most peasants paid taxes by way of rent each year. Even more, in the U.S.A in colonial times, the 102 Pilgrims formed a pact that bound them to a set of laws, among them the creation of taxes and assessments, including land taxes.

Only since the later 18th century this tax begins to be thought of not only as a source of state revenue but as an economic incentive (Cameron; 1999). For instance, French Physiocrats, especially François Quesnay, suggested that property, and explicitly land, was the only logical base for taxation, being the outcome of land (agriculture), the only productive sector

of the economy and the only one able to produce a surplus over the real cost of production – *produit net*-. Later, David Ricardo and Robert Malthus focused their attention on the role of land in relation to economic production, income distribution and growth. The former, pointed that land was the appropriate factor of production to be taxed, because landowners received a rent for the use of land that did not represent a real cost of production.

This preliminary argument was used by Henry George to assert that the return on land represented an economic rent that could be taxed. As land is fixed in supply, those who own land should contribute through taxes on land that might capture the economic surplus arising from landownership.

George highlights that taxes levied upon the value of land are non-distortionary. In his work *Poverty and Progress*, he presented the problems inherent to existing tax and the difficulties to detect frauds and evasion of taxpayers. He argued that the government should raise all its revenues by a single tax on the value of land. Henry George addressed his argument by saying that private property of land was wrong and even more when its value increased without any particular effort. To solve this problem, he proposed to charge a 100% tax on the value of land, penalizing ownership and the profits associated to land tenure. Nonetheless, the 100% land tax was widely criticized because it might penalize any attempt to make land efficient. There would have been no incentive for landowners to use their land more intensively as any profit with impact in land value would have been taxed.

Notwithstanding, a tax of less than 100% land value is feasible because using land intensively will only alter the site land value tax but not the whole productive activity. Site land tax is easy to assess, as land cannot be hidden and it has a specific jurisdiction.

George, as well as Ricardo and Quesnay succeeded in the idea that land generated rents, which justified levying it. Nonetheless, they failed to admit that rents might be attributable to all factors of productions. However, they brought an initial step to assess property taxation. In other words, they assessed the notion of levy upon land rent from a fixed and not reproducible factor, differently from other factors of production.

The discussion regarding property and tax has two arguments, the first, saying that property, by existence, has to be charged taxes. The second supports the idea that it is not property by its inner qualities but income it generate the implement of taxation. In the 19th century the discussion on property and taxation was complex and disaggregated land in different components to understand the possibilities to levy.

During the 1960s, the debate mainly addressed the purpose of property tax on development programs. Lindholm (1960) suggested that property tax would mobilize the agricultural surplus to develop sectors like industry. However, at that time, the argument was the performance of Japan and U.S.A, as it would be reproduced in other latitudes. Nonetheless, Fitchett (1962) highlighted that, the underdeveloped countries at that time (like Latin American countries), presented traditional relationships in land that played a significant role in any attempt to change agricultural and tenancy conditions. *Metayage* and *corvée* and absentee, were common and might have been an obstacle for the expansion of agricultural productivity. Therefore, any attempt to foster agriculture towards property tax programs had to recognize the historical and social distribution of land.

Currently, the discussion on property tax mainly focuses on the local jurisdiction mechanisms to collect revenues. Specifically, the interest of property taxation has given local governments a stable and certain source of revenues in order to fulfill their public investments and provision. The notion that property taxation might create incentives for agricultural activity is still present but neglected from the policy discussion.¹

Summarizing, property tax in general can be disaggregated in two important components: urban property tax and rural property tax. The former refers specifically to urban territory (or land) and improvements (edification) located in urban areas of a specific jurisdiction. The latter, which is the main concern of the present document, refers to a levy upon land

¹ In order to better control economic activity, there is a penalization of unproductive land which is taxed with higher rates thus encouraging landowners to partake on some activities toward exemptions. However that is not the objective of property taxation but these are some complementary characteristics of the tax system.

and land improvements (houses or any edification) located in rural areas of the jurisdiction.²

II. Property Right and Taxation

Property, taxation, the building of the State and citizenship are closely related. The idea of property tax or a duty on property existed much previously than the Modern State³, however the birth of the Modern State reshaped the notion of property, taxation, state responsibilities and citizens duties. For example, during the revolution of the United States of America in the 18th century, the colonies agreed to raise taxes (mostly through property, except in the south where the tax system was more dependent on poll taxes) by state quotas.⁴ Even at the time, people found difficulties in levying taxes and clashes among the types of tax systems (national vs. federal system). Throughout the nineteenth century, most state and local governments raised their revenue through the property tax, much like in today's contemporary society.

Besides, property tax and the birth of the modern state's relationship is more than a fiscal responsibility imposed in order to collect needed revenues. Moreover, it is the recognition of "property" as a fundamental concept on the creation of modern states and citizenship. Property right defines a relationship between the State and individuals. As Wunderlich (1995) suggests, "arguments about property are ultimately about the relation of the state to the individual. These arguments have been framed as the "taking" of property by the state via eminent domain, regulation or taxation. [...] A less passionate but more imposing issue is the level and form of taxation of land use" (1995: 2). The State might have different interests and meddling over land, like expropriation for social reasons, regulation of uses,

² The notion of rural and urban is ambiguous; it mainly refers to a special/geographical category that might focus on the population distribution or/and the provision of public goods (routes, utilities, among others).

³ Here, the notion of modern state refers to a form of political association or *policy* that is distinguished by the fact that it is not itself incorporated into any other political associations, though it may incorporate other such associations. The state is thus a supreme *corporate* entity. One state is distinguished from another by having its own independent structure of political authority, and an attachment to separate physical territories. The state is a modern political construction that emerged in early modern Europe, but has been replicated in all other parts of the world.

⁴ At that time, tax collection quotas were defined by the population.

regulation of prices, and so on. Nevertheless, tax is a fundamental power that defines a sort of relationship between the state and citizens.

Property tax implies the notion of “property”: property right has been a persistent debate in political economy, political philosophy, sociology, and law, among other disciplines. Around the idea of property rights, there are several works⁵, and arguments. Without entering in this discussion, the following definition of property right will be stated as follows:

“A property right is the exclusive authority to determine how a resource is used, whether that resource is owned by government or by individuals. Society approves the uses selected by the holder of the property right with governmental administered force and with social ostracism. If the resource is owned by the government; the agent who determines its use has to operate under a set of rules determined” (Alchian; 1965: 817).

Accordingly, the fundamental purpose of property rights establishes that they eliminate destructive competition for control of economic resources. Well-defined and well-protected property rights replace competition by violence with a peaceful competition. The extent and degree of private property rights affect the ways people compete for control of resources. The more complete private property rights, the more influence by market exchange reducing the relative weight of personal status and attributes in the competition (Alchian, 1965)

Moreover, Feder and Feeny (1991) state that the process to define property rights evolves over time and combines three categories of institutions: constitutional order, institutional arrangements and normative behavioral codes. The constitutional order refers on the mainstream order, the fundamental rules that organize a society. Institutional arrangements

⁵ See: North, D.C. & R.P. Thomas (1973). *The rise of the western world: a new economic history*. New York, NY: Cambridge University Press; Alchian, A (1965) “Some Economics of Property Rights.” *Il Politico*, No. 4; Alchian, A and Demsetz (1967). “Production, Information Costs, and Economic Organization.” *The American Economic Review*, Vol. 62, issue 5, Dec. 1972, Alchian, A. and Demsetz (1973) “The Property Right Paradigm.” *Journal of Economic History*, vol. 33, issue 1; Rose-Ackerman, Susan (1985), ‘Inalienability and the Theory of Property Rights’, *Columbia Law Review*, 931-969; Williamson, O (1990), ‘A Comparison of Alternative Approaches to Economic Organization’, *Journal of Institutional and Theoretical Economics*, 61-71; Eggertsson, Thrainn (1990), *Economic Behaviour and Institutions*, Cambridge, Cambridge University Press, 385 p.

are laws, regulations, and contracts defined by the constitutional order. Finally, the normative behavioral codes refer to accepted cultural values that legitimize both, constitutional order and institutional arrangements.

Following these three categories, the definition of property rights explains that they are institutional arrangements defined by constitutions and legitimized (or not) by culturally accepted codes. The Constitutional order gives the general aims and motivation of the nation towards private property and exchanges. Another legislation defines specific mechanisms of property rights transfer, titling, values, and so on. Cultural codes, or informal rules determine how society and specific groups recognize and legitimize what a formal institutions express. In that sense, as an institutional arrangement, property rights imply a system of relations between individuals; involve rights, duties, power and privileges. However, the lack of congruence among the three institutional categories may lead to difficulties on a clear definition of property right and insecurities on its stability and permanence.

Therefore, property rights, as institutions, that involves not only rights (to transfer, to use, among others), but also responsibilities that limit any excess of owners, which includes duties and levies. Hence, property tax is a natural result of the institutionalization of “property right” and it is closely associated with the construction of the state.

The recognition of property leads to a legal and legitimate process of titling and for the State’s identification of its duty toward it; thus, leading to an imposed and reciprocal duty of owners with the state through taxation. In that sense, property and taxation are sources of the existing formal relationship among the State and citizenships (owners).

Nonetheless there is the importance of titling, which in general is implemented for other reasons besides to “strengthen the relationship with the state”. Arguments in favor of titling underline its importance as an instrument to increase tenure security, fostering land market and credit market. The fiscal feature of titling is underestimated in the titling process perhaps because the economic aspect (market and credit) has been seen as the main objective of the discussion on land and it is expected to have more results for economic development. By contrast, taxing might have indirect development outcomes in function of

a tax collection destination; even though this has not been the “fundamental” issue behind land policies.

But titling and property rights cannot be assumed. Institutional arrangements have to be in place to secure property rights leading to greater correspondence among citizens and the State. As Hoff (1991) states, the property rights system reflects the combined effect of rules, the governmental order that gives them legitimacy, the administrative and judicial conditions that enforce them, and the social norms that support them. Looked at from this angle, it is easy to see why land rights in many developing countries are insecure: undergoing evolution of three categories of institutions: constitutional order, institutional arrangements and behavioral codes. There is a lack of congruency among them that makes land rights costly and insecure.

The 19th century political debate addressing the creation of democracies under the Republican framework, brought-on issues related to property and taxation. Earlier in history, the philosophical debate undertaken by Locke and Hobbes analyzed the aim of property and taxation.

In the *Two Treaties on Government*, Locke made a seminal defense on rights, liberties and property. According to Locke, the defense of property is not a sufficient base for taxation. He suggests that property is a poor basis because to own property is not connected in any way to the benefits received from the state. Here he seems to disregard the importance of State in securing property rights, which is the modern idea of property. Even more, Locke asserted that a tax on property was unfair, because property is unequally distributed; which is one of the current arguments in favor of taxing property.

In the same perspective, Thomas Hobbes rejected property taxation because it was not a tax with incidenced in the majority of citizens. His arguments claimed that people would understand the value of public order if they were conscious of the private benefit of an individual effort. If the majority did not possess they would not be conscious of the efforts of others and, by contrary, they would free ride from the social benefits of other duties (Hale; 1985: 391)

Even though these were undesirable perspectives of property tax, other authors were aware of its need in the construction of a modern society. From the political economy point of view, William Petty, Adam Smith, Francois Quesnay, David Ricardo and John Stuart Mill addressed this debate. They supported the *benefit doctrine* according to which the relation between the citizen and the state is a sort of exchange relationship. In that sense, private agents would contribute to the state as much as they perceived future benefits from their property rights, were secured by the state. In that sense, property is linked to state contribution but according to the interest citizens have in the public peace. That makes the property tax an individual contribution to the extent that, agents expect something from the state.

The *benefit doctrine* has a long life; the debate in the 19th century changed the balance in favor of the “liberal” or “democratic” public finance doctrine with the argument of uniformity and universality of taxes. According to this rising doctrine, “uniform and universal property tax was thought to be democratic because it would tax all property, at the same rate; based on objective, marked-value assessments” (Hale; 1985: 394). The property tax debate switched and the idea that each individual had obligation in order to get protection became the leading idea. There was consensus on democratic and liberal federations that “men of property should pay for sustaining them.

- ***The property tax: features and performance***

As Hale asserts, “the property tax is in fact the oldest tax in any modern system of public finance, and because of its age it has been associated with both modern and pre-modern tax philosophies” (1985: 382). That is to say, property tax is an ancient duty but not the first form of enforced public obligation. As a duty, property tax needs the conceptual and social formation of property (not necessarily private, but yet with a certain relationship between people and property). Obligation associated to property varied among societies, and took the form of payments and services according to uses of property and social circumstances of the people.

As a tax that constitutes a system, property tax has to include the rate, the base, the levy upon, the exemption, the administration procedures and the jurisdiction. Those

components are associated with general characteristics of property tax –visibility, inelasticity, inherent arbitrariness and autonomy-, which have been associated with its benefits.

- The property tax rate will define, along with the assessment value, the tax liability. Tax rates may be locally defined or defined by a central government or a mixed situation, leaving some local discretion based on a range of rates established by the central government.

The difference between the determinations of taxes will rely on the expected process of decision-making. In theory, when locally and autonomously defined, local governments have to first determine their requirement for expenditures. Then, they define their sources of revenue available (taxes, transfers, user fees and others). Given the information, these local governments then obtain a result in a property tax requirement that will be divided by the taxable assessment. The result is the tax rate.

By contrast, the definition of taxes created by the central government defines a range within some limits. The range may help to avoid some distortion if a municipality decides to tax very lowly in order to attract some business (which may be unfair if poor municipalities cannot use the same strategies as rich municipalities).

In addition, the logic of property tax is to have differentiated rates that differ from property class (residential, commercial, industrial) or are dependent on the location (urban, rural). Rate differentiation is justified because it is fair, efficient and it incentives some uses. The fairness of the differentiated rate is, in respect of the differentiated benefit, received by each property (benefits are not uniform for different types of properties: for instance commercial ones may receive more benefits, therefore they pay more). The efficiency of the differentiated rate is due to the fact that property tax has capital components and has to be taxed more lightly in order to achieve it. Finally, the variability of tax rate may incentive some uses or discourage urban development, if needed by the jurisdiction.

In addition, the property tax rate definition involves the decision of using a flat tax rate or a graduate rate. The most commonly used is a graduate rate that increases as the value of property is raised. Rural areas have attempted to use progressive land taxes depending on the value and extension of the property. In many cases, “idle lands” are taxed much higher in order to discourage them.

Lastly, there is no rule that defines the general level of nominal tax rate. That is to say, there is no common property tax nominal rate that is used by countries as a benchmark or as a policy to follow. In particular, higher rates are about 3% in developed countries while developing countries always shown lower nominal tax rates, which at the most reach a 1%, maximum.

As Binswanger (1995) says, progressive property taxes are often advocated as the means of making land speculation less attractive and inducing large landowners to sell out or use their land more intensively.

- The property tax base refers to the assessed value of the property (land and buildings) that is subject to taxation.

There are four types of assessing tax base by using: (1) market values; (2) site values; (3) unit values and (4) self-assessment. (1) Market value takes into account the price in a willing transaction. It estimates the value that the market places on individual properties. When selling occurs, the price of selling is the market value. When properties are not transfer, the comparison with similar properties or depreciating costs or capitalizing income estimates market value. (2) Site values follow the same logic of market values but only assessing land without considering improvements. (3) Unit-value is tax base that combines building areas and lot areas. Even though the three forms of assessing a tax base are used, scholars acknowledge the advantage of the market value in the sense that it captures more information than only the inner characteristics of the property and land. It may capture information of the location, the demand, services, and so on and so forth. (4) Self-assessment requires that owners place and assess value on their own property; being a good alternative in countries with little administrative capacity. In some cases, to

guarantee a self-assessment close to the market value, tax authorities have the right to buy the property at the assessed value when expropriation is needed.

Pagano and Jacob (2008); Piffano (2010), Bahl and Martinez-Vazquez (2007); suggest that rural property tax might have two different bases: on land value (the most common), and on land productivity (which makes it an indirect tax). The former has been the most common and used land tax base, as it charges the property no matter the kind or amount of use it has. It levies the possession, the tenancy of a private property that has to be safeguarded by the state. The second notion, a land productivity tax, should be a complement of the direct toll on property. It is a charge on the use and outcomes of a productive activity done on the rural area and on the gains arising from this activity. If a property is not economically exploited, this does not excuse the owner of paying a tax proportional to the value of land. These two categories should not be confused but might be, as the second one may reduce the owner's responsibility with the State.

- What to *levy*? The property tax is too general and contains different natures of properties that might be subject to levy. In particular, property tax levies on all types of properties –residential, industrial, commercial and farms - which might be treated differently and are subject to exemptions.

In particular, some countries tax only land while others tax only buildings, even if it is rare. The majority tax both, land and buildings (or improvements) usually together.⁶ Tax only on land is known as “site-value taxation”⁷ which taxes locations rents regardless of the improvements, creating incentives to develop the land in its most profitable way as improvements will not be taxed. Taxing only land will as well be more progressive because it bears more heavily to high-income taxpayers, making it efficient and equitable.

⁶ A study made by Bird (2000) shows that in Kenya and some parts of Australia and South Africa, property tax is levied only on land while in Tanzania tax is only on buildings. Most countries tax both, land and improvements.

⁷ The notion of site value taxation was originally developed by George in the late 19th century, when he suggested it in the context of growing development of the city of San Francisco.

Despite the virtues of “site value taxation”, there are problems to implement it properly, as it needs precise information to differentiate the value of land from the value of improvements and this subtraction may be difficult and far from being accurate. In fact, most countries rely on the combination of land and improvements tax even though it might lose some in terms of efficiency.

In addition, property has tangible and intangible components: ownership and realty, agricultural, commercial, and residential uses. The tangible components are land and its uses; the intangible components are associated to the right of possession and the status given by it. Tangible components might create incomes to be taxed. In the same way, intangible components might have incidence on the value of the property

In addition, socially and historically speaking, land has a significant power and role in the organization of societies and economic activities. As said before, the tenancy and property remain as significant values that create linkages at the political, social and economic spheres.

As a resource, land has unique characteristics that make it different from labor and capital: land is not produced by human labor, is not reproducible, it is limited in quantity and its quality is heterogeneous. In addition, land is of unlimited duration in reasonable conditions and land is not transferable in space that makes it rigid compared to labor and capital that can be mobilized and their geographical location may have impact in the amount of rent they generate.

The inner conditions of land as a natural resource and a factor of production are the determinants of its taxation. Taxes on land are among the oldest forms of taxation. Rural property taxation recognizes some factors in determining a tax base and a tax structure: the original characteristics of land, geographical location, value of property, improvements

- The property tax *exemptions* might be defined by central government or granted locally. Exemptions are diverse, but in general, properties occupied by government

are generally exempt from taxes. Factors of exemption include: ownership (public ownership); use of property (charitable use); or the characteristics of the owner or occupier (disability). In general, colleges, universities, churches and cemeteries; public hospitals, charitable institutions, public roads, parks, schools, libraries, foreign embassies, and properties of international organizations are exempt of property taxation. In some countries, agricultural land is also exempt.

Exemptions are highly criticized by academics and policy-makers. Exemptions narrow the tax base and increase the relative weight on the remaining taxpayers in order to finance local services. Exemptions may vary among municipalities, creating disproportionate tax burdens across jurisdictions. Nevertheless, the nature of an exemption is to recognize that some properties have different uses and natures and should be removed from the tax base and the potential revenue from a property tax. Decisions on what kind of properties apply for exemptions are social decisions and a political choice, in spite of their effects on collection.

- Property tax jurisdiction: it is suggested that property taxation is the backbone of municipal finances since the 19th century. Currently, the local government relies on property taxation, among other local taxes, as a traditional and common mean to provide local incomes and services. Theory on taxes points out that property tax is a good tax for the local government. Particularly property tax that has been presented as fair; difficult to evade and promoting of local autonomy and accountability.
- Property tax administration is the core of its performance. Tax administration is about the technical and operational mechanism of the local government or the tax agency to collect revenue. It requires three key steps: Property identification, issuing an assessment and issuing tax bills and collecting tax.

Policy recommendation, in order to design the most reliable local taxation, points that *Property Identification* includes information about the address of the property, its owner, building and lot size in square meters or hectares, the age of the building and information on renovation or improvements. This information is crucial to

assign and assessed value of the property and to issue the bill in order to collect taxes. Kitchen (2003) suggests that property identification is more difficult in developing countries as they may lack proper maps; ownership data may not be provided and property records and land ownership may be maintained by different agencies with weak links.

Second, the issue of assessment refers to the uniformity and frequency of the reassessment. Specifically, it compares assessments among municipalities. The more uniform an assessment is, the more reliable and transparent the value. As Kitchen (2003) underlines, uniformity is most easily achieved when done from a centralized level; using standard assessment manuals and procedures that should consider properties and lands in the same perspective, achieving comparable information and data. At last, frequency of assessment is expected to preserve information as reliable as possible throughout periodic valuations and annual adjustment indexing values. Policy recommendation is to keep assessment revaluation at least at a three to five year cycle.

Finally, issuing a tax bill and collecting taxes is a function that may be a responsibility of local governments or of a tax agency. A tax bill is the contractual responsibility of owners and the payment prove or arrears. But collection includes more than billing; it also implies some policies on arrears and long-term evasion – enforcement mechanisms-. The first may lead to a late fee while the later may define some norms on a prohibition of property transfer unless the property tax is paid.

As Binswanger (1995) says: to administrate a tax on land, requires having an official record, of cadastre, size, value and ownership status of each tract of land; its productive capacity and information on the costs of outputs and inputs. Land tax administration also requires a property tax law that assigns property rights and tax obligations and an administrative organization that keeps the register up to date and assesses, collects, and enforces the tax.

In addition, it is suggested that property tax has the following advantages: visibility, inelasticity and autonomy.

- Visibility of a property tax refers to the fact that it is generally paid directly by taxpayers in periodic lump sum payments. In other words, taxpayers are more aware of the amount of the tax they pay compared to other taxes. In addition, it is very likely that property taxes finance visible services (roads, garbage collection, parks), making it more visible. Tax visibility enhances accountability as taxpayers are aware of what they pay and expect some services in exchange. Nonetheless, the visibility, property tax is not a popular tax and has been hard to rise in general.
- The inelasticity of property tax suggests that as the only mechanism to increase tax revenue is to increase tax rates; tax revenue cannot change automatically with changes in prices and income. In that sense, changes in property values will take longer than changes in income as a result of economic activity. Inelasticity is also a characteristic of property taxation that leads to accountability but also to taxpayers' resistance (resistance of changes in property values and rates increases).
- The autonomy of a property tax accounts for the fact that, local governments levy it and therefore it supports local autonomy. Some additional circumstances define the extent of local autonomy: local governments can (1) decide whether or not to levy the tax; (2) establish the base; (3) determine the tax rates and (4) enforce tax by autonomous agencies. These circumstances will define a "pure locally" property tax, which very few countries in fact have.

According to the theory, property tax is a local and efficient tax upon property in a specific jurisdiction; making it predictable and stable. In addition, tax upon property is highly visible, and taxpayers have to pay it directly in a periodic lump-sum payment making taxpayers be aware of this levy. However, the idea it being a local tax is quite recent in history, this occurred when The United States abandoned property taxation during the Great Depression due to the collapse of property values and gave municipalities this source of revenue. Accordingly, property tax is a levy that presents better conditions for collection performance because it is a tax upon an immovable asset, which means, the asset is completely inelastic. In addition,

property tax is paid exclusively by landowners and, in theory; land tax induces the productive use of the asset having a positive effect on collection and in some economic sectors like construction, agriculture and land market (Leibovich; 2005: 73).

In addition, there are also some disadvantages of property tax: effects of the property tax on land price; the visibility (here as a disadvantage); the tax erosion, inherent arbitrariness and political constraints.

- Economic effects of property taxes are the reductions of land price due to the capitalization effect of the tax and incentive urban development and prevention of speculative use of land; low taxation of property makes it an attractive investment and so its price rises leading to a gain for the existing owner, that is, an untaxed capital gain. Skinner⁸ suggests this will erode government tax base because a large fraction of new owners saving takes form of more expensive non-taxable property. The central argument deals with high taxation on properties so distortions can be minimal.

In addition, Simon (1943) suggests that property tax levies upon immobile factors such as real estates and land that will increase housing price affecting consumers. He considers this tax a regressive one, which levies high to low value housing owners in proportion to their income.

The policy recommendation is to tax high properties so distortions will be minimal. In the same perspective, Fieldstein suggests⁹ that variation in land values due to low levying has intergenerational effects because it can benefit existing landowners, whose lands will increase in value at the expenses of future generations who lose because of higher land prices.

According to Skinner (1991), rural property tax presents some features that difficult low application of it, even though theoretically there is plenty support for it. Land

⁸ Quoted in Evans and Wolfson (1996: 5)

⁹ Cited by Evans, pp 7

taxes do not work because landowners have the belief that their property value will drop.

- An advantage for tax in theory results as a problem to taxpayers. The visibility of the property tax makes it unpleasant for taxpayers. It is also unpopular because of the volatility of the value. The inelasticity of property tax is a disadvantage to the local government and jurisdiction, as the base of the tax does not increase automatically over time this leads to only one possibility which is to raise property tax revenue by increasing the rate of the tax; and as a result it makes it more unpopular and increases the taxpayer's resistance to it.
- The tax base erosion is a problem because the political decision over a tax base limits property tax collection. There are a number of exemptions and exclusions that narrow property tax base. Finally, property tax administration is complex and may become inefficient becoming a problem for the tax capacity. In order to administrate the property tax a local government needs, to identify the properties being taxed, prepare a tax roll and issue tax bills, collection and to deal with arrears. Those steps are costly for the municipal government and may become inefficient over time. As Slack (2010) suggests, one main outcome related to this problem is the outdated of assessments in many countries, because of the cost associated of the process.
- The inherent arbitrariness is due to the process of defining a tax base value that implies a process of valuation, which may be perceived as unfair and arbitrary. There are three options, the self-assessment system that may incentive to undervalue the property; the "official cadastral assessment" that is perceived by owners to overvalued the properties and finally, the assessment as a result of a property sold. No matter the assessment, it is a costly, and greatly viewed as arbitrary and unfair operation even under the assumption that it clearly reflects market values.
- Political constraints of the property tax. Tax on land and property has both, fiscal and non-fiscal effects. Property taxation is a source of local revenue. The extent of control over property of local governments will allow them to have more or less

autonomy in their expenditures decisions. Thus, property taxation at the local level is a source of revenue and expresses the extent of the decentralization policy.

Therefore, political constraints depend on constitutional arrangements and fiscal norms that define the framework of a political decision upon property taxation and the limits of this source of revenue. In fact, political constraints are not necessarily a disadvantage of the property tax system; by contrary, they define rules that local governments have to abide to and they make it more transparent and homogeneous among jurisdictions.

III. Property Tax Performance

Nonetheless, as Hale (1985) presents, arguments against property tax¹⁰ have not found enough support to eliminate it. Their discussion proved to be insufficient to restrict property tax, besides, it has survived for different reasons like *tradition* (and old tax is a good and accepted tax); *economic* (lucrative source of revenue to local governments) and political (as a cost of property rights). Property taxes are still common, even if they have loose relative weight among other duties.

Even the apparently worthy attributes of property tax, as Slack (2010) presents that property tax revenue rarely exceed 3 percent of Gross Domestic Product –GDP– in any country, which means it might be important at a local level but not as significant as other taxes at a national and aggregate level.

Furthermore, property tax, as a local source of revenue has to be compared in a local level basis. That is to say, even if the relative weight is low, as a proportion of GDP, its importance or significance has to be assessed based on the relative weight on local revenues. For example, in ODCE countries, property tax is the primary local tax revenue

¹⁰ See Netzer (1966) *The Economics of the Property Tax*. Washington, D.C.: Brookings Institution.; Mieszkowski and Zodrow (1989) “Taxation and the Tiebout Model: The differential effects of head taxes, taxes on land rents, and property taxes”, *Journal of Economic Literature*, 27: 1098-1146. and Plummer (2003) “Evidence of Incidence of Residential Property Taxes across Households”, *National Tax Journal*, Volume 56, Number 4.

source, producing about 90% of local tax revenue. When including other non-tax sources of revenue, property tax accounts for about 30% of all revenues.

Cross-country analysis of property taxation mainly focuses on property tax on GDP ratio and some information on rates; this is due to the scarce information. However there might be other interesting features to assess: the ratio of market property values to GDP; the ratio of assessed base to market values; the ratio of taxes assessed to taxable base and the ratio of taxes collected to taxes assessed (which represents enforcement).

Nonetheless, some ideas can be made of the performance of property tax across countries. Taxes on land and property are the main minor revenue sources in all countries. As Bird and Slack show (2002), for developing countries it accounted for about 0.4% of GDP, about 2% of total tax revenue in 1990; while for OECD countries it remained at about 1% of GDP and 4% of all tax revenues.

Nonetheless, property tax is an important source of sub national revenue in many countries. At a sub national level, property tax accounted for 40% of all sub national taxes in developing countries: 35% in developed countries and around 12% in transition countries during the 1990s. Around the same period of time, property taxes financed a bit more than 10% of sub national expenditures in developed and developing countries.

In spite of the importance of property tax at the sub national developing countries level, it is much more important in OECD countries. For instance, countries like Canada show the highest property tax to GDP ratio (4.1%); followed by United States (2.9%) and Australia (2.5%)¹¹.

In addition, as Bird and Slack (2002), present data from the United States showing that the effective rate of property tax - ERPT¹² for commercial property is about twice the rate of residential property slightly higher than industrial property. They also suggest a great divergence among states with a range of 0.4% to 2.9% for residential properties.

¹¹ Canada, United States and Australia are the three richest federations.

¹² ERPT represents the proportion between total collection and property value.

They point out that ERPT is considerably lower in most developing countries. Information for Colombia, Philippines and Indonesia for 1997 indicates that ERPT reported it was 0.41% in Colombia, 0.07% in Philippines and from 0.01% to 0.41% for Indonesia.

It results interesting how the information presented in regards to differences on property tax ratio on GDP and ERPT does not tell us the reasons why it explains the different performance. As Bird and Slack highlight, administrative factors may play a role due to exemptions, statutory rate and collection efforts.

As Sokoloff and Zolts (2005) highlight “Even if the respective levels of government in Latin America relied on the same tax instruments as did their counterparts to the north, the fact that local governments were so much smaller implies that property and wealth holders would contribute a relative modest proportion of the government revenue overall. Local/municipal authorities accounted for only about 10 percent of total government tax revenue in Brazil, Colombia and Mexico, throughout the 19th century” (2005: 22).

In addition they suggest that local government growth in Latin America was minimal. Local governments relied on indirect taxes that maintained a weak relationship with the citizens. In addition, as the government did not need to growth in rural areas, no important public investments were made during the 19th century. That pushed them to widen participation of citizens, which would mean being more accountable to them and increasing public investments.

Besides, the analysis of Assunção and Moreira (2004), models the Latin American land tax situation where land is not only used for productive purpose but also as a safeguard under risky and uncertain situations. They study the problem of optimal taxation given in the Latin American context and they conclude that “relying only on land tax is optimal only when the social planner information about farmers is complete or when farmers do not hold unimproved land; otherwise, the optimal scheme is a linear combination of output and land taxes” (2004: 3)

In Latin America property tax works as an alternative to finance local public goods, except from Cuba, El Salvador and Haiti which have not yet established property taxes – *prediales*-.

According to De Cesare (2010) in Latin America, total taxation is about 19% of GDP. Property tax represents about 1.6% of total taxation, with a greater proportion in Chile (3.33%) and lower property tax as a proportion of total taxes in Peru (0.92% and Costa Rica (0.58%). In average, per capita collection is about 14 US dollars per year.

Table no. 1
Property Tax as a % of GDP (2010)

Country	Tax burden/GDP (%)	Property tax	
		%of GDP	% of Tax Burden
Argentina	27.44	0.44	1.61
Brazil	26.48	0.45	1.72
Chile	18.83	0.63	3.33
Colombia	----	0.62	---
Costa Rica	20.55	0.12	0.58
Guatemala	12.30	0.16	1.30
Honduras	18.35	0.31	1.69
México	20.60	0.21	1.00
Panamá	15.86	0.35	2.21
Paraguay	13.49	0.27	1.97
Perú	16.41	0.15	0.92
República Dominicana	14.15	0.13	0.94
Average	18.59	0.32	1.57

Source: De Cesare (2010)

As a proportion of GDP, the property tax represents about 0.32% where countries like Chile and Colombia represent about 0.60% of GDP. This is far lower than developed countries where property tax is about 1% of GDP (4% in Canada, US and UK).

Table no. 2
Property Tax Revenue as a Share of GDP

	1970's	1980's	1990's	2000's
OECD Countries	1,24	1,31	1,44	2,12
No. Countries	16	18	16	16
Developing Countries	0,42	0,36	0,42	0,60
No of Countries	20	27	23	29
Transition Countries	0,34	0,59	0,54	0,68
No of Countries	1	4	20	18
All Countries	0,77	0,73	0,75	1,04
No of Countries	37	49	59	65

Source, Bahl (2007)

According to the previous table, there is visible representation of a small proportion of GDP; nonetheless there are important differences between countries. Developing countries show a lower performance and growth than OECD and transition countries. Latin American countries, which are in the former groups, are where property taxes account for an average of about 0.32% as a proportion of GDP in 2006. Recalling De Cesare's analysis, tax burden in Latin America remains lower. DiJohn (2006) suggests that this may be do to (1) weak leverage over elite economic cases (2) poor administrative capacity; (3) high level of tax evasion and (4) rise of exemption levels.

Traditionally, this tax is the responsibility of the local and regional government, specifically the governments of municipalities. In Latin America, there is no single government level responsibility on this tax. For instance, in Chile there is a complete centralization of this tax in terms of definition of rates, bases and collection; nonetheless destination of total collection is designated to municipalities. The opposite situation, or highly decentralized property tax are the cases of Brazil and Venezuela where municipalities have great autonomy to define rates and exemptions.

However, the most common path is a restricted autonomy of the local government, where the central government can define ranges of rates and control tax bases throughout central agencies while local governments control rates within the range and collection.

As De Cesare (2010) suggests, Latin America presents reduced municipal autonomy, in general, implying that low taxation may be related to weak technical capacity, collection

and cadastral valuation at local level and advising the need for national government leadership to overcome local weakness.

In terms of rates, there is also a mixed task of national, regional and local government. In countries like Chile, Costa Rica, Guatemala, Paraguay and Perú, rates are defined at the national level. In Argentina, the *Provincia* has this task. In Ecuador, Colombia and Honduras, municipalities determine rates based on a range defined at the national level.

There is no unique and uniform rate for rural and urban land taxation. For instance, the countries' property tax ranges from 0.025% to 2% of land value. According to De Cesare (2010), urban property tax range is higher than rural tax range. The former is about 1.31% to 2.57% while rural is 0.39% to 0.90%.¹³ Rural land taxation's rate average is about 0.65% in Latin America. According to this numbers, the Colombian rural land tax rate average is below Latin America's average at about 0.56%.¹⁴

IV. Concluding remarks

Summarizing, property taxes have been studied extensively in the past, although the research has concentrated on the effect of property taxation on economic growth. In discussion amongst scholars, policy advisors have defended property taxation even though it is also highly criticized. Important works by Bird (2008); Bird and Slack (2004, 2002); Bird and Zolt (2003), Oates and Shwab (1997), Slack (2010), Kitchen (2003); among others, have contributed to better understand what is property taxation, how it is implemented in different countries and what are its strength and weakness.

Moreover, as presented above, the technical issues of property tax already give an idea of its difficulties. Even in the few developing countries able to meet these conditions, property

¹³ De Cesare analyzes 12 Latin American countries (Argentina, Brazil, Chile, Colombia, Costa Rica, Guatemala, Honduras, Mexico, Panama, Paraguay, Peru and Dominican Republic). Information is available from a sample of municipalities for each country. She includes information on legislations, tariffs, collection and procedures of land taxation, including data for rural land taxation.

¹⁴ This average is calculated base on *Acuerdos Municipales* and taking into account land area and values.

taxes are relatively unimportant, suggesting that the administrative or political costs may be higher than the incentive advantages associated with them.

Likewise, tax is a powerful instrument of the local government: it is one of the mechanisms to collect needed revenues, penalize the under use or inefficient use of land and foster economic activities. However, in Colombia the use of property tax is under its potential. As some of the highlights, political constraints are part of the story and may restrict the wide use of property tax.

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