PBL Netherlands Environmental Assessment Agency

Mercator Research Institute on Global Commons and Climate Change (MCC) gemeinnützige GmbH

Policy Brief April 2017

Land Taxes as Fiscal Instruments to Promote Sustainable Development

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Introduction

The international donor community committed itself to support "*countries that need assistance, including through substantially increasing ODA and technical assistance for tax and fiscal management capacity, particularly to LDCs*" through the Addis Ababa accord of July 2015. The Addis Ababa Accord sets out the importance of domestic revenue mobilization for financing development. International cooperation can help strengthen fiscal capacity and facilitate knowledge exchange. The idea of land taxes is not new, but the implementation of land taxes has been relatively limited. Recent developments have renewed interest in the potential of land taxes, specifically for countries that depend for their economic development to a large extend on land. This policy brief summarizes the findings of Kalkuhl et al (2017), which explores the potential of land taxes for sustainable development.

Land taxes

Land taxes tax an economic rent, i.e. the excess amount earned by a factor over the cost of its supply. Land taxes are in principle non-distortionary, and as they make it possible for governments to make less use of distortionary taxes like labor, capital, consumption or trade taxes, they tend to have a welfare improving effect. Land taxes not only provide a stable and efficient basis for government revenue, they can have a positive impact on the sustainability of land use and the distribution of wealth and income too: a land tax reduces the incentive to clear forest for agricultural development and it can be used to re-distribute land rents from large land owners to the poor.

Specific benefits for developing countries

Some developing countries already use land taxes. However, property taxes which tax land as well as buildings are more common, but have a number of drawbacks like that they facilitate urban sprawl. In our report, we find that land taxes are interesting for developing countries for a number of reasons

1. Land taxes require a **land registry or cadastre**. While this is associated with substantial implementation and maintenance costs, improved land tenure security and formal land rights also enable and facilitate access to finance, investments, and sustainable land use management.
2. **Tax evasion** of conventional taxes like income, value added or trade-related taxes is particularly high due to a large informal economy where activities under taxation can be shifted to. Land taxes are more difficult to evade because of the visibility of land and property.
3. Many developing countries require substantial financial sources for financing basic infrastructure related to access to water, sanitation, education, and health. Land taxation can increase domestic revenues to help **finance the SDGs** without harming the economy.
4. Land taxes are best administered on a local level because acceptance by tax-payers is higher when the tax is used locally. Thus, land taxes can be part of a **fiscal and political decentralization** reform that may increase the quality of political institutions and governance.
5. Land taxation gives an additional incentive to **put land under its most productive use**. This is relevant for land which is hold for financial objectives rather than for production or usage.
6. Some developing countries are characterized by **large deforestation and urban sprawl** – differential land taxes on agricultural land or housing land could provide additional incentives to mitigate deforestation and urban expansion.

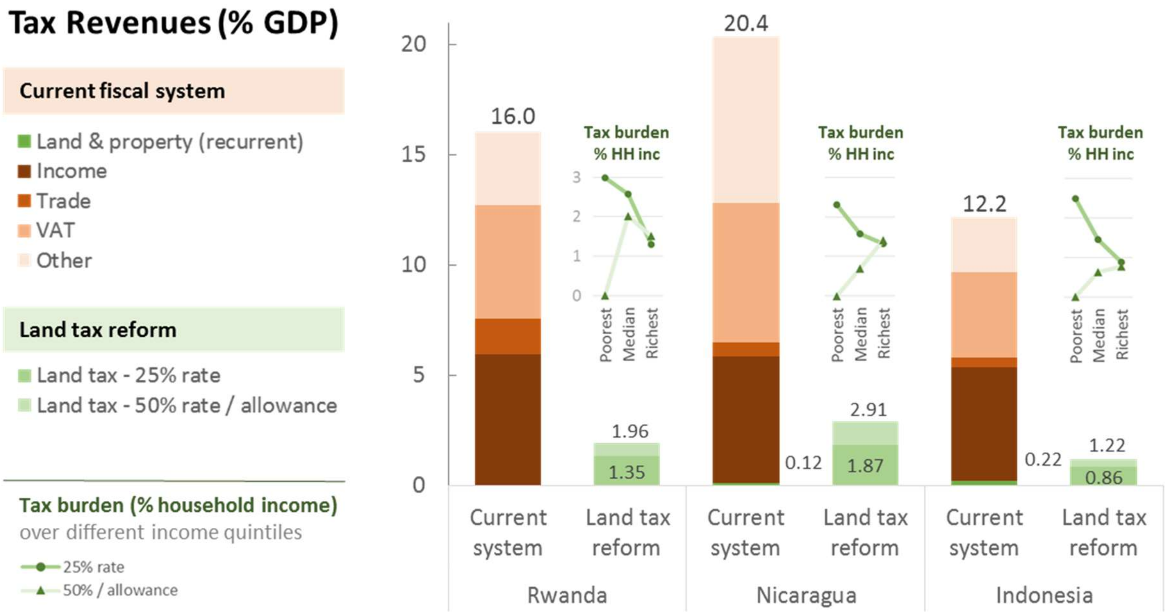
Implementation: challenging but manageable

A major obstacle for implementing land taxation is the creation and maintenance of a **cadastre** with up-to-date land rights and values and **fiscal capacity** to collect and administer taxes and address non-compliance issues. We find that the administrative costs of land taxation, including valuation, are similar to the costs of other taxes. Although tax evasion and non-compliance are major issues, recent experiences in developing countries introducing or improving property or land taxes shows that the challenges are manageable. Overall, the benefits of introducing land taxes greatly outweigh the costs.

Revenue potential and distributional effects

For a number of countries we explored the potential benefits and the feasibility of introducing a land tax. Roughly, we found that taxes on the actual or inferred land rent income can **raise government revenues in the order of 1 to 4 percent of GDP,** depending on the tax rate used (see Figure). This implies an increase of the total government budget by 7 to 18 percent. Actual revenues might be even higher, as the household data used do not include foreign investors' or private sector land use.

It is important to acknowledge the potential distributional consequences of land tax implementation in tax rate design: To avoid land taxes putting a relatively large burden on poor households, exempting small-holders from taxation by introducing a tax free amount (allowance) helps to improve distributional outcomes, and to reduce transaction costs. Such progressive schemes for land or property taxes are already used in some countries. Earmarking tax revenue for (local) infrastructural investment further improve impact for the poor and public acceptance.



Way forward

In the Addis Ababa Accord the world leaders committed to collaborate on the strengthening of fiscal systems and tackling of tax evasion and avoidance to increase the basis for mobilization of domestic revenues. Our findings suggest that land taxes can be an important part of this. The following agenda would help land taxes to meet their potential. First, develop "fit for purpose" land registration systems, as suggested by the International Federation of Surveyors (FIG), the World Bank and others. Second, design country and context specific land taxes, which corresponds to the capacity of the country's land administration system and which use the available information on land. Third, implement a tax free amount in the design of the land tax, which exempts subsistence farmers from the land tax and which relieves low-income households. Finally, strengthen public administration to make sure that the additional tax revenue is used in a transparent and productive manner to increase acceptance of the tax and taxpayer morale.

Reference

Kalkuhl M, B Fernandez Milan, G Schwerhoff, M Jakob, M Hahnen, F Creutzig (2017). Fiscal Instruments for Sustainable Development: The Case of Land Taxes. MCC Berlin. www.mcc-berlin.net/landtaxreport.

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