

# Taxing urban land and property

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## To clarify: What do I mean by land/property taxes?

- **What we're focusing on:**
- Recurrent taxes are applied on properties regularly, typically annually.
- In Pakistan, this is called Urban Immovable Property Tax.
- **What we're not focusing on today** are transaction based taxes such as the provincial Capital Value Tax, stamp duties, and FBR's withholding tax and capital gains taxes.
- But you can click [▶ here](#) for why this is a less good tax.

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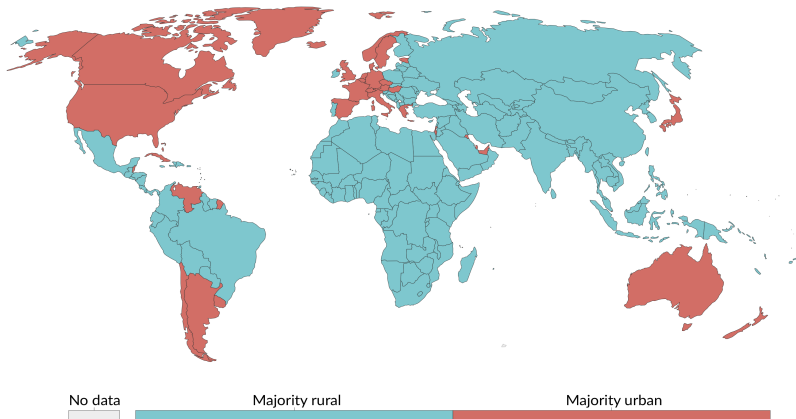
1 Why tax land and/or property?

2 How to tax land/property?

# The world is becoming urban.

## Do more people live in urban or rural areas?, 1952

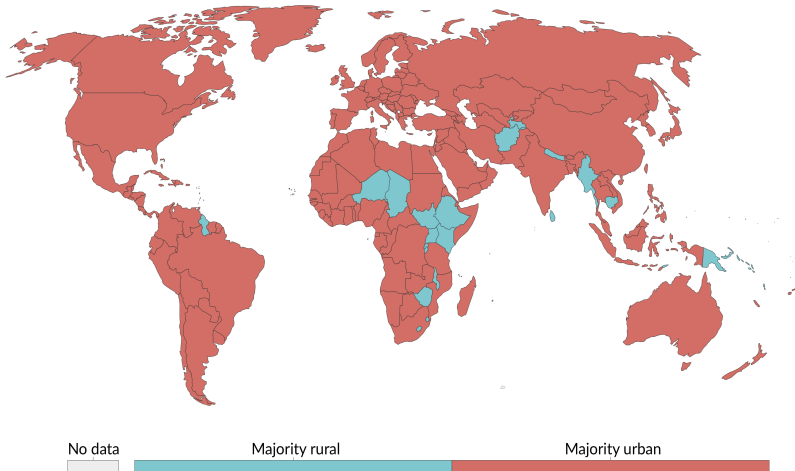
Share of the population which live in urban versus rural areas. Here, 'majority urban' indicates more than 50 percent of the population live in urban centres; 'majority rural' indicates less than 50 percent. Urban populations are defined based on the definition of urban areas by national statistical offices. This is based on estimates to 2016, combined with UN projections to 2050.



Source: OWID based on UN World Urbanization Prospects (2018) & Historical Sources (see Sources tab)  
[OurWorldInData.org/urbanization](https://OurWorldInData.org/urbanization) • CC BY

## Do more people live in urban or rural areas?, 2050

Share of the population which live in urban versus rural areas. Here, 'majority urban' indicates more than 50 percent of the population live in urban centres; 'majority rural' indicates less than 50 percent. Urban populations are defined based on the definition of urban areas by national statistical offices. This is based on estimates to 2016, combined with UN projections to 2050.



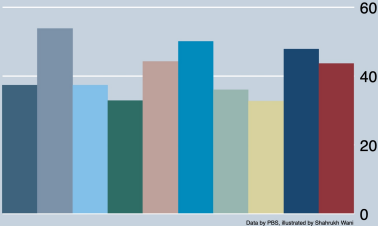
Source: OWID based on UN World Urbanization Prospects (2018) & Historical Sources (see Sources tab)

# Pakistan is no exception

## Pakistan's 10 biggest cities

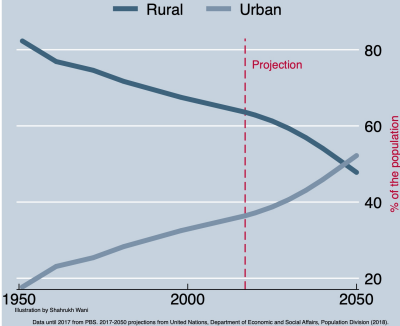
% change in population between 1998 and 2017

- Karachi
- Lahore
- Faisalabad
- Rawalpindi
- Gujranwala
- Peshawar
- Multan
- Hyderabad
- Islamabad
- Quetta



## Pakistan's urban transition

% of Pakistanis living in urban vs rural areas



# This is a good thing

Figure 1: Correlation between GDP in 1960 and growth between 1960 and 2010 among a sample of poor countries in 1960 (Bryan, Glaeser Tsivanidis, 2020)

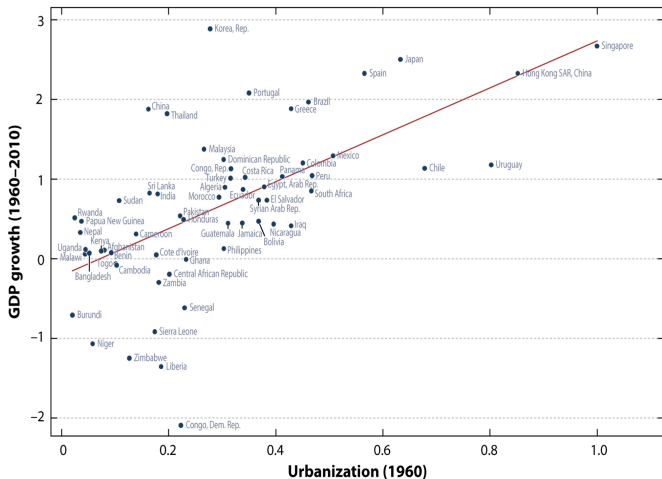
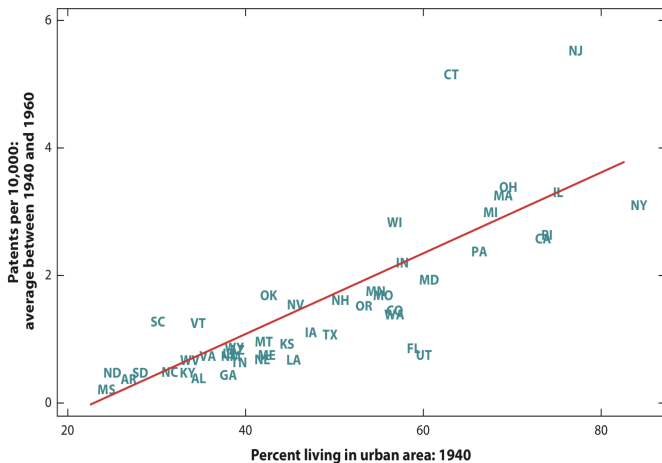


Figure 2: Population density was much higher in the most inventive US states during the early twentieth century (Akcigit and Nicholas, 2019)





but cities require a lot of infrastructure to work well

HOME > Opinion

## The living, breathing creature that is Karachi's traffic

SAMAA | A Correspondent - Posted: Aug 28, 2019 | Last Updated: 1 year ago

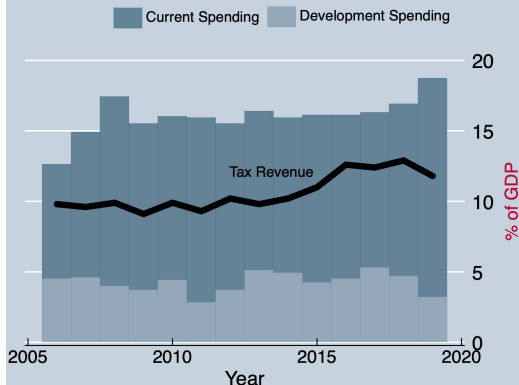


Photo: Online

# So how can we pay for it?

## Not raising enough taxes

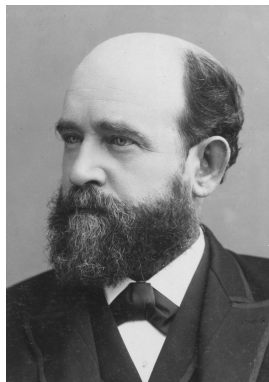
Spending (current and development) vs tax revenue as % of GDP



Data from Ministry of Finance. Illustrated by Shahrukh Wani.

## Reason 1: Why tax land and/or property?

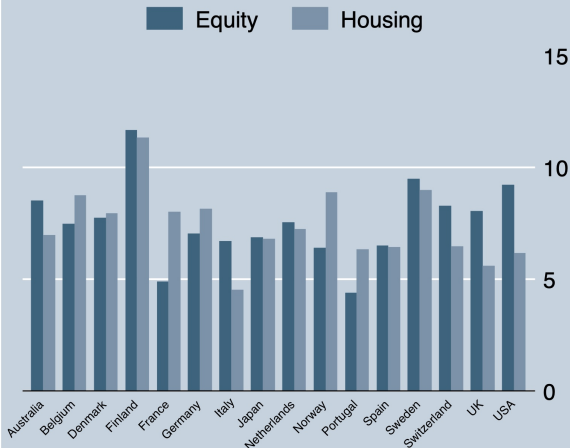
- It is fair way to tax wealth.
- It is inherently progressive → the rich own more property, and more valuable one. (although the broader incidence is more complicated)
- Urbanisation provides significant agglomeration rents for land owners → so people who own land can extract its riches via rents without doing any work.



# Henry George was right

## Long-run Returns On Housing

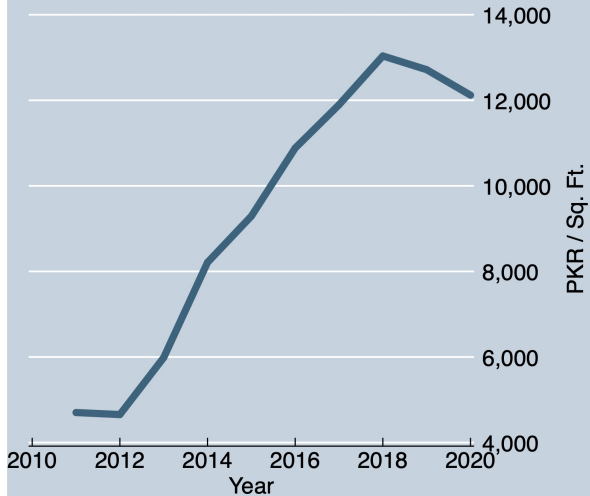
% average annual returns on equity and housing (1870-2015)



Excluding World Wars

Source: Jordà, O., Knoll, K., Kuvshinov, D., Schularick, M. and Taylor, A.M., 2019. The rate of return on everything, 1870-2015. Illustrated: Shahrulkh Wani.

### Karachi Residential Property Prices



Data by Zameen.com. Single data point taken every Jan of the year.

## Reason 2: Why tax land and/or property?

- It is (more) **efficient**.
  - Land taxes (which doesn't consider how land is used) **don't** distort economic activity by creating bad incentives, such as to under-invest, or cannot reduce the supply of land. It can even move land to more efficient use – for example, by discouraging vacant plots and allowing land to be transferred to its highest value use (see Arnott and Stiglitz, 1979 in the *Quarterly Journal of Economics*).
  - Property taxes, which take the value of the construction into account of the tax liability, will effect incentives, but evidence shows that they're **less harmful to investment and growth** than other taxes such as income and corporate tax (see OECD's 2010 *Tax Policy Reform and Economic Growth*)

# Just remember, the incentives

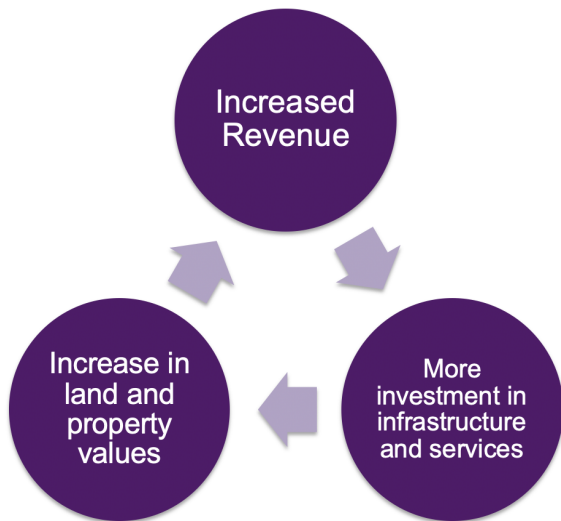


## Reason 3: Why tax land/property?

- It is the most **local** of taxes, and that is important for running cities.
  - They can provide **regular place-based stream of revenue for cities**. Ideally, they should correspond with the level of services provided by the city.
  - Nationally, it is fair for people who benefit from urban investment pay for it.
  - As it is place-based, you can not hide or move land/property between areas. Although the capital invested on land can be moved.
  - It can give city leaders a stake in their cities progress.
  - It might be good for democracy. Recent evidence shows that property tax collection can lead to higher demands for government accountability because of high visibility. (a study ongoing in Punjab is trying to see if this is the case in Pakistan)



Together, this leads to cities into a virtuous circle

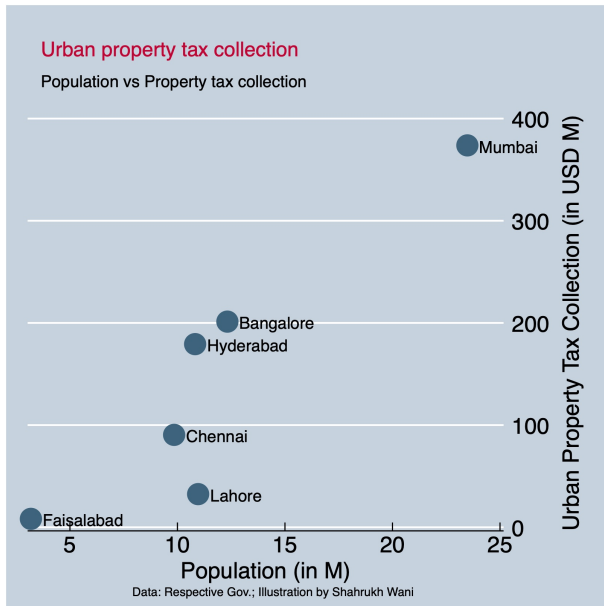


## Reason 4: Why tax land/property?

- It is also a **significant** source of revenue.

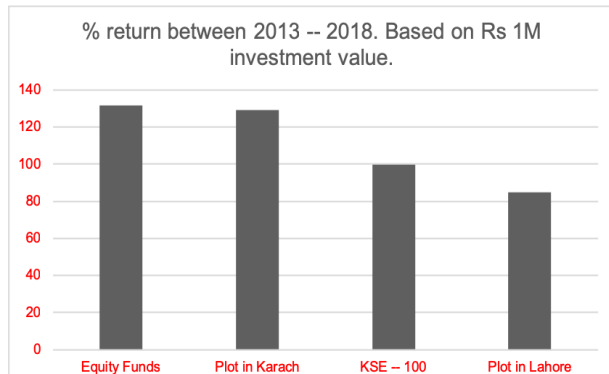


# Even in South Asia, Pakistan lags behind



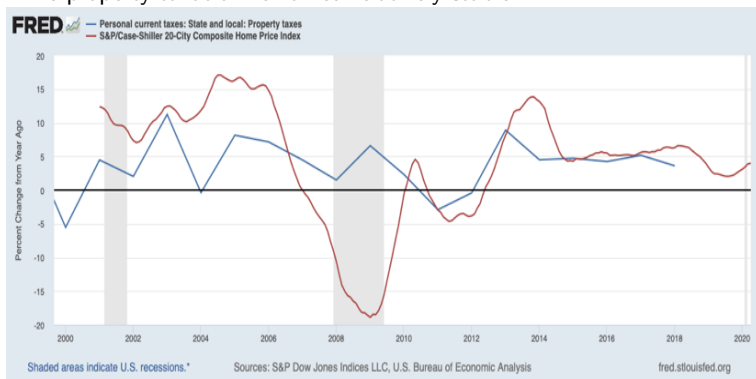
## Why tax land/property? Bonus reason for Pakistan

- Due to low regulatory oversight and low taxes, real estate in Pakistan might be encouraging speculative investment.
- Although no robust evidence to back this.
- What we know that there is significant return in real estate. If you had 1 million PKR in 2013, you would have the following return in five years, based on where you invested (SBP, 2019):



## Why tax land/property? COVID19 Angle

- Taxes revenue will go down due to the pandemic-induced economic slump.
- Can land/property taxes be a more stable source in this uncertain times?
- More on this in a new paper upcoming in late-Oct.
- Home prices recovered within 2 years in the U.S. after the 2008 economic crisis, while property taxation remained relatively stable.



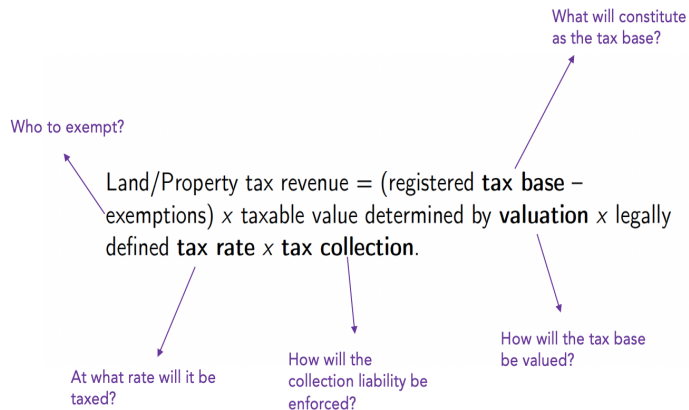
# Recap

- Why tax land/property?
  - It is fair.
  - It is efficient.
  - It is local.
  - It is significant.
  - It (might) decrease speculative investment.
  - It (might) be more stable.

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# Main considerations for land/property tax policy

Three questions to ask:

- Do you know who owns what?
- What to tax?
- How to tax?

## Do we know who owns what?

- In information-scarce environments, governments may not know who exactly owns what – in other words, doesn't have a good cadastre.
- To levy property/land taxes, tax authorities need to have reliable information, but also keep it updated.
- **Unclear property rights can end up inferring large costs on tax administrators.**
- In Pakistan, historically, land records have been kept manually. However, technology is being increasingly used: especially those kept by the Punjab Land Record Authority. But, challenges remain, especially in urban informal settlements. Compounded by a weak court system which makes disputes long and costly (for the tax collector too).
- Improvements can have big pay-off: Bogotá spent USD4 million updating its land cadaster b/w 2000-2003, but generated a USD24 million increase in annual property tax revenues every year afterwards.

# What to tax?

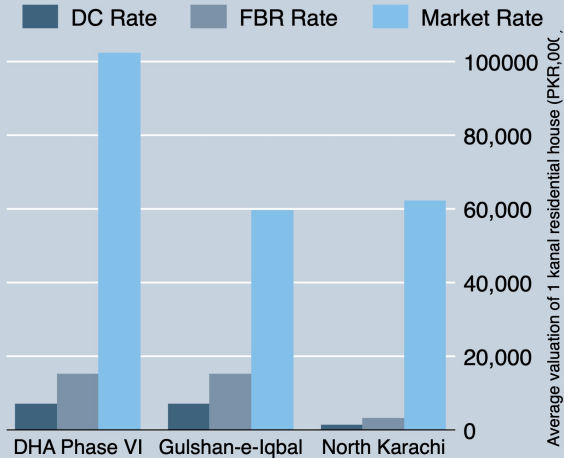
- Distinction between urban vs rural plots of land can be complicated.
- Should tax just land, land and improvements, or just improvements?
  - Land creates the least economic distortion, so it does not discourage productive activity. But, requires data on real land value.
  - Land and improvements would capture the truer value of the asset, but can discourage productive activity.
  - Just the improvements on land?
- Should different types of properties be taxed differently?
  - Commercial vs. residential properties
  - Owner-occupied vs. rental properties vs. second-properties (this is a MAJOR issue! Pakistan currently gives large discounts to owner-occupation)
  - Exemptions? (schools, hospitals, low-income communities? Asset rich, income poor?)

## How to tax?

- What are the different methods which can be used to calculate the value?
  - Area based: Tax the property **based on its area or location**, based on a fixed rate per unit of land and or structure. This usually includes few coefficients related to value, such as the quality of structures.
  - Rental-value based: Tax the property based on its **perceived rental value**. Data may be easier to obtain if high proportion of properties are rented and is buoyant, i.e. should change reflecting economic circumstances. However, it typically reflects present use rather than best use of property which could induce inefficient market behavior. Thin rental markets can make data hard.
  - Capital value: This is the most accurate **market-based assessment** of land and property value, but require a vibrant real estate market to generate data. Governments also need to keep up-to-date data on contents and characteristics of properties.

## Under-valued Properties

Data from SBP (2019), Illustration by Shahrukh Wani



## What Freetown is doing



As Freetown was entering lockdown in mid-April, the city announced that it will move to a new property tax system a “point-based” hybrid model — the city used satellite imagery to identify and measure every property in Freetown and then send teams to collect data on easily observable characteristics such as the quality of walls, roofs and windows. All of this data was used to create a new, simple model for calculating the taxable value of each property.

Average tax payable	Existing system	New system	Average change
1st Quintile	\$14.33	\$4.31	-70 %
2nd Quintile	\$15.85	\$9.48	-40 %
3rd Quintile	\$16.10	\$17.40	+8 %
4th Quintile	\$23.38	\$36.94	+58 %
5th Quintile	\$41.64	\$142.25	<b>+242 %</b>

Source: <https://africanarguments.org/2020/05/21/freetown-just-implemented-a-new-tax-system-that-could-quintuple-revenue/>

## Some policy directions for Pakistan

- Giving **land more weightage in property taxes**. Annual Rental Value is a poor proxy, and changing it can lead to large tax increases, even on D.C. rate.
- Value assessments need to be **timely** to capture changes in value, ideally these values (and how they're calculated) should be publicly available so people can verify.
- These taxes are intrinsically tied to how well defined are **property rights**: making sure that there is a clear database of who owns what is an important first step.
- Trade-offs between various policy decisions around **exemptions** should be evaluated carefully.
- Tax should be **local**, as it is in law but not in practise. And linked to benefits received. For this, we need cities to be governed by local governments.



## Stay in touch:

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- Twitter: [@ShahrukhWani](https://twitter.com/ShahrukhWani).

## one-off vs recurrent taxes

- Should you tax land/property 'one-off' based on transactions or recurrent?
  - In Pakistan, the UIPT is a recurrent tax, while the provincial Capital Value Tax, stamp duties, and FBR's withholding tax and capital gains taxes are transaction based.
  - Transaction-based are bad for efficiency "as they may reduce turnover of property and hence distort the allocation of this important component of capital." (Norregaard, 2013) In Toronto, Dachis et al. (2012) show that the Land Transfer Tax caused a 15pc decline in the number of sales. Need Pakistan-specific evidence on this.
  - Essentially, people may keep properties in their sub-optimal use, as **transaction-based taxes discourage transfer.**
  - It may also incentivise property owners to understate taxable value, which may weaken the database. (as Alm, Annez, and Modi show in the case of India in a 2004 paper).
  - Keeping transaction-based taxes low and using them to build database for recurrent taxes.

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