



Linking Property Tax Revenue and Public Services

Wilson Prichard

Introduction

In practical terms most property tax reforms are, first and foremost, efforts to increase tax revenue. But the ultimate goal of tax reform is, of course, broader: expanding tax revenue in order to finance the provision of valuable publicly-provided goods and services. Tax reform is only socially desirable if tax revenue is, in fact, translated into improved public outcomes. Otherwise taxation amounts to little more than the extraction of revenue from taxpayers.

Tax reformers are correspondingly faced with a simple question: is the revenue from tax reform actually likely to be translated into publicly-provided goods and services? Perhaps more importantly, could property tax reform programmes be designed

explicitly to increase the likelihood that revenue will be translated into valued publicly-provided goods and services? Rather than only raising more revenue, tax reformers may have the power to proactively shape the quality of public spending.

One strategy is to strengthen the implicit and explicit connections between property tax revenue and specific goods and services. Such links appear to be most straightforward and likely where property taxes are raised by local government – and this may be an important advantage of decentralised property taxation.¹ But they remain possible where centrally-raised property taxes are shared with local government – or even where revenue is fully under central government control.

¹ Goodfellow, T. (2017) *Central-Local Government Roles and Relationships in Property Taxation*, ICTD Summary Brief 12, Brighton: IDS.

African Property Tax Initiative (APTI) – supporting robust, policy-relevant research to boost wider use of more effective property tax systems in Africa

Why link property taxes to services?

Governments may wish to explicitly highlight and formalise the connection between property tax revenue and publicly-provided goods and services for three broad reasons:

1. *To increase the quality and quantity of publicly-provided goods and services:* relatively explicit connections between revenue and spending can generate popular support for promised spending, lead to the creation of specific structures for delivering that spending, and improve monitoring of promises that have been made.
2. *To build political support for property taxation:* it is increasingly recognised that the primary barrier to more effective property taxation in many contexts is a lack of political support. By making clear the public benefits that will arise from expanded revenue – and then delivering on those promises – governments can build political support for reform.
3. *To enhance trust, compliance, and the credibility of government:* where taxpayers do not believe that tax revenue is used effectively, they are less likely to comply with taxes, and may hold more broadly negative views of local government. Effective connections between revenue and services may enhance trust in government, contributing to tax compliance and broader government credibility.

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These motivations are, of course, complementary. More and better public goods and services will strengthen support for reform and trust in governments, while greater public engagement with reform efforts is likely to also strengthen demand for public goods and services.

Links between revenue and services may be relatively informal, or may be a legal commitment to spend a specific share of property tax revenue on specific kinds of goods and services. The primary objection to these more formal commitments is that such earmarking may reduce budgetary flexibility: it may make it more difficult for governments to shift spending to other priorities in the future, as circumstances change.

What should the property tax pay for?

If property tax revenue is to be linked to public goods and services, the subsequent question is: which goods and services should be supported? Traditionally, there have been two types of answers to this question:

1. *Property tax revenue should benefit the areas it is collected from – and thus most benefit those who pay the most:* in this ‘benefit tax’ view, property taxes amount to an indirect payment for local public services. The more taxes you pay, the more services you should receive – much like a user fee. And the more services you receive, the more you should pay. In practical terms, this could mean that property tax rates are higher for properties that have access to better services: electricity, piped water, paved roads, higher quality sanitation and the like.² Alternatively, it could lead wealthier households to demand that public service spending be concentrated where they live and pay taxes.
2. *Property tax revenue should be used to benefit the broader community:* in this view property taxes are a tax on a specific type of wealth, which can be used to support the overall spending needs of the community. In this view those who pay more property

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taxes should not necessarily expect a greater share of public spending. Instead, property taxes can be used to fund the broad costs of government, and to support redistribution through broad-based spending.³

In practice, most property tax systems are likely to have elements of both rationales – that is, they function both as taxes on wealth and payments for services. While we lack systematic data, it appears that property taxes in Africa normally fund the general needs of local government, but, at the margin, are higher where services are better – while also funding additional services in areas that contribute the most to revenue. Critically, even where funding is focused on the needs of wealthier taxpayers this is likely to have broader benefits: better roads, stronger security, improved sanitation and the like generally have a strong public goods element. This is particularly true where

² Zebong, N., Fish, P. and Prichard, W. (2017) *Valuation for Property Tax Purposes*, ICTD Summary Brief 10, Brighton: IDS.

³ Ibid.

budgeting occurs entirely at the aggregate local government (rather than neighbourhood) level, covering both high- and low-income areas. And, of course, in some cases wealthy constituents may nonetheless favour spending focused on broader public needs.

Placing greater stress on the benefit tax and wealth tax rationales for property tax can, nonetheless, have distinct advantages and disadvantages. Where property taxes are understood primarily as benefit taxes, this reduces their redistributive potential – payments and spending are concentrated among the wealthy – but may mobilise greater political support from wealthy constituents. Where property taxes are understood as wealth taxes they have greater redistributive potential, and will correspondingly depend on mobilising broader-based popular support.

Options for connecting property taxes and services

How, then, might governments seek to demonstrate the connection between property taxes and publicly-provided goods and services in practice? Options for doing so can run along a continuum from entirely implicit to highly explicit connections.

- *General funding for government:* at one end of the spectrum, governments explain that

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revenue is used to fund government activities, but do not provide more detailed information. This may be enough where taxpayers already trust the government. However, where there is little trust in relevant levels of government – as in much of Africa – such implicit links are unlikely to encourage significant support for expanded taxation. It may nonetheless be a useful and necessary starting point in countries where property tax is highly centralised, and such transparency has not previously existed.⁴

- *Transparency about public spending, but no explicit links:* a common form of tax-expenditure linking is for governments to publicly post details about local public revenue and spending – though without any explicit links between specific revenue sources and specific spending. Such efforts are, however, often limited by their generality and complexity, as taxpayers struggle to understand where new funds from specific taxes have contributed to improved welfare.

⁴ Goodfellow, T. (2017) *Central-Local Government Roles and Relationships in Property Taxation*, ICTD Summary Brief 12, Brighton: IDS.

- *Explicit links, but no legal requirements:* elsewhere, governments have been more explicit in proposing that specific new tax revenue will be used to fund specific new services – for example, the introduction of new bus or sanitation services, or improved market facilities. These links have not been embedded in the law, but may lead taxpayers to identify new revenue with specific popular benefits.
- *Earmarking of revenue:* finally, the strongest form of revenue-expenditure linking comes where governments formally earmark new property tax revenue – that is, some or all of property tax revenue is explicitly allocated to specific purposes under the law, either indefinitely or for a defined period of time. So, for example, a proportion of property tax revenue could be legally dedicated to road repairs, local security, specific salaries or public toilets.

As governments move along this continuum they are more and more likely to be able to convince taxpayers that new revenue is being used well, and thus build trust. However, the stronger and more explicit the revenue-expenditure links, the more they may reduce budgetary flexibility. The right answer is likely to depend on the particular circumstances of individual governments. Critically, where property taxes are raised by local government the viability of these strategies may be shaped by broader national laws – the more autonomy

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local governments enjoy in allocating revenue, the greater the potential for establishing strong and credible connections between revenue and expenditure.

Ways forward

There is a clear case for local governments to strengthen the links between property tax revenue and public spending. Recent large surveys in Sierra Leone and the Democratic Republic of Congo, for example, indicate that taxpayers have very little confidence that governments use local tax revenue effectively – while qualitative evidence suggests that this is also true elsewhere. This has, in turn, undermined potential political support for

stronger property taxes. Meanwhile, recent reform experiences in Sierra Leone, Malawi, Nigeria and elsewhere indicate that where governments establish clear links between taxes and expenditure, this can improve service provision, expand government credibility and generate popular support for reform.

Developing such links is likely to be easiest where property taxes are largely or entirely controlled by local governments, as they are able to dictate how much revenue is raised, from whom and how it is spent.⁵ This is a potentially important advantage of decentralised property taxes. However, stronger connections between property tax revenue and publicly-provided goods and services remain possible where central government plays a larger role in property tax collection, particularly where local government retains control of rate-setting and/or over how at least a share of revenue is spent.

In deciding what types of connections to establish between revenue and services, government may want to answer the following questions, which can guide specific policy choices:

1. *What problem is the government trying to solve through stronger tax-expenditure connections?* Is the goal to improve the provision of specific services? To secure particular types of political support for reform? Or a combination? How might this shape what, and how, tax-expenditure links are established?
2. *Where has the government encountered difficulties in translating tax revenue into effective services, and how could strong tax-expenditure links most help?* For example, if the government has had problems securing adequate funding for key areas of spending, legally-binding earmarking may be a means to guarantee necessary funds. If service provision has suffered from poor delivery, it may be more useful to make revenue-services connections highly public – whether legally binding or not – in order to mobilise public pressure for improved performance. Where there are major problems of oversight, governments may wish to implement legally-binding earmarking alongside the creation of specific oversight mechanisms.
3. *What are the key political barriers to reform, and how might tax-expenditure links help to overcome them?* This might include the potential for such links to foster the emergence of ‘reform champions’ within government or the tax administration, efforts to mobilise broad-based popular support, or the ability to foster partnerships with

⁵ Ibid.

community-based organisations, business associations, religious organisations, traditional authorities or other potential allies.

4. To what extent are more explicit tax-expenditure links needed in order to build trust? Or are more implicit links sufficient, while retaining flexibility? And what is the right pace at which to introduce expanded tax collection? Where trust is extremely limited, strong and legally-binding links between revenue and expenditure may be more important, while it may be useful to phase in new taxes slowly, in order to demonstrate their connection to service provision step-by-step.

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Further reading

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Credits

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