# Submission of Input for the Financing for Development Elements Paper

**Submitted by the Local Government Revenue Initiative**

**October 15, 2024**

# Introduction and Summary

**Within the broader discussion of strategies for financing development efforts in lower-income countries, strengthening domestic resource mobilization through taxation remains the most critical element.** There has been growing attention to the potential of alternative financing through debt, public-private collaboration and other mechanisms. However, despite expansive attention to those novel mechanisms, the reality is that those funding sources have historically remained of limited value to lower-income governments – and especially to subnational governments – who struggle to access them. One reason is that accessing these novel sources of finance often depends upon first having reliable counterpart streams of revenues from domestic sources.

**There is, in turn, a particularly urgent need for the financing for development process to increase focus on strengthening domestic revenue mobilization at the subnational level**. In recent decades decentralization has expanded the responsibilities of subnational governments, but new fiscal transfers and local revenue mobilization have not kept pace. Property taxes, which are the backbone of local government finances around the world, make up 2% of more of GDP in some higher income countries, but often only 0.1% - 0.2% of GDP in lower-income countries. That makes property taxes by far the most underperforming major tax type across lower-income countries, undermining the ability of sub-national governments – and especially of rapidly growing cities – to meet the urgent needs of citizens in critical areas of sub-national responsibility like sanitation, waste management and water and environmental management. This is true despite property taxes being economically efficient, relatively progressive and conceptually attractive as a tax on an immovable, and thus highly visible, category of asset. It has, in turn, also undermined the potential of decentralization to drive improvements in state capacity and accountability.

**Yet despite the importance of subnational revenue mobilization the topic has been largely absent from the financing for development process**. In the 2015 Outcome Statement of the Addis Ababa Action Agenda there is only a single sentence devoted to subnational revenue mobilization: “We will strive to support local governments in their effort to mobilize revenues as appropriate” (p.38). In turn, in the most recent Financing for Sustainable Development Report (2024) only four sentences are devoted to sub-national revenue raising within an 11-page discussion of domestic resource mobilization. Put simply, the importance of strengthening subnational revenues to the achievement of the SDGs is far greater than the very limited attention that the issue has received to date.

**More optimistically, the past decade has seen major advances in our understanding of how to strengthen property tax systems in lower-income contexts, with a corresponding opportunity to strengthen international commitments to achieving improved outcomes**. Research programs – including, notably, work by the International Centre for Tax and Development and Local Government Revenue Initiative – have offered careful assessment of the reasons for historical under-performance, and mapped novel strategies for accelerating reform efforts. In turn, a growing number of cities have adopted, or are beginning to adopt, those new insights, and have achieved rapid and highly cost-effective improvements in performance.

**Reflecting those successes, there is an opportunity to give a more central place to subnational revenue raising in the financing for development program moving forward.** This could include:

* A commitment by multilateral institutions to strengthen support to efforts to strengthen subnational revenue mobilization, and property taxes in particular.
* A commitment by “donor countries” to expand support for sub-national revenue raising reform.
* A commitment by “partners countries” at national level to expand their support for strengthening sub-national revenue mobilization, particularly by revising existing national legal frameworks to enable the adoption of novel reform strategies.
* A collective commitment to strengthening international programs aiming to generate comparative knowledge, learning and tools to support sub-national revenue reform
* A collective commitment to strengthen available IT resources to support effective administration.

# The importance of strengthening sub-national revenue mobilization

**Over the past two decades national governments and international aid donors have increasingly emphasized the potential development benefits of decentralization in historically highly centralized lower-income countries**. Decentralization promises to bring development efforts closer to citizens, increasing responsiveness to local preferences and providing more direct and immediate channels for building public accountability. Pursued effectively, state building and accountability at the local level can form an important foundation for similar governance improvements at the national level.

**However, the promised benefits of decentralization are critically dependent on the ability of subnational governments to raise own source local revenues**. Without being able to raise local tax revenue effectively the decision-making autonomy of sub-national governments is limited, weakening the link between local preferences and local development efforts. In turn, when local governments do not raise taxes from local citizens incentives for strengthening local state capacity are more limited, and citizens are less likely to be engaged in holding subnational governments to account.

**In practice, while the decentralization of expenditure responsibilities has advanced significantly, the strengthening of sub-national tax collection has progressed extremely slowly.** This has undermined the potential benefits of decentralization, while increasing fiscal stress in low-income states. Across lower-income countries subnational governments remain overwhelmingly dependent on transfers from higher levels of government, undermining their autonomy, increasing budgetary uncertainty and undermining key channels for strengthening broader state building and social contracts. While international discussions have often focused on expanding access to novel sources of financing, like bond markets and public-private partnerships, there is a large body of evidence that these financing sources are likely to remain relatively inaccessible for lower-income countries and sub-national governments, and are not a substitute for effective local taxation.

**The relative weakness of subnational revenue systems has also meant continuing reliance on comparatively regressive and economically inefficient sources of revenue**. Among the most common sources of local tax revenues property taxes tend to be the most progressive, with the bulk of taxes paid by those with more valuable properties. However, property taxes are also comparatively administratively complex, and have often severely underperformed. Where local revenue systems are weak local governments have tended to rely instead on far more regressive sources of revenue, including businesses licenses, market fees, poll taxes and a wider variety of small levies, fees and fines. As a result local revenue systems have not only failed to raise significant revenue, but have also exacerbated inequality.

**In seeking to strengthen local revenue mobilization property taxes are a particularly important and attractive focus for government action.** This reflects five key considerations: (1) Revenue, (2) Equity, (3) Economic efficiency, (4) Strengthening other government functions, and (5) Building effective and accountable local governance.

***Revenue*: While property taxes are the foundation for local government revenues in most higher income countries, they are by far the most underperforming major tax type in lower-income countries, thus offering significant untaped revenue potential.** In higher income countries property taxes frequently provide 2% of GDP, or sometimes more, in revenue, and are the foundation of local government finances. While data for lower income countries is far more incomplete, a growing body of evidence suggests that in most countries recurrent property taxes provide less than 0.2% of GDP. The relative underperformance of property tax collection in lower-income countries is much greater than for any other major tax type.

***Equity*: Strengthening property taxes has the potential to significantly improve the progressivity and equity of local government tax systems**. Property taxes are most commonly levied as a fixed percentage of the value of properties. When they are well administered the majority of taxes are paid by the wealthiest taxpayers, making them relatively progressive. By contrast, the most important alternative sources of local revenue - including business licenses, market fees, local poll taxes and other types of levies and fees - tend to be heavily regressive because they are not directly linked to income or wealth. Unfortunately, the potential progressivity of property taxes has often been undermined by ineffective administration, making investment in more effective administration critical to realizing improved outcomes.

***Economic Efficiency*: Taxes on property have long been a favorite of economists owing to their economic efficiency,** as they are levied on immovable property and thus do not distort key economic decisions related to work and investment to the same degree as other key tax types. Indeed, property taxes may increase economic efficiency by encouraging more efficient use of land, and reducing incentives for speculation in property markets. Thisstands in sharp contrast to other source of local revenue, which are often highly distortionary.

***Strengthening other government functions*: While property taxes are critical to raising revenue, they also have the potential to contribute to strengthening a variety of other critical government functions.**  At a macro level, there is a well-established historical literature showing that investments in strengthening tax administration can catalyze broader improvements in the quality of public administration. At a micro level, the data that is collected in the process of property taxation can be a valuable input for strengthening urban planning, national land administration, national revenue collection and other government functions.

***Building effective and accountable local governance*: Property taxes hold the potential to contribute to the strengthening of the social contract between citizens and governments.** There is a large body of evidence that the expansion of taxation can be a catalyst for processes of “tax bargaining”, through which citizens demand reciprocal benefits in return for tax payments, thus progressively deepening local social contracts. Property taxes are a particularly good candidate to drive such processes because they are highly visible to taxpayers, while their collection at the sub-national level allows for direct and highly visible links between revenue collection and local service delivery.

# Emerging Lessons for Strengthening Property Tax Systems

**While property taxes hold enormous potential to expand local revenue collection, increase equity, support local economic development and strengthen processes of state building, that potential has rarely been realized in practice**. Instead, systems have fallen short of their revenue potential, systems have been plagued by inequity and corruption, and public trust has remained limited. This has reflected, among others, weak identification of properties, highly ineffective property valuation, manual administrative systems plagued by corruption, weak collaboration across government agencies and, perhaps above all, weak public trust and political support for reform.

**Recent years have, however, yielded a much clearer understand of the reason for underperformance – and spurred the emergence of novel reform models better suited to the distinct contexts of lower income countries**. These insights and new models have expanded opportunities for rapidly improving performance. This has been reflected in a number of ref0orm success stories built upon a focus on simplified mapping and valuation, locally appropriate IT systems and investments in building public trust and support.

**In Freetown, Sierra Leone, a novel reform program launched in 2019, and deployed in 2020, is illustrative of the potential for rapid transformation**. A “property tax first” approach to mapping, coupled with the adoption of a simplified “points based” valuation approach, led to a five-fold increase in revenue potential. That increase reflected major improvements in equity, with greater transparency and simplicity leading to large increases in the assessed value of the most valuable properties, while leaving tax bills for the majority relatively unchanged. Those improvements in the system were then reflected in outcomes: revenue collection tripled in the first year of deployment, while the government introduced a process of local participatory budgeting to build public trust and sustainable support for reform. The same reform model has now been successfully implemented in multiple cities in Sierra Leone, in Kananga in the Democratic Republic of the Congo and is being piloted, planned or discussed across a much wider range of countries.

**What follows outlines five key areas in which property tax systems have historically underperformed, along with recent lessons about how outcomes can be improved.**

## Strengthening Property Identification

**The foundation for effective property taxation is a comprehensive register of taxable properties, but in practice property tax registers are often highly incomplete in lower-income countries**. It is not unusual to find that only about half, or even less, of properties in a given jurisdiction are registered for taxation, including often significant gaps in registering relatively valuable properties. This not only undermines revenue collection, but entails major inequities as some properties are asked to pay while neighboring properties are excluded from taxation.

**The weakness of property registration often reflects the fact that legal frameworks require properties to be legally registered and titled before they are eligible for property taxation.** Property registration and legal titling are often lengthy and costly processes, leading to significant challenges with ensuring completeness and regular updating. However, even where the law allows greater flexibility in registering properties for property taxation, prior to legal titling, gaps in registration are common. This reflects weak collaboration across government agencies, limited technical capacity for effective property mapping and political opposition to more comprehensive property tax registers.

**Recent research and reform experience have highlighted the potential to rapidly and comprehensively improve outcomes through three key strategies: relying on GIS tools to map all properties in a jurisdiction, relaxing the requirement that properties have legal title before registration for taxation, and empowering local authorities to play a larger role in the process.**

**The starting point for most successful reform programs has been the deployment of GIS tools to improve the comprehensiveness of property maps**. The availability of low cost but high quality satellite imagery – or, where available, even higher quality drone imagery – has made it relatively low cost to map every built property within a given jurisdiction. While mapping parcels of land is somewhat more complex, more rapid approaches to mapping land by combining physical indicators and community consultation have become increasingly common and effective. The end result is that building comprehensive register of all properties in a jurisdiction is now comparatively simple in technical terms.

**The second key innovation has been to relax the requirement that properties be legally registered before being able to be taxed, while empowering tax authorities to map properties.** This has allowed for a shift from “cadaster first” to “property tax first” approaches to property taxation and land administration, with mapping for tax purposes sometimes preceding formal land titling. That approach is made possible by the fact that properties are immovable, and can thus be successfully taxed even where legal owners are not initially know. By allowing all properties to be quickly incorporated into the tax system this approach has increased revenue potential, ensured equity and facilitated regular updating of data by local authorities.

## Property Valuation

**The most striking weakness of many property tax systems lies in property valuations that are often incomplete, inaccurate or severely out of date**. Most low-income countries have historically relied upon systems of expert valuation, in which professional valuers visit every property in a jurisdiction. However, that approach is costly and time-consuming, compounded by the existence of only small numbers of certified valuers in many countries. In turn, the relatively subjective nature of expert valuations, and difficulty of verification, increases risks of collusion and corruption. Despite those challenges systems have proven difficult to reform owing to entrenched opposition from those invested in existing systems.

**Recent research and reform experience has, however, clearly demonstrated the potential offered by the adoption of simplified models of computer assisted mass appraisal (CAMA) to lower costs of valuation while increasing consistency and transparency.** Those systems – often referred to as “point based systems” – rely on building simple formulas to produce estimates of property value based on readily observable information about property size, location, key construction characteristics and access to local services. These simplified systems dramatically reduce cost and timelines for valuation, as they only require collection of simple and easily observable data, while dramatically increasing transparency – and thus building trust and reducing the scope for corruption. There is now growing agreement across countries about the need to pivot toward CAMA approaches, and a growing body of evidence in favor of highly simplified CAMA approaches in lower-income countries.

## IT Systems

**While there has been major investment in recent decades in introducing new IT systems to support national tax administrations, the adoption of effective IT systems for property tax administration has been comparatively rare.** Even where property taxes are administered by national revenue authorities IT tools to support property tax administration have often been comparatively limited. Meanwhile, where local governments have adopted new IT tools evidence suggests that they have often been highly imperfect, owing to inadequate functionality, a lack of technical robustness, inadequate technical support or a poor fit between the complexity of those systems and the needs and capacities of local councils. The relative lack of digitalization of property tax administration has hindered effective property mapping and valuation, created challenges in managing existing data, and limited the use of IT tools to facilitate engagement with taxpayers.

**While digitization remains a challenge, recent years have seen important successes where government have adopted locally appropriate, fit for purpose, solutions.** At the core of several such successes has been the adoption of flexible, modular, open platform systems that seek to minimize costs, maximize flexibility and ensure sustainability. Focusing on core functionality and simple workflows has ensured affordability and usability in lower-capacity environments. Modularity allows for easy customization to distinct contexts and updating over time. While adopting an open platform approach has ensured flexibility for governments by guarding against vendor lock-in. The adoption of such affordable and flexible systems has been key to recent reform successes, and popularizing those successful options can help future reformers to achieve improved outcomes.

## Intergovernmental cooperation

**Underpinning some of the challenges of effective property tax administration have been challenges in operationalizing effective intergovernmental cooperation.** Most property tax systems rely on national land agencies for the mapping and registration of properties, valuation is often controlled or tightly regulated by central governments and in some systems billing and collection of property taxes is managed by Ministries of Finance. Thes kinds of arrangements rely on highly effective inter-institutional cooperation, but in practice that cooperation often proves challenging owing to misaligned incentives, limited systems integration and interinstitutional rivalries. The absence of effective collaboration has, in turn, exacerbated challenges with property mapping, property valuation and effective billing and payments.

**A growing body of research and practical experience has highlighted the potential to significantly improve outcomes through institutional reforms that reduce bottlenecks and create clearer incentives for reform by empowering local authorities**. It has, in particular, stressed the value of empowering local authorities to exercise greater leadership in identifying properties, initiating new valuation exercises and pursuing compliance strategies with taxpayers. That reflects that fact that local governments often face the strongest incentives for improving outcomes, and by virtue of being close to their communities are well placed to guide key data collection and updating.

**That said, the best outcomes are likely to arise from close, but more balanced, collaboration across levels of government.** Local governments often lack the technical capacity and expertise needed to manage these processes alone. As such, empowering local governments to take initiative, and giving them greater flexibility, is most likely to be successful when paired with strong technical support, and effective coordination across local governments, by central government agencies. In turn, effective inter-institutional cooperation can enable positive spillovers from property tax reform in strengthening land administration, urban planning, national revenue collection and other functions.

## Political support for reform

**Finally, there is a growing body of evidence illustrating that political opposition is often the key underlying barrier to effective property tax reform**. Property taxes are extremely visible to taxpayers, which can prompt significant opposition - particularly from large, wealthy and politically connected taxpayers. In turn, reform has often faced two additional sources of resistance. First, competition between central and local governments for revenue has often led central governments to de-prioritize, or even undermine, reform. Second, front line administrators engaged in collusion and corruption, as well as their allies at higher levels of government, have often opposed reform programs seeking to expand transparency and reduce the scope for informality.

**However, recent reforms have made clear that property tax reform can be politically popular, and sustainable, where taxpayers believe that tax systems are fair and deliver public benefits**. Adopting simplified approaches to mapping and valuation, as described here, can build public trust in the fairness of property tax systems, particularly when paired with significant transparency. In turn, governments can build public trust by taking steps to highlight clear links between new property tax revenues and public expenditures, be that through budgetary transparency, earmarking or participatory budgeting. Where governments can build that base of popular support they are, in turn, better placed confront entrenched sources of opposition, including by building strategies to secure central government support and to win over resistant administrators. One such strategy has been the use of pilot projects to demonstrate the cost effectiveness, fairness and transparency of simplified administrative approaches.

# Supporting successful reform

**While the potential of property taxes to spur development has long been understood, there is now clear evidence of the potential to rapidly transform the performance of property tax systems in lower-income countries**. Recent success stories have relied upon adopting more locally appropriate technical approaches to reform, simplifying and strengthening inter-institutional cooperation and building public trust. However, despite vast potential reform successes have remained limited.

**One barrier to successful reform has been the continued dominance of outdated approaches to reform, poorly suited to contexts of limited resources and capacity.** Fortunately, the past decade has seen major advances in our understanding of how to design effective property tax reforms even in challenging contexts. That said, there remains a need for more careful diagnostic work to identify bottlenecks in existing systems, and tailor reform to local contexts.

**A second barrier to reform, which has been more difficult to change, has been rigid national legal frameworks for reform, which have prevented or slowed the adoption of more flexible, lower cost and transparent approaches.** In many countries national legislation limits the ability of local governments to map and register properties in the absence of national property numbers or legal title, limits the use of simplified valuation approaches or otherwise restricts local government action to increase revenue mobilization (e.g. restrictions on enforcement action).

**Finally, reform has been hindered by international support that has been limited, fragmented and sometimes overly focused on relatively costly technical approaches.** Illustratively, one off investments in new mapping – often using unnecessarily costly technology – or in conducting costly new valuation exercises can appear valuable in the short term. However, those interventions present challenges of sustainability and have rarely generated significant gains unless paired with complementary, and more holistic, reform measures.

**Reflecting these continued challenges there is an opportunity to advance reform by giving a more central place to subnational revenue raising in the financing for development program moving forward.** This could include:

* **A commitment by multilateral institutions to strengthen support to efforts to strengthen subnational revenue mobilization, and property taxes in particular**. This would reflect growing evidence of the importance of sub-national revenue raising, its severe underperformance, and recent evidence of the potential for successful reform. To be most effective that commitment would include (a) drawing on new and locally appropriate models for reform and (b) strengthening coordination across donors - and between programs focused on subnational revenues mobilization and land administration.
* **A commitment by “donor countries” to expand support for sub-national revenue raising reform**. That should include a focus on medium term support that emphasizes sustainability, transparency and efforts to strengthen local social contracts, as recent successes have highlighted the limitations of one-off investments and the need for clear strategies for sustainable change.
* **A commitment by “partners countries” at national level to expand their support for strengthening sub-national revenue mobilization**. The key to such support is a commitment to reviewing often overly restrictive legal frameworks, in order to remove barriers to the adoption of successful reform models, while strengthening collaboration with sub-national authorities in implementing reform.
* **A collective commitment to strengthening international programs aiming to generate comparative knowledge, learning and tools to support locally appropriate approaches to sub-national revenue reform**. International and national expertise related to property tax reform has historically been limited: the pool of international and national experts is relatively small, research into successful reform models limited, and technical resources to support reformers similarly limited. This stands in contrast to the large pool of research, experts and resources dedicated to supporting national tax reform efforts, and adjacent fields like land administration. These is an opportunity to expand resources for supporting property tax reform.
* **A collective commitment to strengthen available IT resources to support effective administration**. Effective property tax administration requires solid IT systems, but local governments – and even national agencies supporting them – often lack the capacity and resources to procure or develop appropriate systems. There is a clear opportunity to invest in the developing IT platforms that are built on open-source or open-platform principles, interface easily with other government systems and digital public infrastructure, have clear plans for sustainability and which could be scaled across government and localities.

**A key attractions of property tax reform is that it follows a relatively standard administrative cycle, with clear and measurable indicators of success, which can allow for clear monitoring and assessment of impacts**. While cross-country data on property tax collection remains very limited, at the subnational level it is possible to track the coverage of property tax registers, to assess the accuracy of valuation efforts and to gain a fine-grained understanding of compliance. Property taxation similarly lends itself to close and direct linking of new revenues to new public spending, ensuring that investments in strengthening tax system are translated into broader public benefits. This make strengthening property taxes an attractive target for expanded international and national support under the financing for development agenda.