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REAPPRAISING URBAN LAND TAX EFFECTIVENESS AGAINST POLICY GOALS

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REAPPRAISING URBAN LAND TAX EFFECTIVENESS
AGAINST POLICY GOAL

BY

Orville F. Grimes, Jr. *

Land taxation in urban areas is an idea whose time has been coming for more than sixty years. That is a long time to recognize the benefits of taxing land more heavily than other factors of production, and the equity of capturing betterment, for so few tangible results. Isolating reasons for this apparent anomaly is a difficult task, one whose magnitude is increased by the tremendous variety of economic and social contexts within which land taxes have been applied. Even so, a rough but reasonably firm generalization seems possible. In the experience of most countries or municipalities, taxation of urban land value increments has been less of a failure absolutely than relative to the efficiency and equity goals it was designed to achieve -- goals that have often been unrealistic and overambitious. At the same time, the practical difficulties of tax collection and administration and the potency of political opposition to taxing land have been underestimated.

The theme of this paper is one of (very) cautious optimism that urban land taxation is now beginning to come into its own. The process has been slow and iterative. Urban land taxation remains more as potential than reality. Yet the advantages and the variety of taxes on urban land are increasingly being recognized, particularly in the developing world. Tax tools are being sharpened, in Taiwan, France, Korea, Sweden, Colombia and elsewhere. More importantly, experience has taught that land taxes are rarely if ever effective when used alone. They are increasingly viewed as part of an integrated approach to urban land development, in which improvements in urban land use occur through fiscal tools applied in combination with public acquisition of parcels in advance of need, pre-emption, land reserves and preservation of open spaces.

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INSTRUMENTS

The rationale for taxing urban land increments is well established.^{1/} It consists of three main components: (1) A tax on land does not affect the cost of holding land relative to the cost of developing or selling it, and so will not alter production decisions at the margin; (2) land as a physically fixed factor will not "leave town" no matter how heavily taxed; and (3) Against a backdrop of sustained land price inflation in both developed and developing country cities, governments are missing an opportunity in not capturing more socially earned incremental value for their own use. Fiscal instruments at the disposal of governments include (a) land value increment taxes; (b) betterment levies; (c) taxes on speculative gains from the sale of land; and (d) improvement charges. This paper will briefly review these instruments and discuss their effectiveness in the light of alternative policy goals. Implications of land taxation for urban project design will be examined in a concluding section.

Land Value Increment Taxes

Attempts are legion to capture for use by local governments and other public bodies the increment in land price arising from general inflationary forces, decisions of private firms having external effects on the taxable parcel, and actions of the public authorities themselves, either by direct investment or by planning decisions. Since, in Harriss' apt phrase, the development value of a parcel is "the worth of a planning permission," public authorities have long felt justified in removing at least a part of this increase through taxation.

Important questions arise in the application of land increment taxation. First, few would disagree that the tax should be levied on unrealized as well as realized gains. Land increment taxation may occur at the time of sale (as in much of Latin America, India, Korea, Indonesia and Israel) or periodically though the parcel has not changed hands (as in Denmark, Italy and the United Kingdom). In general, though, Ministries of Finance must be satisfied with taxation of realized gains, since it is rarely worth the cost of reassessment to determine imputed values at intervals short enough to capture significant increments.

- ^{1/} Since this paper focuses primarily on land value taxation, no attempt will be made to describe the workings of the orthodox property tax (on land and buildings) or to examine the effects of switching from a property tax to a tax on land alone. This subject has been extensively treated in Hicks (7). For the same reason I abstract from the question of the appropriate tax base -- annual vs. capital value -- and related issues.
- 2/ C. Lowell Harriss, "Land Value Increment Taxation: Demise of the British Betterment Levy," National Tax Journal, XXV (December 1972), p. 568.

A case can be made that land value increment taxation should be progressive. The Land Value Increment Tax (LVIT) of Taiwan, for example, one of the most successful, has rates of 20 percent of land price increment if the increment is less than 100 percent of the parcel's previous value; 40 percent on the increment between 100 and 200 percent; 60 percent on the increment between 200 and 300 percent; and 80 percent on all increments over 300 percent of the parcel's previous value. The recent experience of Taiwan as a whole and of Taipei shows that about 54 percent of total LVIT collections were obtained from the 1/80 percent bracket, with another 24 percent from the 60 percent bracket.^{1/} An important unresolved issue is whether progressive land increment taxation encourages parcellization of holdings. In the presence of progressive rates, households have an incentive to divide their holdings among relatives or friends and pay in the lowest bracket on each. This has usually not proved much of a problem in practice, however, first because title registration is long and time consuming, and second because decisions about whether to build, improve or sell are more difficult for the landowner to make and enforce if nominal ownership is dispersed, even among members of his immediate family.

Betterment Levies

Since 1427, when Great Britain authorized charges to appropriate the increase in land value brought about by street widening, sewer extensions and other public investments, the return on land attributable to community investment has been regarded as a collective good. Britain's experience with capturing betterment in modern times provides valuable lessons of procedure and technique.^{2/} A development charge instituted in 1947 attempted to capture all of the "development value" of land, the difference between value in current use and value in the future, more productive use (adjusted for costs including risk) that planning permission made possible. The experience was largely a failure because landowners refused to sell at a price which did not reflect their anticipation of the future net worth of the land. With a 100 percent development charge, the effective supply of land for urban development dried up. The 1967 Land Commission levy, with a rate of 40 percent, was more successful in avoiding these "lock-in" effects.

^{1/} Department of Taxation, Ministry of Finance. Data pertain to 1972.

^{2/} Betterment is "any increase in the value of land (including the buildings thereon) arising from central or local government action...(and) enhancement in the value of property arising from general community influences, such as the growth of urban populations." Final Report of the Expert Committee on Compensation and Betterment, London, 1942, paragraphs 260 and 276. For completeness, explicit mention might be made of the fact that actions of private households and firms on other parcels might also affect the parcel in question, and so should be included in a definition of betterment.

These and other experiences seem to have produced a consensus that the optimal rate of betterment collection may be around half that to which society is theoretically entitled. The feasible rate is often somewhat lower. In Taiwan, pure betterment levies, called "construction benefit charges," are often reduced from recommended levels of 50 to 70 percent to 30 or 40 percent through constituent pressures operating through the Taipei Municipal Assembly. In Australia, where land increment taxation has long been in operation, betterment levies were introduced in New South Wales in 1945 and 1970. The first, at 80 percent, was never applied largely because the Valuer-General could not determine that the granting of planning permission or other overt public action was in fact the cause of land price increases.^{1/} The second applied specifically to land of "intermediate" worth -- neither urbanized nor rural -- at 30 percent, a rate certainly lower than the revenue-maximizing rate but potentially high enough to influence land use in the desired directions. The Calcutta Improvement Trust levies a betterment tax of 50 percent of the annual value increment chiefly on road improvements such as widening.^{2/} Unfortunately, little reliable information on the performance of this tax seems to be available.

The ultimate incidence of a betterment levy is bound up with its effects on the quantity supplied of urban land. If landowners had well formed expectations that the tax would be permanent, the burden is likely to fall entirely on the seller. On the other hand, there are two situations where part of the tax might well be passed on to purchasers of developed land. The first occurs when there are widespread expectations that the betterment levy will be repealed (as in Great Britain in 1949-50 and 1968-69) and thus that land prices will be able to resume their unfettered growth. The incentive to delay selling produces a leftward shift of the supply curve. In the second situation, a tax is levied when the land is actually developed instead of when planning permission is granted. In this case the landowner can defer development until the rise in the price of his property compensates for his tax liability.

Taxes on Speculative Gains from Land Sales

Perhaps because land speculation is difficult to define, it is often treated as an unmitigated evil to be eliminated through heavy taxation or other means. This approach seems shortsighted. Just as speculators in wheat avert astronomical prices and perhaps famine next year by buying wheat this year and releasing it slowly, speculators in land can help ensure that land develops at an optimal rate over time. In a risk-averse world,

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- ^{1/} E. Hort, in Introduction to Land Development: Contribution Law and Practice in New South Wales, 1972. I am indebted to Donald G. Hagman for material on the New South Wales experience. It is worth noting that difficulties arose from the separation of value increments on land and not, as many had feared, from assessing land value and building value separately.
- ^{2/} For a perceptive overview of urban land policies in India, see Rakesh Mohan, "Indian Thinking and Practice with Urban Property Taxation and Land Policies: A Critical View," Princeton University, March 1974.

as long as there is uncertainty about what the future price of land will be, someone deserves a payment for bearing the risk that not all land will appreciate in value to the expected degree. A land tax should not eliminate speculation but reduce it to socially acceptable levels. What these levels are is largely a political decision that each municipality or central government must make.

Most taxes on speculative gains from the sale of land define speculation in terms of the time period between sales, and are not concerned about establishing intent. A high or even confiscatory rate applies on gains from the sale of land held less than 2 to 7 years in most cases. In the 1963 French tax reforms, gains from the sale of buildable land held less than 5 years are treated as a form of "commercial and industrial profits," and are thus subject to individual income taxation. In India, gains are similarly added to income and taxed at the ordinary income tax rates. On land held less than 2 years, all of the capital gain is added to income, while on land held 2 years or longer 65 percent of the gain is added to income. Prior to 1967, Swedish capital gains from land transfers were taxed in full on land held less than 7 years, were not taxed at all on land held 10 years or more, and were taxed at 75, 50 and 25 percent on land held less than 8, 9 and 10 years respectively. The current system makes the long term withholding of land more costly. Gains from the sale of land held less than 2 years are taxed in full, while land held longer than 2 years is taxed at 75 percent. This system seems to have fewer undesired effects on the supply of urban land than when the high tax rate period is longer. With the French tax, many landowners simply waited out the 5 year period before selling on the basis of a long term gain.

Improvement Charges

Improvement charges, as distinct from betterment levies, aim to recover for the public authorities the cost of publicly supplied improvements. There is little concern about the relation between these costs and the aggregate benefits to landowners. They may also encourage private improvements on vacant land. From the wide variety of taxes and charges which fall into this category, three have been singled out for special attention: (a) taxes encouraging improvements; (b) equipment charges; and (c) land replotting and readjustment operations.

Taxes encouraging improvements -- These taxes, for control rather than revenue purposes, are used where ordinary land taxation does not adequately punish vacant land relative to developed land. This may occur if, as in India and other countries, properties are assessed on an annual rental value basis and there is thus no hypothetical rent. Taxes encouraging improvements have been poor relations among land taxes, but not because they are inherently unworkable. Rates are generally lower than the opportunity cost of improving the land, i.e., the anticipated gain in market value due to development in the future rather than now. Moreover,

an effective tax encouraging improvements might place significant short term pressure on the building materials and construction labor markets. Assessment problems may also arise. The French variant land tax ("taxe d'urbanisation") instituted by the Land Planning Law of 1967 was never put into practice because no one estimate of market value could be relied upon. Finally, and most important, the tax is neutral with respect to the ultimate use of the land. It encourages all productive uses of land equally. This is why many countries have found it advisable to supplement improvement-encouraging taxes with planning mechanisms to control the timing and direction of development.^{1/}

Equipment Charges -- Despite drawbacks such as problems in apportioning costs and benefits and erosion of the tax base through political compromises, the attractiveness of what might generically be termed "equipment charges" is gaining wider attention. France, for example, has traditionally attempted to recoup the cost of publicly provided infrastructure, principally through direct participation by developers. In the early 1960's a forerunner of the current equipment charge was designed to make property owners share in the cost of public works. Insuperable problems arose in its application, however, and it was never put into effect. The base had been severely restricted by the exemption of businesses and industries. More importantly, local authorities continued to prefer financing their investments through levies on developers. The current infrastructure charge ("taxe locale d'equipement") is levied on the basis of floor area constructed. In widespread use in the late 1960's, the tax is currently less effective because many localities switched back to direct charges on developers beginning in 1971. Equipment charges in France are also levied by a number of public land development agencies. The Etablissement Public Basse-Seine in Rouen, in charge of drawing up and applying land use plans in Upper Normandy, receives two thirds of its revenue from a special charge it is empowered to levy on the owners of properties it improves. The other third is earned from land sales.

Land replotting and readjustment -- Another "self-financing" method of land development gaining attention is the land readjustment scheme, most often associated with Korea and Taiwan. Associations of landowners or the public authorities themselves undertake projects involving land conversions to more productive uses, amalgamation of parcels, and installation of public facilities on land. In Korea, land readjustment schemes have succeeded

^{1/} An interesting variation on this theme is the Land Hoarding Charge advocated by the Conservative government in Great Britain in April 1973. A charge of 30 percent per year would have been levied on properties undeveloped three years or more after having been granted planning permission. The planned impact was of course to increase the supply of serviced sites, although one predictable result would probably have been fewer properties being put up for planning permission. Even before the recent change of government it appeared that the Conservatives would not carry the proposal forward. See "Widening the Choice: the Next Steps in Housing" (Cmd. 530, April 1973).

in developing large sections of Seoul and other principal cities. According to a complicated formula, landowners cede to the city a portion of their property in return for access roads, sewer mains and water and electricity hookups on the remaining portion. As much as 50 percent of the land is retained by the municipality to meet its expenses and to increase the supply of sites on which public facilities are provided. Even so, with land price inflation the aggregate value of all remaining private parcels after completion of the readjustment project is typically greater than the pre-project value of the entire area. Therefore, both the landowners and the government may see themselves as being better off with these projects than without them.

THE PANOPLY OF EXPERIENCE: AN EMERGING SYNTHESIS

Categorizations of land taxes qua instruments would be incomplete without a judgment as to the targets these instruments are designed to reach. At the risk of oversimplification, it may be suggested that land taxes aim to accomplish three major objectives:

- provide revenues for general use by national and especially local governments;
- underwrite the cost of specific public improvements;
- achieve a more equitable distribution of urban real resources.

The redistribution objective is by far the most difficult to evaluate, and the one where the actual and the declared priorities of public authorities may diverge the most. Its impact depends first on whether the percentage of net wealth held in the form of land is large or small. Empirical evidence on this score is very scarce. In developing countries, land holdings may form a significant portion of wealth because of a lack of alternatives. Securities are often uncompetitive with land in embryonic domestic capital markets, and real interest rates on savings deposits are typically low or negative. Korea in January 1974 instituted stiff measures designed to redistribute wealth away from landowners. At the same time as exemptions from property taxation were increased at the low end of the scale, progressively larger rate increases were levied on high valued properties. The increase in the highest bracket was 2500 percent over the previous rate. Whether this will discourage large holdings or simply invite evasion remains to be seen.

Control of land price inflation through capitalization of land tax liabilities is a means of attaining land use objectives, not an objective in itself. For example, the redistribution objective will be furthered by reduced land price inflation if landowners tend to have higher than average incomes and if barriers to entry are eased for low income families establishing themselves in urban areas. Poor families may be able to locate closer to centers of employment and thus to incur smaller outlays for transportation. These impacts are extremely difficult to measure, however; the evidence accumulated so far is notional at best.

Compared with income taxes, excise duties and other fiscal tools, land taxes are meager but not insignificant providers of resources to government. As indicated in Table I below, certain land tax revenues have risen over the past five years both in per capita terms and as fractions of GDP. Except for the Taiwan Land Value Tax, collection elasticities of selected land value taxes are greater than unity, as shown in Table II. All elasticities except the Taipei Land Value Increment Tax were significant at the two-tailed .05 level despite the low number of degrees of freedom.^{1/}

One must nonetheless conclude that revenue performance has not been very impressive. In the recent past only the two land value levies in Taiwan and the land component of the French property tax brought in more than \$1 per person. Development charges per capita in Singapore did increase fivefold from 1967 to 1971, but from a low initial level. Comparisons on a tax effort basis, using total receipts as a percent of GDP at current market prices, demonstrate that only the 1972 Taiwan Land Value Tax accounted for as much as one half of one percent of GDP.^{2/}

This state of affairs would cause more concern if maximization of tax receipts were the sole objective of land value taxation. It is not, of course. As Neutze states, land taxation is one of a series of measures to "prevent the (urban land) market from undermining the objectives of urban planning."^{3/} Betterment levies and land value increment taxes, and all other taxes for that matter, fulfill different and often conflicting objectives at different times. It is often thought desirable for certain

^{1/} It should be noted that these estimates are highly preliminary and must be treated with great caution. They are based on a small number of years and, because of time pressures, have not yet been corrected for price movements. Since land and building prices typically rise more rapidly than wholesale or retail prices in general (particularly in Korea and Taiwan), these estimates would tend to overstate the true elasticities.

^{2/} A more robust data base would have permitted these preliminary comparisons to be adjusted for more influences on fiscal capacity than is possible here. To the extent that development charge and betterment levy receipts can be locationally determined, the pattern of receipts could be related to locational differences in per capita income. Comparisons on a per taxpayer basis would also have been useful.

^{3/} G. M. Neutze, "Policy Instruments in the Urban Land Market Summary Report," paper prepared for the Fifth Meeting of the Urban Environment Sector Group, OECD, November 1973.

Table I. Land Tax Revenues as Fractions of Population and GDP

Tax	Revenue Per Capita (US\$)	Revenue/GDI (Percent) 1/
France, Land tax ("contribution foncière des propriétés non bâties")		
1968	4.28	.168
1973	8.95	.2
Taiwan, Land Value Tax		
1967	0.76	.3
1972	2.16	.5
Taiwan, Land Value Increment Tax		
1967	0.16	.06
1972	1.60	.3
Singapore, Development Charges		
1967	0.17	.03
1971	0.84	.09
Korea, Real Property Speculation Check Tax		
1968	0.005	.003
1973 2/	0.11	.03

1/ GDP at market prices.

2/ Estimate.

Source: Direction Générale des Impôts; Dominique Lewandowski and Pierre Bilger, Note sur la fiscalité foncière. Paris, Ministère de l'Économie et des Finances, 1971; Ministry of Finance.

Table II. Land Tax Collection Elasticities, Selected Countries * rel. to increase

Country and Tax	Constant Term	Collection Elasticity	$\frac{1}{R^2}$
Korea, Property Tax	-16.1 (-7.9)	1.65 (12.1)	.97
Korea, Registration Tax	-13.0 (-4.2)	1.48 (7.2)	.93
Seoul, Property Tax	-13.2 (-4.0)	1.53 (6.3)	.91
Seoul, Registration Tax	-12.2 (-3.6)	1.51 (6.1)	.90
Seoul, All Local Land Taxes	-7.0 (-4.5)	1.19 (10.4)	.96
Seoul, All Land Taxes	-7.6 (-4.6)	1.26 (10.5)	.95
Taiwan, Land Value Tax	2.1 (2.0)	.41 (5.0)	.85
Taiwan, Land Value Increment Tax	-10.2 (-1.9)	1.37 (3.2)	.70
Taipei, Land Value Increment Tax	-4.3 (-1.1)	1.61 (2.6)	.89
France, Land Value Tax ("Contribution foncière des propriétés non bâties")	-6.4 (-15.5)	1.01 (33.5)	.99

* t-values in parentheses below the coefficients

taxes to be economically neutral, raising revenue with a minimum of disturbance to the economy. (The practical reality that no tax has ever been neutral across all marginal allocations in no way suggests that the goal is not worth being reached). At the same time, the tax system as a whole functions as a structure of incentives, encouraging desirable resource allocations and discouraging undesirable ones. This disparity of goals arises often in land taxation. An improvement-encouraging tax clearly tries to reallocate resources by punishing vacant land relative to developed land. Yet a tax on incremental value, if calculated correctly and administered fairly, can remove only the "unearned" increment not due to private production decisions and thus not disturb the marginal investment choice. Similarly, a betterment levy is in part a device to produce revenue for public investment in cases where funds from other sources, in particular the orthodox property tax, may not be found. Yet financing projects through betterment levies can clearly have important allocative effects.

In practice, the justification for taxation of land increments is as much financial and economic as moral. Raising total tax receipts from land can alleviate some of the burden of taxes on capital, stimulating the flow of investment and the development of financial institutions. Moreover, a program of public works financed by betterment levies or equipment charges tends to reduce uncertainty about the pattern of future growth of the metropolitan area. Private investors might be more willing to commit funds to development projects if they know that a certain volume and type of public expenditure will also be undertaken.

When land policy instruments are viewed in the context of alternative objectives, the range of potentially available tools rather suddenly becomes much wider. Traditional approaches emphasized the contrast between market and non-market controls; between measures influencing the decisions of households and firms (taxation, building code restrictions, zoning) and public investments with specific multiplier effects on the urban economy. One analyst speaks of "a market system approach for the private sector and...an urban land policy approach for the public sector." ^{1/} What is emerging in fact is a synthesis in which the urban land market itself is the central variable. Instead of competition between market forces and planning measures, there is a range of public and private decisions affecting the land market and through it the price of land, the distribution of access to urban services among income groups, and the price and availability of housing.

To take one example, until quite recently few urban economists and planners considered that user charges in public services can have

^{1/} R. W. Archer, "Urban Land Policy," in Urban Planning and the Property Market (University College, London, 1971), p. 2.

important impacts on the spatial configuration of urban land use.^{1/} The concentration of values downtown implies that recipients of water, sewerage and drainage installations often pay charges far in excess of the cost of service to them.^{2/} The excess of receipts over average incremental cost of supply could be used to finance extensions of water supply and other services at the periphery.

Admittedly, one must guard against what might be termed the "micro-aggregated" view of urban development, which takes land (or transport or public finance or any other specialization) as the keystone of an urban system. Yet it would be difficult to argue with the breadth of Archer's definition of urban land policy as "the study of all government policies and programmes affecting the development and use of urban land and the process of policy-making." ^{3/}

IMPLICATIONS FOR PROJECT DESIGN: A FINAL NOTE

The foregoing provides a brief typology of urban land control devices, with emphasis on advanced and developing country experience. Another common element, though an obvious one, deserves mention. Land development is typically a discrete process. It tends to be narrowly defined spatially and specific in scope, often radically changing the configuration of the community where it is undertaken. In essence, land development lends itself well to being undertaken on a project basis. The focus of the World Bank and other agencies on the site and services approach to provision of low income housing well illustrates this project approach to the land development process.^{4/}

Consequently, land control instruments must be scrutinized carefully to determine their fit in project contexts. Betterment levies can be used when most or all project benefits are easily measurable and especially when most or all project beneficiaries are readily identifiable. This type of financing is thus best suited to investments in quasi-public goods benefiting particular segments of the population, such as highways, rural feeder roads, sewer systems and street improvements.

^{1/} Notable exceptions are Paul B. Downing, "User Charges and the Development of Urban Land," National Tax Journal, XXVI (December 1973), pp. 631-37, and J. A. Stockfisch, "The Outlook for Fees and Service Charges as a Source of Revenue for State and Local Governments," National Tax Association, Proceedings of Sixtieth Annual Conference, 1967, Columbus, Ohio, 1968, pp. 86-100.

^{2/} This is the case, for example, in Sydney. See R. W. Archer, Site Value Taxation in Central Business District Redevelopment. Urban Land Institute Research Report No. 19, 1972.

^{3/} "Urban Land Policy," p. 2.

^{4/} This section draws on material contained in Part III of my "Urban Land and Public Policy: Social Appropriation of Betterment" (IBRD Working Paper, 1974).

Given the low taxable capacity of cities in developing countries, user fees such as equipment charges are often an attractive and feasible means of project finance. There is consequently the risk that priority will be given to investments in which benefits are localized rather than generalized and the benefits attributable to a small number rather than to the population as a whole. To an extent this is of course true for all development projects, and is one reason why action on projects with significant employment, nutrition and income distribution effects, in which benefits have been more difficult to quantify, has not been as rapid as in other sectors. Nevertheless, availability of finance should not be the overriding factor in the choice of land improvement projects.

In light of these considerations, land taxation financing (through betterment levies, equipment charges and the like) would seem to be appropriate for projects in which:

- a) Benefits are great in relation to costs, to minimize resistance. This is often difficult to achieve since revaluation of properties, usually a necessary component of land taxation finance, can constitute a major portion of total project cost;
- b) Benefit measures account for decreases in land value in areas other than the project site. This "compensation for worsenment" is part of the land use control systems of the Netherlands, Sweden and Taiwan;
- c) Execution of the project and payment of charges to finance the project or to capture benefits are closely associated in time;
- d) Careful scrutiny is undertaken of projects in jurisdictions where evasion of property taxes reduces revenues significantly. These projects may in fact represent a transfer from those who pay for the improvements to those who had previously evaded other taxes.

This list is certainly not exhaustive, but is intended to highlight certain components of project evaluation. Its coverage can be widened and deepened in the course of further research and project experience.

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