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THE CREATION OF FISCAL SPACE FOR THE PROPERTY TAX: THE CASE OF CENTRAL AND EASTERN EUROPE

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ABSTRACT. The case for the property tax as a significant revenue generator has been well made by many eminent scholars in public finance. It nonetheless continues to remain a tax that is under-utilised in many transition countries. The purpose of this paper is to investigate whether there is the fiscal space to develop the property tax within the eight CEE[1] countries that joined the EU in May 2004. Currently, property tax revenues within the selected countries represent approximately 0.5% of GDP, whilst the average for the OECD is just over 1%. This difference in relative importance would appear to suggest that, whilst there is potential for the property tax to create greater revenues, there are structural problems that are preventing this. The paper highlights a number of these problems and suggests mechanisms to address them. It is argued that properly designed, the property tax could crowd out many of the 'nuisance' taxes and fees that already exist within local government.

KEYWORDS: Fiscal space; Property tax; Transition countries; Revenue importance

1. INTRODUCTION

The creation of fiscal space is potentially the main mechanism whereby the relative importance of the property tax could be strengthened. In its broadest sense, fiscal space can be defined as the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government's financial position (Heller, 2005). Usually, the idea is that in creating fiscal space, additional resources can be made available for government spending. The incentive for creating fiscal space is strengthened where the resulting fiscal outlays would boost medium-term growth and perhaps even pay for itself in terms of future fiscal revenue (Chalk and Hemming, 2000). In principle, there are different ways in which a government can create such fiscal space. Additional revenues can be raised through tax measures or by strengthening tax administration. Explicit in the definition is the link to the concept of fiscal sustainability. This relates to the capacity of a government, at least in the future, to finance its desired expenditure

[1] Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia

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programs. For transitional and emerging market countries, the issue of fiscal space arises in the immediate term. There is a pressing need for expenditure today, and the challenge is how to find the resources for its financing.

In spite of many important differences between individual Central and East European countries before 1989, decentralisation reform has been a key political driver in all of the countries. A common feature of almost all transition economies is that they began from a legacy of a highly centralised system of public finances, with local government acting mainly as administrative units with little independent fiscal responsibility (Devas and Delay, 2006; Bird et al., 1995). Decentralisation whilst meeting other laudable objectives such as efficiency in service delivery, local participation, enhancement of local democracy and greater political accountability (OECD, 2002), can at the same time be the tool in assisting the development of fiscal space, particularly, at the local government level. Several key drivers of decentralisation have made it the focus of attention for transition countries (Bahl and Martinez-Vazquez, 2008; Litvak et al., 1998). Firstly, there can be a real demand from the local level for local democratic control and financial autonomy, such as occurred in Central and Eastern Europe from the early 1990s as a reaction against the failures of the centralised state (Dabla-Norris, 2006; Hollis and Plokker, 1995). Secondly, it is generally agreed that decentralisation results in a number of welfare gains (Wetzel and Dunn, 2001). In essence, it is considered that local needs and preferences for public services can be best met by local rather than central government. Thirdly, devolution of expenditures can relieve pressure on the national government budget, indeed, this important trend in municipal finance results in the transfer of financial responsibility from central governments to local governments thereby 'forcing' local governments to deliver and fund an increasing number of services (Swianiewicz, 2003). Finally, as suggested by Bryson and Cornia (2000), decentralisation has been seen as an integral component of tackling many of the challenges facing transition countries including increasing demands on public services, demographic pressures and growing public expectations regarding the quality of services. These can directly contribute to the fiscal need for local government but do not provide for the solution to the fiscal space problem.

Enshrined in local government legislation in most transition countries is the right to have financial autonomy and administrative independence from central control. The right to have 'ownership' of their own tax base has resulted in a consideration of the most appropriate local taxes. Decentralisation thus forms an important component of the development of democracy, as reflected in the *European Charter of Local Self-Government* adopted by the Council of Europe in 1985 (Council of Europe, 1985). The basis for decentralising public tasks and developing local autonomous finance is fundamental, such that 'local government shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers (art. 9.1); and at least a part of their own resources should be derived from local taxes and charges of which, within the limits of the statute, the local authorities shall have the power to determine the tax rate.'

The re-emergence of sub-national local governments has been the inevitable consequence of decentralisation programmes as well as the application of the principle of subsidiarity (Dabla-Norris, 2006). Several of the countries instituted systems of local governance that ensured recognition of the principles of local autonomy (Szalai and Tassonyi, 2004). The challenge for the CEE countries is to find stable structures of government that are both politically acceptable and revenue sufficient so as to be able

to promote efficient and effective provision of services at the local level. In debates about decentralisation, size matters. It matters because of the impact on democratic participation and political accountability, on the one hand, and economies of scale and policy co-ordination, on the other. In the CEE countries, the demand from below to manage affairs locally has resulted in a significant fragmentation of local government. For example, the Czech Republic has some 6,239 municipalities with almost 80% having a population of less than 1,000; Hungary has 3,156 municipalities with some 54% having a population of less than 1,000 (Szalai and Tassonyi, 2004); and for the Slovak Republic the figures are 2,911 with 68% less than 1,000 (McCluskey and Plimmer, 2007; Nam and Parsche, 2001). This potentially achieves the objective of bringing decision-making close to citizens but at a cost, particularly in terms of providing services that have scale economies. It also creates difficulties in terms of logistical capacity in delivering services and in administering own revenue sources (Nam and Parsche, 2001; OECD, 2002).

Therefore, it could be logically argued that programmes of decentralisation and the drive for own tax revenue sources for local government have created the environment for the property tax. The next section of the paper will examine the rationale for the property tax.

2. THE PROPERTY TAX AND ITS ROLE

Restraints imposed by national governments have created the need for own source local taxation for local authorities (OECD, 2002) and a requirement to have some autonomy over local taxes in terms of defining the base and setting the tax rates (Davey and Peteri, 2006). In addition, the political demand for local autonomy coupled with both the European Charter of Local Self-Government (1985) and the fiscal federalism theories should have resulted in a stronger emphasis on local taxing power in the reforms of the early 1990s. However, the reality is that few CEE countries have devolved important taxes to the local level. The level of funding available to local governments is an important determinant of the quantity and quality of services that they will be able to provide. Over the last twenty years, through decentralisation, countries have increased the powers and responsibilities of local governments but they have generally not matched those responsibilities with revenues at the local level, as Bird and Bahl (2008) commented, few countries permit local governments to levy taxes capable of yielding sufficient revenue to meet expanding local needs. However, Bryson et al. (2009) have found that, particularly in the Czech Republic, it is unlawful for central government to devolve expenditure responsibilities without the necessary match funding. Local governments within these CEE countries derive their funding from a variety of sources including shared revenue from personal income tax and corporate income tax, and grants along with a myriad of local fees and taxes and sale of property. Many of the local taxes and fees assigned to local government could really be construed as ‘nuisance’ taxes with low revenue potential and high administrative costs (Dabla-Norria, 2006). Local own revenue sources are often seriously inadequate to finance the responsibilities assigned, while intergovernmental transfers are vulnerable to political manipulation, poorly designed allocation formulae and often come with the usual attached strings (McCluskey and Bevc, 2007). In short, revenues at the municipal level have not kept pace with the increased expenditure requirements (Bird and Slack, 2004; OECD, 2006).

Taxes on land and buildings were introduced or re-introduced within the CEE countries shortly after their various declarations of ‘independence’ (Kelly, 1994). For example, Poland introduced taxes on agricultural and forestry land, urban land and structures in 1985,

whilst for the majority of the other countries it was in the early or mid-1990s (see Appendix 2). However, as Bird and Slack (2008) have found, more recently, many of the transition countries have been revisiting their property taxes with a view to reform. Historically, local governments in these countries tended to levy communal taxes based on property size (rather than value) and on the turnover of and/or employment in local businesses. As these countries entered the global market economy, there was pressure to reduce the huge burden of taxation (national and local) on businesses, to remove the disincentive to employment represented by local payroll taxes, and to lower personal income tax rates. The emergence of property markets offered opportunities to shift to a more realistic and substantial basis for the taxation of property – that is property value, albeit with all the attendant problems of valuation and revaluation (McCluskey and Plimmer, 2007; Malme and Youngman, 2001). The re-establishment of property rights and restitution schemes since the early 1990s have contributed to more liberalised land and property markets (Sulija and Sulija, 2005). Privatisation programmes have largely been completed within all of the countries hence creating an enhanced tax base upon which the property tax can be levied (Malme and Youngman, 2001).

Despite all this, local governments have generally preferred to rely on taxes on businesses, where the main burden of such taxes is borne not by local voters but by 'non-voters' (i.e. businesses) or is 'exported' to those outside the jurisdiction. Thus, in Hungary, business taxes continue to provide 84 per cent of local revenues, compared to 12 per cent from property tax (see Szalai and Tassonyi, 2004). In the Slovak Republic, where property is the only tax available to local government, once controls on property tax rates were liberalised, it has been taxes on business properties that have risen rapidly, rather than taxes on domestic properties (Davey and Peteri, 2006; Bryson and Cornia, 2000).

Personal income tax (whether levied directly by local government or, more commonly, collected by national government and subject to sharing with, or surcharge by, local government) is significant in several OECD countries. Fiscal decentralisation and the drive for a measure of fiscal autonomy by sub-national levels of government within the countries of Central and Eastern Europe (CEE) requires local government to have authority to own-finance locally and at least one significant tax source. The traditional theory of fiscal federalism prescribes a very limited tax base for sub-national government (Oates, 1972). The only "good" tax are said to be those that are easy to administer locally, are imposed mainly on local residents and do not raise any problems of harmonisation or competition between levels of government (Bahl, 1998). The only major revenue source that passes these stringent tests is the property tax. This to a large extent has created an opportunity for the imposition of property taxes. But the question that needs to be considered is whether the fiscal space has been created for the property tax?

Real property taxes are often cited as "good" candidates for independent subnational administration, in fact, the property tax is considered almost as the "perfect" tax. It provides a predictable and durable revenue source for local budgets; fosters local autonomy and provides a fiscal mechanism for decentralization (Bird and Bahl, 2008). Indeed, few fiscally significant taxes are more susceptible to local administration than the property tax (Bird and Slack, 2004; Mikesell, 2003). The immovability of the tax base makes clear which government is entitled to the tax revenue. The tax captures for local government some of the increases in the value of land that are partially created by public expenditures. As McCluskey (1999) points out, real property is visible, immobile, and a clear indicator of one form of wealth. The property tax is especially attractive when compared with other potential sources of local

taxes (Bird and Bahl, 2008). The property tax is thus difficult to avoid and if well administered can represent a non-distortionary and highly efficient fiscal tool.

It has often been argued that the fundamental weakness of the property tax is its administration (Bahl and Martinez-Vazquez, 2008). If the administration is inefficient either by design or default unfairness and inequities can result. The key administrative tasks of property identification, record keeping, assessment, billing, collection and enforcement are resource intensive in terms of manpower and technical expertise. Creating the baseline data for a value based property tax can be a significant task, and often beyond the scope, ability and capacity of local government. However, there are excellent examples where central government have taken the initiative in developing the necessary legislative and political support required to at least begin the process. For example, in Slovenia (State Surveying and Mapping Authority), Latvia (State Land Service), Lithuania (State Enterprise Centre of Registers) and Estonia (National Land Board) central governments have established the framework in terms of collecting the base property attribute data, collating sales and other property transaction information, developing innovative fiscal cadastres, and building Geographic Information Systems central to managing the layers of relevant property data. However, in Poland, Slovakia, Czech Republic and Hungary this integrated unified approach is yet to be comprehensively developed to the same extent. Therefore, it could be argued that some of the CEE countries are ad valorem ready whilst others still remain in more of a transition stage. Clearly, the role of central government has been fundamental in both supporting the development of the property tax in some instances whilst delaying it in other cases. However, the cost of such systems needs to be viewed not simply as a property tax cost but rather a cost that is defrayed more widely due to the benefits of having a full inventory of the built environment at a national level.

However, except in a small number of countries, notably the United States, United Kingdom, Australia and New Zealand and Canada the tax has not been used to its full potential (Bahl and Martinez-Vazquez, 2008; Mikesell, 2003). This application significantly reduces the contribution that the tax potentially could make to local fiscal autonomy, both in terms of giving local governments a tax whose rate they can control and in terms of giving them a tax that could be locally administered. There are so few fiscally significant taxes that can be satisfactorily applied at the local level.

A stable tax generates revenues that are predictable and relatively inelastic to short term changes of income or other factors. In that sense, land and real property markets reflect long-term asset values, which tend to respond more slowly to the current changes of economic activity. Therefore, the property tax is regarded as relatively steady revenue source when compared to other local tax sources, like income or consumption tax (Mauer and Paugam, 2000).

3. FISCAL SPACE: DOES IT OR CAN IT EXIST?

There is clearly a revenue financing problem for local government within the selected countries. To create the fiscal space for the property tax there would have to be accommodations made within existing national fiscal structures. These structures tend to be dominated by significant tax sharing arrangements (primarily through Income Tax, Corporation Tax and Sales taxes) particularly in Czech Republic, Estonia, Latvia and Slovenia. Several of the countries use a myriad of relatively low revenue taxes (Estonia, Lithuania, Poland and Slovenia), whilst in the Czech Republic, Latvia and the Slovak Republic the property tax tends to be the only local tax. Appendix 1

highlights local government's own revenue sources which are broadly split between taxes, fees and charges. What is evident is the use of a wide range of such fees and charges.

As one might expect tax revenues tend to play a significant role in the local budgets of the Central and East European countries with such revenue contributing approximately 47% of total local government revenue (see Table 1).

However, within OECD countries tax revenue is important but to a lesser extent, representing approximately 42% of total local revenue. Looking specifically at tax revenue, Table 2 shows that for OECD countries the two largest contributing taxes are Income and Corporation tax and the Property tax, representing approximately 38% and 32% respectively. Of more interest is that the property tax as a percentage of local government tax revenue within the eight CEE countries represents approximately 6.2% (see Table 1). Given that the property tax is used in each of the eight countries with all of the revenue being allocated to local government, its level of importance is clearly variable; being, for example, relatively insignificant in Czech Republic, Estonia and Hungary, but slightly more important in Lithuania, Poland, Slovak Republic and Slovenia. To some extent this analysis would support the hypothesis that the property tax is generally under-utilised within the eight countries.

Table 1. Local government revenue sources in the CEE countries

Country	Tax revenue as % of total LG revenue	Property tax as a % of LG tax revenue	Property tax as a % of all LG revenue
Czech Republic	50	2.9	1.4
Estonia	41	14	3.0
Hungary	23	11	2.6
Latvia	72	7.8	3.9
Lithuania	38	12	10.0
Poland	31	30	9.4
Slovak Republic	52	12.9	6.8
Slovenia	70	17.9	12.1
Average	**47.12**	**13.56**	**6.15**

Source: Ministry of Finance, General revenue statistics

Table 2. Tax revenue sources for local government

Country	PIT/CIT	SSC	Payroll	Property tax (other)	Goods/ Serv.	Other	Recurrent PT
Australia	0.00	0.00	0.00	0.00	0.00	0.00	100.00
Austria	29.50	3.90	20.68	6.01	33.52	1.05	5.35
Belgium	68.64	0.29	0.00	0.00	14.09	0.00	16.98
Canada	0.00	0.00	0.00	7.40	2.01	3.12	87.48
Czech Republic	**54.77**	**0.00**	**0.00**	**0.00**	**42.36**	**0.01**	**2.86**
Denmark	93.20	0.00	0.00	0.00	0.08	0.00	6.72
Finland	94.66	0.15	0.00	0.00	0.06	0.00	5.13
France	0.00	0.00	6.62	10.60	16.49	24.59	41.70
Germany	79.52	0.00	0.00	0.00	5.15	0.12	15.21
Greece	0.00	0.00	0.00	21.12	31.94	0.00	46.95
Hungary	**0.03**	**0.00**	**0.23**	**12.05**	**76.61**	**0.00**	**11.09**
Iceland	72.81	0.00	0.00	0.00	12.78	0.06	14.35
Ireland	0.00	0.00	0.00	0.00	0.00	0.00	100.00
Italy	19.92	0.00	0.00	1.75	26.75	39.01	12.57
Japan	51.07	0.00	0.00	1.33	19.87	0.98	26.75
Korea	15.05	0.00	1.36	37.82	20.66	12.13	12.98
Luxembourg	89.89	0.00	0.00	3.18	1.69	0.37	4.87
Mexico	0.00	0.00	0.08	7.65	0.30	79.50	12.47

(Continued)

Country	PIT/CIT	SSC	Payroll	Property tax (other)	Goods/ Serv.	Other	Recurrent PT
(Continued)							
Netherlands	0.00	0.00	0.00	0.00	50.16	0.00	49.84
New Zealand	0.00	0.00	0.00	0.00	9.87	0.00	90.13
Norway	88.67	0.00	0.00	5.47	1.79	0.00	4.07
Poland	**62.40**	**0.00**	**0.00**	**0.63**	**6.73**	**0.00**	**30.23**
Portugal	21.94	0.20	0.00	20.92	29.40	0.52	27.05
Slovak Republic	**72.99**	**0.00**	**0.00**	**0.00**	**14.07**	**0.00**	**12.95**
Spain	19.44	0.00	0.00	8.62	46.38	3.34	22.23
Sweden	100.00	0.00	0.00	0.00	0.00	0.00	0.00
Switzerland	84.38	0.00	0.00	12.82	0.22	0.00	2.58
Turkey	28.92	0.00	0.00	3.57	43.48	14.89	9.14
United Kingdom	0.00	0.00	0.00	0.00	0.00	0.00	100.00
United States	5.96	0.00	0.00	0.02	22.62	0.00	71.40
Average	**38.46**	**0.15**	**0.97**	**5.37**	**17.63**	**5.99**	**31.44**

Source: OECD Revenue statistics, 1965-2007

A generally more informative comparative measure is the property tax expressed as a percentage of GDP. For OECD countries Table 3 shows that the recurrent property tax[2] as a percentage of GDP is approximately 1%; in comparison, with the eight CEE countries the percentage of GDP is 0.57% (see Table 4). One interpretation that could be made is that with greater fiscal decentralisation in the eight countries more emphasis could be placed on the property tax. Bahl and Martinez-Vazquez (2008) contend that greater expenditure at the local level along with improvements in property tax administration could increase the GDP/ property tax ratio.

This relatively low percentage of GDP may be the result of the visibility of the tax, problems with administrative capacity at the local level and the narrowness of the tax bases through wide exemption programmes. In addition, national marginal rates of taxation may be so high that local government are often unwilling to bear the political cost of imposing even higher rates on citizens. The lesson here is that the structure of local revenue tax instruments is not only a local issue but must fit into a well designed and balanced overall tax system.

[2] Figures for the recurrent property tax exclude transaction taxes such as transfer tax, stamp duty, gift tax and inheritance tax which can all be considered as 'property taxes'

Table 3. Property tax as % of GDP for OECD countries, 2006

Country	Property tax as % of GDP
Australia	1.73
Austria	0.27
Belgium	0.46
Canada	3.01
Czech Republic	0.19
Denmark	1.26
Finland	0.09
France	2.47
Germany	0.50
Greece	0.23
Hungary	0.29
Iceland	0.83
Ireland	0.75
Italy	0.92
Japan	2.51
Korea	0.67
Luxembourg	0.09
Mexico	0.17
Netherlands	0.75
New Zealand	2.14
Norway	0.40
Poland	1.31
Portugal	0.68
Slovak Republic	0.61
Spain	0.80
Sweden	0.90
Switzerland	0.21
Turkey	0.24
UK	2.97
USA	2.84
OECD Average	1.01

Source: OECD Revenue statistics, 1965-2007

Table 4. Property tax as % of GDP for CEE Countries, 2006

	Property tax as % of GDP
Czech Republic	0.19
Estonia	0.23
Hungary	0.29
Latvia	0.80
Lithuania	0.40
Poland	1.31
Slovak republic	0.61
Slovenia	0.70
Average	**0.57**

The combination of high levels of shared taxes and transfers reduces the incentive to develop the property tax as a significant revenue source. However, in an environment of ever-increasing pressure on central government to cut taxes, particularly personal income tax there is the pass-on effect of this in reducing grants and percentage share of central taxes to local government. The increasing responsibilities of local government as service providers creates the need for additional resources and not less. This to a large extent can create the fiscal space for the property tax. However, other things have to be taken into consideration such as individual tax capacity, overall level of taxation so that a balance can be achieved between ability to pay and tax necessity.

The contribution of own source revenues as defined by the European Charter (i.e. taxes whose rates are determined by the recipient local governments) to local budgets remains modest throughout CEE countries. The reluctance to introduce municipal taxes is partially explained by the large inter-locality differences in local taxing capacity: due to the inherited significant regional and urban–rural variance in tax base, most of the local governments rely heavily on intergovernmental transfers. Ministries of Finance are reluctant to curtail their monopoly of power over fiscal policy. Local authority associations rarely if ever seek taxing power for their members; their demands focus on increasing shares of nationally determined revenues, an approach which has lower local political costs.

Based on the foregoing analysis the fiscal space for the property tax could be created but this would require a rebalancing of the key revenue sources for local government to emphasise the role of the property tax whilst at the same time de-emphasising the reliance on shared taxes and grants. Notwithstanding this the property tax itself suffers from a number of structural problems that would have to be overcome. The next section of the paper examines a number of these problems.

4. CONSTRAINTS ON THE PROPERTY TAX

Notwithstanding the need for additional revenue sources at the local level and the potential role that the property tax could play, it is clearly evident that there are several constraints on existing property tax structures that prevent them from reaching the potential that many authors suggest it has.

Since their independence many of the CEE countries have been undertaking various reforms of their national and local tax systems partly to give local government a greater degree of local fiscal autonomy. Over reliance on shares of centrally controlled taxes and transfers reduce local autonomy and decision making. Whilst the property tax can be viewed as a potential high revenue generator (as seen in such countries like Australia, Canada, United States and the United Kingdom), it is not sufficiently developed in many of the CEE countries as demonstrated by the earlier analysis. Appendix 2 shows that the majority of property taxes in the eight countries are based on building size or land area. This was largely to reflect the fact that real estate markets had yet to develop any form of maturity at the time when countries were striving to introduce 'property' based taxes. According to Dale et al.

(2007) land and property markets are a complex interaction of political, economic, cultural, social, legal and financial issues that require to be sufficiently developed to give transparency, security and confidence to those participating in the market. Those countries moving from command, centrally organised administrations to market-based economies have had to deal with all of these issues. In the early 1990s area-based property taxes predominated but as a consequence of developing real estate markets and accession to the EU, several of the countries have made progress towards ad valorem based property taxes. Latvia and Lithuania have incorporated market information in the valuation of both land and buildings (Aleksiene and Bagdonavicius, 2008; Tomson, 2005); Hungary and Slovenia are planning to introduce a value-based property tax in 2010 (Jokay, 2007; McCluskey and Bevc, 2007). However, the Czech Republic, Poland and the Slovak Republic, whilst having experimented with *ad valorem* based property taxes, have been somewhat reluctant to make any further progress (see Appendix 2).

It has to be recognized that ad valorem taxes are expensive to create, implement and administer. Therefore, fiscal and non-fiscal benefits need to be reflected in creating an environment where support is mobilised in favour of the property tax. From a fiscal perspective countries such as Estonia, Latvia, Lithuania, Hungary and Slovenia have low property tax revenues but have incurred significant costs in developing ad valorem systems, on the other hand Poland and Slovakia raise greater revenue from simple area based taxes. This dichotomy to some extent can be balanced when non-fiscal benefits are considered such as promoting land use allocation through market forces (Brzeski and Frenzen, 1999).

The choice of tax base can therefore affect the elasticity of property revenues which is a reflection of two elements firstly, growth in the tax base with new properties being added and secondly, growth in the assessed value of the tax base. The tax base multiplied by the tax rate gives a measure of buoyancy or elasticity in terms of the revenue. If constant growth in the tax base is achieved in terms of new properties being added then an *ad valorem* tax can provide buoyancy/elasticity in the tax base through the changes in property values: however, this growth can only be captured at revaluation. If one were to assume regular and frequent revaluations, then the changes in the property market values can be readily captured. For area-based property taxes, the size of property is also a constant and represents essentially zero growth, implying that the only way to achieve revenue buoyancy is to increase the tax rates (Bell et al., 2008). The main problem with area approaches is that they are not sufficiently progressive, nor revenue buoyant (i.e. revenues do not automatically increase with economic growth). As Mauer and Paugam (2000) found, this lack of buoyancy can create significant problems for area-based systems in that tax rates need to be adjusted annually to ensure revenue keeps pace with expenditure requirements. Article 9(4) of the *European Charter of Local Self-Government* asserts that the resources available to local authorities should be of a "sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of carrying out their tasks" In addition, area based taxes tend to over-tax commercial and industrial property whilst under-taxing residential property (Brzeski and Frenzen, 1999). It also fails on land use efficiency arguments as there is no value differentiation of different land uses and different locations (Paugam, 1999).

Notwithstanding the problems of the area basis there are a number of advantages such as simplicity (by basing the tax on the physical size of the land and/or buildings thereby reducing the additional complexity of trying to determine the market value of the land and/

or buildings); predictability (the tax base represents a constant, albeit with some limited growth therefore year-on-year revenue is relatively static); and stability (the tax base does not fluctuate with economic conditions unlike the property market particularly in recessionary times).

Given that property taxes seldom account for more than 20% of local current revenues (Bahl and Martinez-Vazquez, 2008) it cannot easily provide sufficient revenue to finance any significant expansion of local public services. Whilst the fiscal space can be created it is argued that pure area based systems are not designed to fill this space simply because of the revenue buoyancy issue. However, a further problem with many of the property tax systems in the CEE countries is that of having a narrow tax base. Revenue can be adversely affected by erosions of the tax base in terms of excessive reliefs and exemptions (Bird and Smart, 2002). For example, in Lithuania residential properties are exempt (though there are government plans to extend the tax to include residential property). This was the situation in Latvia though the government has now included residential property and apartments in the tax base (from 2010). Many of these countries did not realise that with EU accession came the opportunity for investors from the rest of the EU to purchase real estate particularly residential and apartments. This foreign investment has been significant in many of the capital cities including Prague, Tallinn, Ljubljana and Warsaw. To continue to exempt residential property has proven difficult and as we see the exemption is being removed, albeit very slowly. In the Czech and Slovak Republics, all new dwelling are exempt for a period of 15 years; Poland exempts some potentially valuable real estate assets such as ports and harbours, airports, railways, structures used for the generation and transmission of energy, gas, heat, fuel, and water; sewage systems; water reservoirs and water courses are exempt. Several of the countries (Czech Republic, Lithuania) do not tax government land and buildings, the justification of this could be questioned on the grounds that such property still requires the provision of services that the municipality must pay for. There are currently very real constraints on the property tax in several of the CEE countries. Opportunities are being taken in several of the countries to broaden the tax base which should have a positive revenue effect.

5. CONCLUSIONS

This paper has provided an insight into whether fiscal space can be created within the national tax structures of the 2004 accession CEE countries to allow for the greater functioning and role of the property tax. Based on OECD data the recurrent property tax for these countries represents around 0.5% of GDP, approximately half of the OECD average. Notwithstanding the potential revenue capacity of this tax, it is clearly under-utilised within the CEE countries. The paper has identified that within national tax and revenue structures there is currently little fiscal space available that could be exploited by the property tax. This is largely because local government revenue is characterised by reliance on shared national taxes such as Income and Corporation taxes and Sales taxes and secondly, by intergovernmental transfers from the centre. There would however appear to be a sense that such reliance on these forms of taxation will be difficult in the coming years. In addition, there is evidence of the lack of support for the property tax at the national level. The Czech Republic, Poland and the Slovak Republic have, since the early 1990s, made little progress in reforming existing area based property tax systems. The reasons are multi-faceted but can include the following; lack of a mature property market which creates problems in deriving value based assessments, new taxes tend to be diffi-

cult for politicians to support, high initial costs in developing cadastres that detail parcels and taxpayers, the continued use of high levels of central government grants to local government and the importance to local government of tax sharing. These have created a hiatus in terms of moving the property tax reform agenda forward.

Whilst on the other hand the Baltic countries have made significant progress in moving towards ad valorem based property taxes. The Baltic countries, Hungary and Slovenia have recognised the potential role for the property tax at the municipal level in terms of the need for revenue (Szalai and Tassonyi, 2004). In these cases the major advantage has been that infrastructure development for the tax is a central government function as is its administration whilst revenue is wholly devolved to local government. Both Hungary and Slovenia will, during the course of 2010, introduce long-awaited property tax reforms to adopt value based assessments.

Whilst the revenue from the property tax tends to be allocated to local government in all of the countries, it is only a significant revenue source in a small number. The paper has identified a number of structural problems being faced by the countries, including an inelastic tax base due primarily to the continued use of building and land size, and the use of widespread exemptions, particularly on residential property that effectively narrows the base. However, it should be noted that several of the countries are now beginning to include elements of property value within assessments and the removal of residential exemptions, both of which should improve the potential revenue capacity of the property tax.

Decentralisation and the strive towards local self government with its own autonomous revenue sources will place significant burdens on centrally controlled national taxes. Many would argue that the property tax is a 'good' tax for local government, but it has some fundamental flaws. It can never on its own meet the majority of the expenditure of local government. Therefore, it has to be used in combination with other revenue raising instruments such as fees and charges, transfers and tax sharing arrangements. An analysis of the fiscal statistics from the CEE countries shows that generally there is scope to increase the revenue capacity from the property tax. The potential exists within the CEE countries provided that the fiscal space can be provided. Clearly, the signs are already appearing with declining emphasis on centrally shared taxes and grants, the move towards a more buoyant value based property tax and the growth in importance of the local government sector.

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SANTRAUKA

NEKILNOJAMOJO TURTO MOKESČIO FISKALINĖS ERDVĖS SUKŪRIMAS: CENTRINĖS IR RYTŲ EUROPOS ATVEJIS

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Nekilnojamojo turto mokestis, kaip neišsenkamas pajamų šaltinis, formuojantis valstybės biudžetą, yra įvairiai ištirtas įžymių mokslininkų. Vis dėlto dauguma pereinamojo laikotarpio valstybių šio mokesčio netaiko. Šio straipsnio tikslas – išsiaiškinti, ar aštuoniose Centrinės ir Rytų Europos valstybėse, įstojusiose į Europos Sąjungą 2004 m. gegužės mėnesį, yra pakankamai fiskalinės erdvės nekilnojamojo turto mokesčiui taikyti. Šiuo metu pajamos, gaunamos dėl nekilnojamojo turto mokesčio pasirinktose valstybėse, sudaro 0,5 % BVP, kai EBPO vidurkis viršija 1 %. Sąlyginė šio skirtumo svarba gali reikšti tai, kad kol yra galimybė gauti didesnes pajamas taikant nekilnojamojo turto mokestį, tol egzistuos ir struktūrinių problemų, neleidžiančių pasinaudoti šia galimybe. Darbe nurodomos tokios problemos ir siūlomi jų sprendimo mechanizmai. Pateikiami argumentai, kaip tinkamai apskaičiuotas nekilnojamojo turto mokestis gali pakeisti daugumą „atsibodusių“ mokesčių ir rinkliavų, kurias vis dar taiko vietiniai valdžios organai.

APPENDIX 1. Revenue sources for local government

Country	Own revenue sources		Shared revenue and grants from Central government	Property tax revenue
	Taxes	Other		
Czech Republic	Real estate property tax.	Dog licence; Sale of tobacco and alcoholic products; Advertisements; Entertainment fee; Use of public open space; Waste treatment; Land fill fee.	Personal income tax; Corporate income tax; Value added tax.	National tax but disbursed to local government.
Estonia	Sales tax; Boat tax; Advertisement tax; Road and street closure tax; Motor vehicle tax; Animal tax; Entertainment tax.	Fees charged on recreation; Education; Cultural activities; Public transport.	Personal income tax.	National tax but disbursed to local government.
Hungary	Business turnover tax; Communal tax on individuals; Payroll tax; Land parcel tax; Building tax; Tourism tax.	Water charges; Sewerage treatment; District heating and lighting; Refuse collection.	Personal income tax; Vehicle tax.	Local tax.
Latvia	Real estate tax.	Fees on recreation, tourist accommodation; Public trading; Keeping of animals; Advertisements; Keeping of boats.	Personal income tax; Lottery and gambling tax; Natural resources tax.	National tax but disbursed to local government.
Lithuania	Pollution Tax; Tax on lottery and gambling; Tax on state natural resources; Hunting tax; Land lax; Real estate tax.	Pollution tax; Tax on state natural resources; Income Tax.	Personal income tax.	National tax but disbursed to local government.
Poland	Real estate tax; Agricultural tax; Forestry tax; Motor vehicle tax; Tax on business activity; Inheritance and gift tax.	Fees on markets, health resorts, mines, betterment, planning gains, hunting, sale of spirits, operating nuclear waste deposits.	Personal income tax; Corporate income tax.	Local tax.

(Continued)

Country	Own revenue sources		Shared revenue and grants from Central government	Property tax revenue
	Taxes	Other		
(Continued)				
Slovak Republic	Land tax; Building tax; Flat tax.	A range of fees apply including ownership of dogs; Sale of alcohol and tobacco; Gambling; Advertisements; Recreation and use of open spaces; Waste disposal and pollution.	Personal income tax; Corporate income tax; Road tax.	Local tax.
Slovenia	Real estate tax; Inheritance and gift tax; the Charge for the use of building ground; Gambling tax; Administrative fees; Tourist tax; Communal taxes.	Income from municipal property; Tourist accommodation fee.	Personal income tax.	Local tax.

APPENDIX 2. Details of the property tax in each CEE country

	Name of tax	Year of introduction	Beneficiary of tax revenue	Basis of tax	Comments
Czech Republic	Real estate property tax.	1993	Local government.	Area.	Adjustment coefficients applied to reflect size of municipality. Discussions in 1990s to move to ad valorem but stalled.
Estonia	Land tax.	1993	Local government.	Market value.	Estimates of market value based on value zones.
Hungary	Tax on plots; Tax on buildings.	1991 1991	Local government.	Land tax based on the area. Buildings tax based on the size of the property.	Discussions in 2009 regarding a unified property tax; implementation of ad valorem tax in 2010.

(Continued)

	Name of tax	Year of introduction	Beneficiary of tax revenue	Basis of tax	Comments
(Continued)					
Latvia	Real estate tax.	1997	Local government.	Cadastral value for land based on the analysis of market sales. Use of value zones. Cadastral value of buildings based on value zones.	Base value corrected for location, restrictions, physical condition, size and pollution.
Lithuania	Land tax; Enterprise real estate tax; Real property tax.	1990 1995 2006	Local government.	Market value (buildings). Normative value for land.	Proposals to value land based on market sales evidence.
Poland	Agricultural land tax; Forest land tax; Urban property tax.	1985 1992 1986	Local government.	Area.	Discussions in 1990s to adopt ad valorem tax but no progress made.
Slovak Republic	Real estate tax.	1993	Local government.	Area.	Adjustments to area for location and use. No reforms planned.
Slovenia	Charge for the use of building ground.	1988	Local government.	Area of the land plot. Area of the building.	Area of the building is adjusted with a ‘point’ system. Market value based property tax due for implementation in 2010.