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Institutional Constraints on Property Tax
and semi-autonomous Municipal Tax Agencies in Peru

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Abstract:

Local governments across the world are struggling to raise the revenue to supply and maintain municipal services and to undertake the necessary infrastructure for development.

The property tax is the single most important local tax in developing countries. Internationally, over 130 countries have some form of tax on property, albeit the relative importance varies substantial across countries. Unlike the transfers that to some extent dominate municipal revenues, property tax may promote broader objectives of local accountability and of efficiency linking the provision of municipal services more closely to their financing.

Property tax revenues in Peru are very low due to institutional constraints at the central and local level. Recently introduced legal changes in the Municipal Tax Code are improving the potential property tax revenues but further steps are needed.

Property tax reform in Peru has to been seen for the broader background of a recently initiated decentralization process and a legacy of weak local institutions.

There do exist a couple of innovative examples on how municipalities can increase their own revenues. The creation of semi-autonomous Municipal Tax Agencies (SATs) can be seen as a result of an adaptation process in the 90s to bypass negative impacts created by national policies. This successful experience in the provincial municipalities of Lima, Piura, and Trujillo is now replicated in some municipalities.

Urban financial resources should not been seen as an optional matter, but as an important and urgent development issue.

*“Les institutions communales sont à la liberté ce
que les écoles primaires sont à la science;...
Sans institutions communales une nation peut se donner un gouvernement libre,
mais elle n’a pas l’esprit de la liberté.”*

Alexis de Tocqueville: De la Démocratie en Amérique. Paris 1848.

1. Introduction

Throughout history, cities have been synonymous with modernization, economic development, social progress and cultural innovation. Rapid urbanization seriously challenges the viability and productivity of cities, especially in developing countries. The biggest challenge to municipal governments in Peru and elsewhere is the development and maintenance of urban infrastructure and the provision of urban services.¹ Local governments across the world are struggling to raise the revenue to supply these services and to undertake the necessary infrastructure development. The fiscal gap between financial resources and municipal expenditure needs is widening as urban populations expand (Lohse 2003).

The property tax is the single most important local tax in developing countries. Internationally, over 130 countries have some form of tax on property, albeit the relative importance varies substantial across countries (World Bank 1999). Property taxes are generally used to charge for the generalized benefits of public services provided by local authorities.

The underlying rationale for property tax is to confront taxpayers with the cost of municipal services (Dillinger 1991) they consume in the pursuit of the efficiency objective. Moreover, regarded as a relatively stable revenue source - especially when compared to other potential local tax sources like wage or turnover taxes, property tax is the only direct tax which is paid by a broad sector of the population (even part of the informal sector).²

1 These services differ from country to country and from one local authority to the other but they can be broadly categorized into water provision, solid waste disposal, physical infrastructure provision and maintenance (roads, drainage), sewerage, health facilities, education, etc.

2 Local administration has a better chance of bringing the population into the system than would administration imposed on them from the distant national capital which may help create a compliance tradition (Mikesell 2003).

Peru is a latecomer in the worldwide move towards a more decentralized government, only in 2002 did it start a decentralization process by dismantling the Ministry of the Presidency, elaborating the legal framework, electing regional governments and transferring some projects to the regional and local level. The hyper centralism of the Fujimori regime (1990-2000) was highly adverse and harmful to local institutional development. Followed by a transition government, the new democratic regime up to & from mid 2001 reinstated some of the municipal competences (formerly dismantled by the Fujimori regime³).

In theory a decentralization process requires subnational governments to determine the level of services and to raise a substantial portion of the revenues to pay for them. Strengthening local taxes as a source to fund local spending is a basic tool. Most tax experts suggest therefore a bigger role for the property tax (enhances accountability and democratic control), even if this tax is believed to be unpopular and difficult to reform, (cf. Heady 2002; Shah 1999; or Ahmad et al. 1998). Others assume that the conventional case for property taxes is to some extent flawed and might be linked to the reluctance of central governments to provide subnational governments access to more lucrative sales or income taxes (Bird 2000).

Property tax yields in developing countries are, however, significantly lower than in other more developed countries (some countries can raise substantial revenue from property taxes), in terms of their overall contribution to local budgets, relative to domestic revenues and compared to gross development product. The property tax is yielding on average –unweighted- 4% of tax revenues in OECD countries and 2% for transitional countries.⁴ Concerning Latin America countries the property taxes have been poorly developed and are relative to GDP for 2002 around 0.6% in Argentina, in Brazil 0,47%, 0.6% in Chile, in Columbia 0,71%, 0,13% in Nicaragua, and 0.21% in

3 Throughout the 90s different laws and executive decrees were little by little cutting into the competences and resources of municipalities. Cf. Blume, Ernesto: *La Defensa de la Constitución a través de la Ordenanza Municipal*. In: D'Acevedo, Martín (ed.): *Temas Municipales*, Gazeta Jurídica- CAL, 1998. The mayors of Lima who were opposed to the Fujimori regime were consequentially financially dwarfed. The dependence of municipal governments on national financing was during the Fujimori regime reflected in local election results.

4 UK, USA, Korea and Japan yielding all over 10% of overall tax revenue. In 1965 the average for OECD countries was still 8%, meaning that property tax has declined in relative importance.

Mexico.⁵ The property tax in Peru is with less than 0,2% of GDP, even compared to the Latin American average extremely low.

Property tax in Peru has reintroduced itself since 2002 on the political agenda, exemplified in the “Carta de Intención” to the IMF for the years 2002-2003 which addresses the need to strengthen the property tax system.⁶ The actual finance minister Pedro Pablo Kuczynski is well aware that the local revenue collection has to be improved.⁷ And the policy-based loan DECSAL II (Decentralization and Competitiveness Loan) of the World Bank (cofinanced by the German KfW) is triggering increased property tax revenues for provincial municipalities.

Property tax administration in Peru is shared between central and local government, the first setting rates and valuation, the latter afterwards applying the parameters and collecting the tax. In theory a cooperative division of functions should combine local autonomy and familiarity with local conditions and central technical skills (cf. Mikesell, 2003).⁸

Peru is with an average of GDP of 2100 US \$/per capita a lower middle income country, but poverty is due to a 4 year long recession between 1997- 2001 and the extra costs involved with the transition period after autocratic rule back to the rates of the mid 90s with more than 50% living in poverty and 25% in extreme poverty, poverty is concentrated on the mountain highlands (Sierra) and the Amazonas basin (Selva).

The structure of the 1.824 Peruvian municipalities is characterized by big differences in size, the concentration of economic activity in some of them and a high fiscal heterogeneity.⁹ Noteworthy is the rapid growth of newly created municipalities: besides the municipalities, there are more than 1600 smaller settlements registered

5 Piza, Julio Roberto: Local Taxes: Lessons Learned on the Implementation of Real Property Tax. In: Burki, Shahid Javed et al. (ed.): Annual World Bank Conference on Development in Latin America and the Caribbean 1999.

⁶ http://www.mef.gob.pe/propuesta/ESPEC/cartafmi/CI_FMI2002_2003.pdf (30.1.2005).

⁷ Kuczynski, Pedro Pablo. Interview in RPP, Enfoque de los Sábados, 22/01/05.

⁸ Property tax systems in international comparison are going over the whole range from: a) Central Valuation, Central Collection, b) Central Valuation, Local Collection, c) Local Valuation, Central Collection, d) Local Valuation, Local Collection.

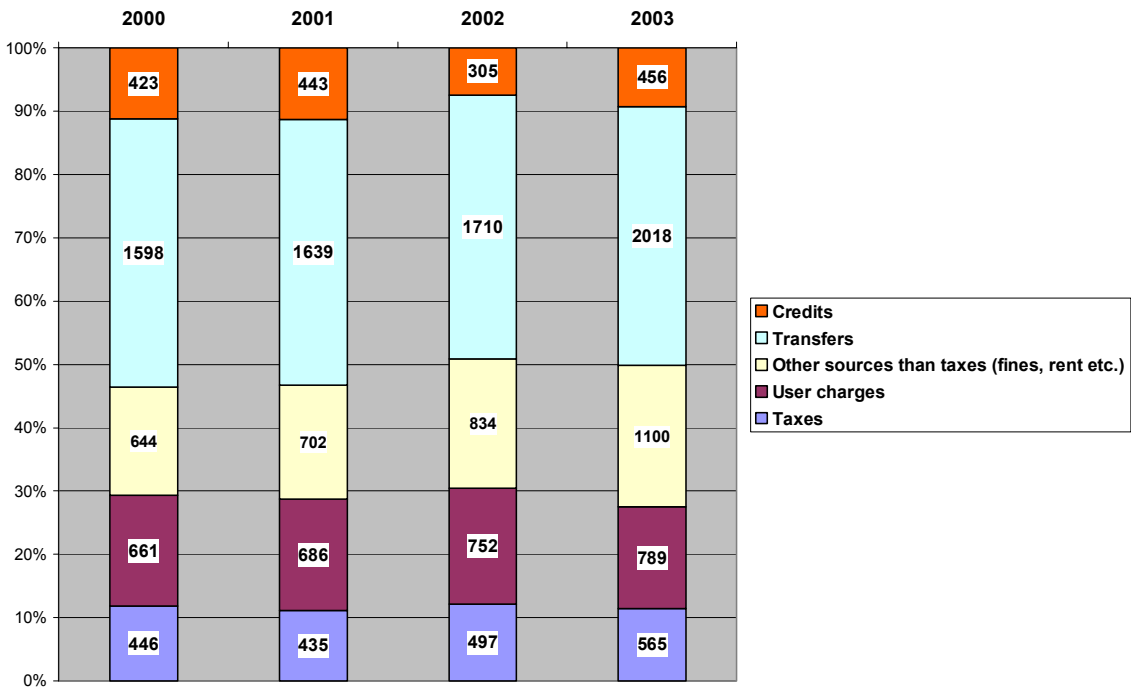
⁹ The Peruvian territory is divided in 25 regions, 194 provinces and as the smallest jurisdiction the districts (provinces and districts are conforming the municipal level).

(centros poblados menores). It is estimated that 72.2% live now in urban areas (INEI 2002).

2. Revenues of Local Governments

The municipalities in Peru can raise taxes on property, on property transaction (the tax is called “alcabala” and consist in 3% of the transaction value), on vehicles no older than three years (taxing 1% of the value, receives the provincial municipality)¹⁰, public gatherings like concerts, movies etc. and gambling. Total revenues for municipalities were 3772 Mill. Soles in 2000 and 4940 Mill. Soles in 2003.

Figure 1: Classification of Revenues of Local Governments (in Mill. Soles)¹¹



Source: Contaduría Pública de la Nación, MEF and SUNAT

It is noteworthy that the revenue from user charges (mostly local security, garbage collection, maintenance of parks) is with 16% (2003) of total revenue higher than that from taxes.¹² About 2/5 of total revenue is coming from transfers (Canon,

10 Which for itself is rather a quite negative incentive, punishing less environmental damaging cars.

11 Statistical data is not available for all local governments, the ratio included is anyway close to/over 90%, apparently the smallest municipalities are confronting problems to transfer data to the Contaduria Pública de la Nación.

12 Perhaps yields are higher because the legal framework provides the local governments with more discretion over the tariffs compared to taxes. The rate of a particular user charge is linked to the valuation of the property

FONCOMUN, tariffs and the earmarked food program (“Vaso de Leche”), without considering the Metropolitan area this ratio is even higher (Carranza/Tuesta 2003). Credit is with 9% if still not substantial but rising (concerning this preoccupation see World Bank 2004).

While the revenues of the local governments during the years 2000 to 2002 were raising on an average rate of 4%, there was a huge increase from 2002 to 2003 having 20,5% more in total revenues: transfers and credit raising over proportional. The revenue out of local taxes was also rising with an impressive 13,5%.

Revenues of local government in Peru did raise due to strong overall growth and the fact that the FONCOMUN is based mainly on a two percent surcharge on the VAT; the other main transfer, the Canon, is also registering highest levels due to the bonanza in the international mineral and hidrocarburate markets. The increase in discretionary budget allocation was somewhat smaller because a big portion of the increased revenues is earmarked.

The revenues out of all tax resources for the Peruvian municipalities are quite low. The Figure N° 1 shows that for the Peruvian municipalities taxes have only a share of about 12% of total revenues. Within the overall tax revenue of local governments, the property tax is by far the most important which is responsible in 2003 for about 66% of all taxes levied; the property transaction tax levies about 10% and the tax on vehicles about 9%. Taxes on public gatherings and gambling make up together 7% (see Figure N° 2).

The property tax is regulated by the Executive Decree N° 776 which came into force in 1994, streamlining the local tax system by eliminating some of the then existing 21 different taxes - some were more costly to administer than the revenue collected. Anyhow, the impact of those legal changes was that urban cities and especially Lima Metropolitan (which was then in the hand of the opposition) were loosing out to the rural areas (Alvarado 1994).

and not by the use/cost of the service provided in the first way. The Constitutional Court was challenging in mid 2004 this practice: municipalities are obliged to take into account cost of services (property valuation might be only one of several parameters).

Total property tax nationwide was rising from 308 Mill. (2001) To 333 Mill. (2002) To 367 Mill. (2003) Soles, about 8% of total municipal revenues.¹³ The property tax collected by all provincial municipalities is together 111,5 Mill. Soles (2003) and of all district municipalities 255 Mill (2003).

Not taken into account the metropolitan area (the two provinces Lima/Callao and 45 districts), the provincial municipalities were able to collect in 2003 only about 78 Mill. Soles and the districts municipalities about 61 Mill. (there are roughly 10 times more districts than provinces) or the equivalent of 38% of the total property tax collected. Even if property tax outside the metropolitan area is not very substantial, it was possible to raise collection from 119 Mill. (2001), 130 Mill. (2002), 139 Mill. (2003) Soles.

The property tax is yielding very little considering that on a vast territory and some 1700 districts and provinces outside of Lima Metropolitan (metropolitan districts and districts of Callao, the harbor) a tax collection of about 139 Mill. Soles (2003), 40 Mill. US \$ is all.

While property tax collection is highly concentrated on the metropolitan area, the picture there is not very favorable as well: the greater metropolitan area of Lima with around 8 Mill. inhabitants were only able to collect in 2003 around 227 Mill. Soles in property tax (ca. 70 Mill US \$).¹⁴

Within the group of district municipalities, 25% are collecting less than 200 Soles/year. Half of the district municipalities have revenues out from property tax that are less than 2000 Soles/year; and 75% raise less than 25.000 Soles/year which is the (monthly!) minimum transferred from the FONCOMUN (National Compensation Fund) to each district.

Within provincial municipalities 50% are collecting less than 55.000 Soles, there are only 12% of the provincial municipalities collecting more than 1 Mill. Soles.

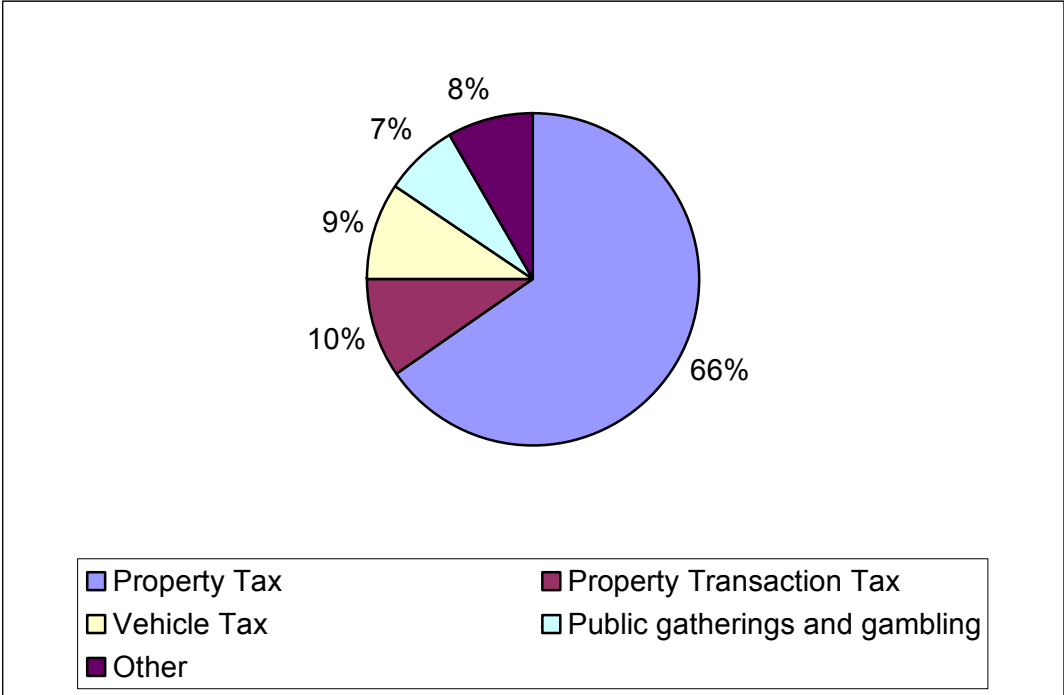
13 From the property transaction tax districts were able in 2003 to levy 32,1 Mill. Soles (without Lima Metropolitan 13,2 Mill.), provinces 23,5 Mill. (without Lima Metropolitan 15,5 Mill.) and from the vehicle tax 53 Mill. (but highly concentrated on the provincial Government of Lima and to a lesser extent Callao, without those two provinces the revenue for the rest of the provinces is only 5,4 Mill.). The property transaction tax is even more concentrated than the property tax (the municipalities which do not have any revenue from this tax is very high). If provinces have an established provincial development fund 50% of the property transaction tax collected by districts should go into this fund, in reality districts do rather seldom comply with this legal obligation.

14 Metropolitan benchmarking would be a helpful exercise.

The data is showing that property tax is highly correlated with urban settlements: while in the case of the biggest municipalities property tax has a rate of total revenues as high as over 20%, this share is reducing the smaller and more rural it gets. Rural municipalities almost have no revenue out of property taxes.

The law 27616 from December 2001 improved the finances of local governments by reinstating the obligation that notaries had to -before registering a transaction of property- make sure that the respective property taxes were paid.¹⁵

Figure N°2: Structure of Tax Revenues of Local Governments (2003)



Source: MEF

3. Property Tax Rates

The identification on taxable properties is based in theory on “self assessment” principles (the so called “autoavalúo principles”) – the taxpayers are legally responsible for providing all relevant data regarding properties - but in practice the municipalities determine the value of a property by using the official index provided nationwide by the “Consejo Nacional de Tasación” (CONATA). The value of a

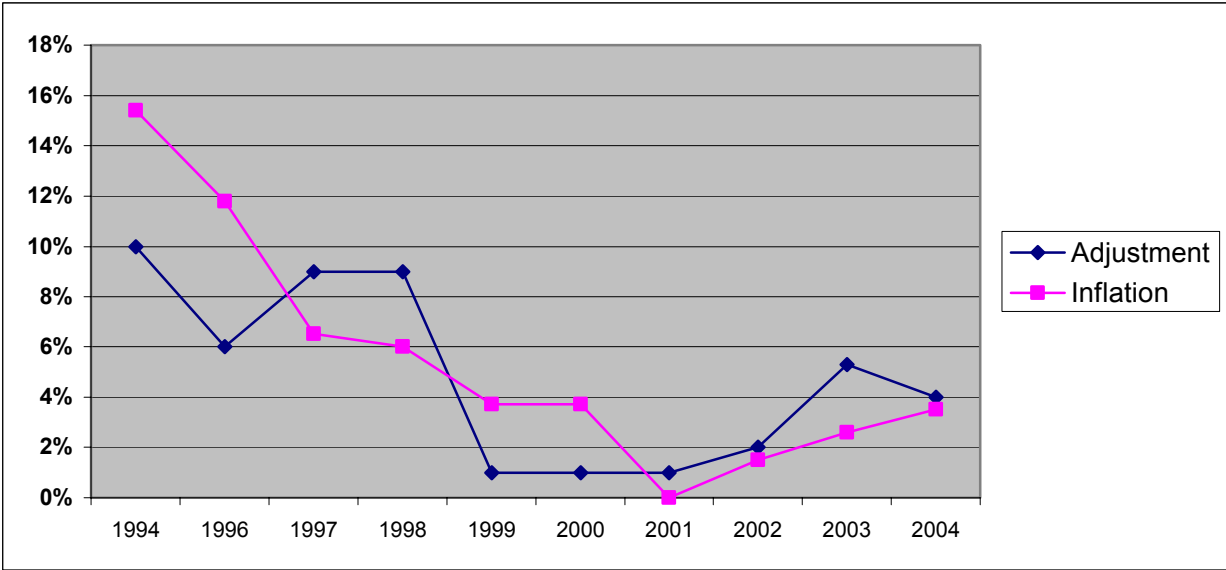
¹⁵ Very favorable was that the property transaction tax was fixed by the same law as the percentage of the value of the commercial transaction and not the mostly lower indexed value of Conata. The property transaction tax is levied in the month after the transaction was legally endorsed, so that the legal changes are highly correlating with higher tax collection. Whereas in 2001 the property transaction tax for the provincial municipalities was around 7 Mill. Soles, this jumped in 2002 and 2003 to three times this level.

property consists of the sum of the value of the land and the building, using a whole set of different parameters (like material of construction, material used for the floors, WC and doors, age of the property, energy and water connection...).¹⁶

CONATA, which is functionally part of the Ministry of Housing (Vivienda) and is operating without deconcentrated offices, is the technical organization to elaborate for the whole country the valuations of buildings and land parcels in the form of an extensive geographical based index (for the urban areas about 1629 square kms are included into this index, 629 square kms alone for Lima/Callao). The budget of CONATA for 2003 was about 4.3 Mill. Soles (3.4 Mill Soles were self collected, having a legally fixed share of 3/1000 of the collected property tax – anyhow, not too many municipalities are complying with this transfer; some municipalities are owing several years, therefore CONATA was looking for extra income by providing services).

In the 90s, CONATA struggled –for the already mentioned political reasons- to keep the index at least even with the inflation (see Figure N°3).

Figure N°3: Average Adjustment of Property Valuation in Comparison to Inflation



Source: CONATA and INEI

Being the main goal of CONATA to increase the rates progressively, there was in 2003 an ill designed attempt to adjust the valuation in a considerably way, meaning for some properties that the tax would have risen by more than 20%. After immense pressure from the media and from organized lobbies, CONATA had to shed away for

16 Other countries were showing favorable results when they introduced a simplified valuation methodology.

a much more moderate increase. Nevertheless, in 2003 the adjustment was not based on a unique rate for all property, in fact the raise was higher for valuable properties, and outside of Lima the average rate was reduced by 16,7%. Overall adjustment for 2004 was about 4%, which is close to the inflation of 3,5%.

CONATA has elaborated up to now about 360 district maps with property rates (every few years these are actualized, e.g.: investment in infrastructure conducts to a rise in the valuation) of a total of 194 provincial and 1.634 district municipalities, concentrating on the municipalities with the biggest potential tax base.¹⁷

A figure of 40% to 60% for the general ratio of the appraised value by CONATA to real market value has often been quoted (although no systematic evidence to back up this estimate is available), offering a big potential upwards.¹⁸ There are no estimates of the market value of the property tax base in individual municipalities or for the nation as a whole.

The local governments are applying then on the property value the progressive tax rates (cf. Table N°1) fixed in the Municipal Tax Code (Ley de Tributación Municipal) meaning in practice that tax rates and the index for the valuation of property are centrally settled while the tax is locally administered. The nominal tax rates look rather low.

As in most countries some taxable properties are exempt by law like charities, property related to education activities, international organizations etc.

Table N°1: Scales of property tax

Scales of property valuation (AUTOAVALÚO)	Tax rate
Until S/. 15 UIT	0.20%
More than 15 UIT until 60 UIT	0.60%
More than 60 UIT	1.00%
Minimum Amount which might be established by the municipality	0.6% of one UIT

One UIT (Unidad Impositiva Tributaria) is in 2004 the equivalent of 3200 Soles (roughly 950 US \$).¹⁹

17 As a self introduced incentive CONATA is giving preferences actualizing those maps of the municipalities that are complying with the transfer of the share of 3/1000 of the property tax. Anyway, it seems as that the local governments –with some exceptions- didn’t show very much interest in the technical work of CONATA limiting their interest in applying the given indexes.

18 For example the most expensive spot in Lima are the square meters the Hotel Marriott is standing on which is valued by CONATA at ca. 170\$ the m², the residential areas behind by 80\$. Market values are based on actual sale transaction data. Sales values are widely believed to be “adjusted” downwards before reported.

19 In 2005 it will be 3300 Soles, about 1000 US\$.

Revenues out of property tax are rising faster than the adjustment by CONATA, meaning there are less tax arrears and the ratio of properties subject of paying tax has increased. Property tax on agricultural land is flawed limiting tax yields in rural areas. The value of land is differentiated by CONATA conforming the quality of the soil and access/form to irrigation, the maximum value is about 12.000 Soles (~3500 \$) but goes down to 10\$, cf. attempts to raise rural property tax (Garzón & Vasquez 2004).

4. Transfers to Municipalities

The property tax can't be assessed without including some special features of the transfer system into the analysis. The two major national transfer programs are FONCOMUN (mainly composed on a 2% surcharge on VAT) and the Canon (composed on 50% of the income tax of enterprises extracting natural resources like oil or minerals). The aim of FONCOMUN is to secure the functionality of all municipalities in Peru, distributed with compensation and equity goals. Distribution is happening in two steps: in the first step the total amount is distributed on the 194 provincial municipalities conforming an index of a) population and b) infant mortality. Inside every province the amount is then in the second step distributed between provincial municipality (20%) and district municipalities (80%) based on the population (rural population is weighted double).

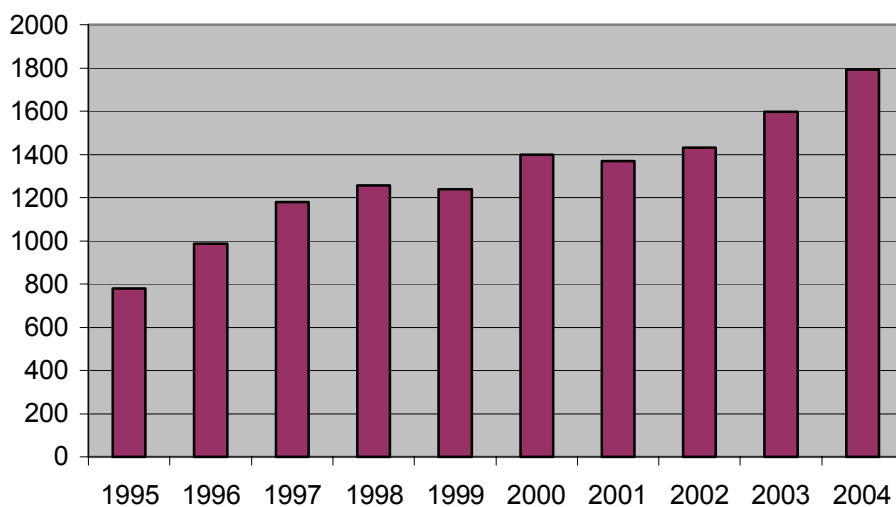
From the Canon are benefiting only the municipalities of the region where the exploitation of natural resources is done, meaning that it is concentrated on some regions/municipalities. Through the bonanza at the international mineral markets the Canon involves for the moment serious money: in 2004 the total amount increased to almost 900 Mill. Soles - about half of the transfers by FONCOMUN (see Figure N°4). Up from 2002 normed by the law 27616 and restated in 2003, the ministerial resolution 076-2003 is regulating that every municipality should get a minimum assignment of 8 UITs/month, which sums up to 25.600 Soles, to the benefice of poor rural municipalities, on the same hand reducing the share the urban areas would have received.

Due to the high number of 1824 municipalities in the territory, about 1/3 of the total FONCOMUN are transferred as a minimum assignment. Every municipality is at least becoming 300.000 Soles, a big amount compared to the very low revenue from property tax: for those 25% of district municipalities with a property tax yield below 60\$ a year or those 50% below a yield of 600\$ the minimum transfer is coming with little incentive to raise own revenues from taxes due to the abysmal difference – (anyway, it can't be said that those municipalities live happily because normally that are also the poorest regions, but the incentive from the distribution of the transfers is at least misleading). It is no wonder that empiric data is showing that the transfers had a substitute effect concerning own revenue collection (Alvarado, 2004).²⁰ Moreover, in the past existed the legal obligation to spend the transferred amounts out of FONCOMUN in investment, adapting to reality the percentage was reduced in 2003 to 70% and up from 2004 expenditure allocation is at the discretion of the municipality (transfers from Canon have to be invested to 100% in infrastructure).²¹ It is highly likely, that this is in fact another disincentive because freeing local governments from the need to raise property tax as a source for discretionary financing.

20 The article 87 of the Decreto Legislativo 776 foresees up from January 2005 an incentive for the municipalities concerning the transfer distribution of the FONCOMUN, the incentive is linked to auto generation of revenues and emphasis on investment in the local budget. In Columbia the law 60 from 1993 was foreseeing that 2,4% of total transfers to local governments were linked as an incentive to own property tax collection, apparently without much success so that the law 715, Art. 79 from 2001 was raising this share to 10%.

²¹ In July 2004 the Law of Accreditation (Ley del Sistema de Acreditación de los Gobiernos Regionales y Locales, Ley N° 28273) was setting that only those local governments will be certified - the certification is linked to transfers of competences and resources - which are using the transfers out of the FONCOMUN at least for 50% for investment - which in practice will work as a legal restriction due the high interest of local governments to get this certification. Municipalities with only the minimum transfer are exempted from this condition.

Figure N°4: Transfers out of FONCOMUN (in Mill. Soles)



The FONCOMUN is legally supposed to be distributed in future (from 2005) also concerning municipal own resource mobilization, the municipalities who did efforts to raise property tax collection before this date should not get penalized for their efforts.

Box N°1: Institutional Constraints

Property tax has to be seen as a part in a fiscal system with dependencies and interactions: national laws and regulations (Congress, MoF and sectoral ministries) are affecting municipal revenues.²²

From the macroeconomic point of view municipalities in Peru up to now hardly count (revenues, transfers, expenditure, and debt). Coming along with, as in most shared administration system, low incentives for the central government, so that property tax comes probably last in policy preferences for the Ministry of Finance (if not be taken into account on benevolent grounds).

MoF, Sector Ministries, Congress (legal framework and regulation):

- little interchange of views with municipalities which comes with legal surprises

22 Just to mention some recent impacts of national legislation on municipal income: a) Reductions for some municipalities in transfers of Canon by adapting a new distribution index through the MoF; b) Ministry of Transport and Communication regulates that traffic fines have to be linked to personal identification and not vehicle specific, impacting a big loss in revenues for municipalities; c) an exemption of 10 UIT was introduced in the Property Transactions Tax; d) the tax on leisure ships/boats (embarcaciones de recreo) which was administered by municipalities has been taken away of them and has been transferred to the SUNAT (goes then into the FONCOMUN), without much of consulting - some maritime municipalities are the losers.

for municipalities (residual centralist approach)

- incentive structure of transfers had/ still have substitution effect
- limited interest in giving municipalities more policy choices
- no real supervision if municipalities are complying law (eg. share of property tax to be invested in cadastre)

Specialized Central Institutions

- SUNARP (property registry): exchange of information with municipalities is suboptimal
- CONATA (valuation index setting): valuation does not reflect commercial value, struggling to increase valuation above inflation
- PETT and COFOBRI (land/property titling) did not show much contact with municipalities

Municipalities

- Low administrative performance (poor local civil service, tax amnesties, bureaucracy etc.)
- Cadastre are often inexistent and mostly not updated, municipalities are not complying legal disposition to invest 3% (now 5%) in maintenance of cadastre
- Some municipalities are not complying with the 3/1000 share of property tax revenues which should get CONATA
- Disincentives caused by political cost of property tax

5. Poor Performance at the Local Level

There are shortfalls in the capacity and technical expertise of local government to handle the property tax. The tax collection ratio which measures the share of property tax levy (property tax bills sent to taxpayers) to that which is actually paid is in most municipalities below 50% (the same is valid for charges), in the following years overdue payments bring the payments close to 90%, meaning that about 10% of the property tax is not collected. The annual tax amnesty is a given praxis and widely expected by taxpayers, overdue taxpayers are not financially punished (no fines, no interest rates).

Poor performance and little local authority brings with it that citizens perceive local taxes as the last urgent financial obligation.

Local administrations tend to be characterized by apparent incompetence, high turnover, no merit based selection of professionals (it is existing the tradition that an incoming mayor is changing a big part of the municipal personal), salaries are not competitive compared to the private sector to attract highly qualified staff.

Mayors more devoted to populism than to long term goals might try to avoid the collection of taxes due to the political costs involved, so that the poor performance reflects also local government's greater vulnerability to local political pressure - a case of political responsiveness acting in the guise of technical incompetence (Dillinger 1991).

Peruvian municipalities show poorly maintained property records. Lots of municipality's -officially responsible for the local cadastre- does not possess one, apparently unwilling to spend resources and efforts on it. Conforming the National Registry of Municipalities (source INEI) there are 367 municipalities with a cadastre, lots of these disactualized (also due to a high ratio of transactions).²³

There are no exact informations available concerning the coverage ratio which measures the amount of the actual property that is included in the tax records (often called cadastral records): it is still no legal obligation to register property (even if the cost involved are no so high) - a legal disposition in the law of 2004 which creates a national cadastre was discussed and later on discarded.

As in so many other Latin American municipalities there was up to now no connection between the property and the fiscal cadastres. The law N° 28294 from July 2004 is creating an Integrated National Cadastre System and will connect it progressively with the national register of property. The self-set goal is to have by 2011 a full functionally working national system of cadastre.²⁴

There do exist problems concerning interchange of information between the National Register entity (SUNARP) and Municipalities. Two special projects PETT (registering of rural property) and COFOBRI (registering of urban property) (the former is getting

²³ Nevertheless the municipalities were obliged to spend in the last years three percent of the collected property tax in a cadastre, an legal obligation which many municipalities didn't follow, the amount of this earmarked share was raised to five percent by the amended Ley de Tributación Municipal in 2004 (in the early 90s this share was even 10%), dictating the creation of a Distrital Cadastre Fund ("Fondo de Apoyo al Plan Catastral Distrital") in every provincial municipality for the period 2005-2006. Municipalities are arguing that cost for employees, office etc. can be subsumised under this header. Impacts will to a big part depend on the will of central government to oversee this legal obligation.

²⁴ Related to the cadastre exists the very challenging issue to find solutions to the many litigations about frontiers of districts, provinces and even regions. According to the Dirección Nacional Técnica de Demarcación Territorial (DNTDT) there are about 320 registered territorial conflicts but the real number is supposed to be as high as 1.500.

financement by IADB, the latter by WB) didn't show very much contact with municipalities.

While at the central level investment as a share of expenditure was continually diminishing in the last years, it is representing with 1320 Mill Soles in 2003 around 33% of total municipal expenditure, situating the municipalities in percentual terms of total expenditure as the state entities with the highest share of investment (helped by different legal obligations to use transfers for investment). Local politicians understand that their political success depend on public works ("obras"). The functional distribution of the expenditure is concentrated with 44,4% on administration and planification, followed by 16,2% on social assistance, 13,9% on health and related issues, 11,9% on transport and 5,4% on housing/urban development.

6. Innovative Strategies in Peruvian Municipalities:

While policy choices for local governments concerning property tax are somehow limited through the given legal framework compared with other countries and the more general perception that municipalities made little effort to raise property tax collection above a certain level, there are some encouraging local experiences:

Innovative strategies in resource mobilization would be expected to either improve the efficient use of a local government's current base or expand the fiscal base of subnational government (Campbell/Fuhr 2004).

1. Tax Management Services

- Favorable performances are showing the three existing independent tax collecting agencies, Servicio de Administración Tributaria (SATs) of three provincial municipalities: SAT of Lima starting in 1997, SATT of Trujillo (1998), and SATP of Piura (2000). Some municipalities like Ica, Chiclayo and Huancayo are trying to replicate the relative success of the SATs having installed similar agencies, lately.

Detracting from an apparently strong growth performance is, however, the fact that growth has been from an extremely low base. Some "traditional" Municipal

Tax Offices do not necessary stand back, at least some successful experiences in Lima are showing, that using partly the same features as the SATs but staying to the norm increased the municipality administration revenues.

2. Tax Incentives

- The municipality of Surco (Lima) did not have a tax amnesty for 8 years now, in “normal” Peruvian municipalities an amnesty is happening on an annual base. The districts of Surco, Villa El Salvador, El Agustino and San Borja are setting incentives (premiums, special offers in restaurants or hotels etc.) to the citizens, who are up to date with their tax obligations. In the last years these municipalities could have raised the timely paid tax revenue to double-digit figures. Surco could have raised over the same period the overall tax influx by almost four times. Other municipalities are giving punctually payer an incentive in the form of a tax rebate.
- Some municipalities in Peru like Ilo and Villa El Salvador have introduced with some success a scheme that allows poor tax debtors to exchange their debt for community work.

3. Online Payment

- To reduce the compliance costs for taxpayers and the collection costs for tax administration it is becoming increasingly possible (mainly districts of Lima) to make your property tax payment online.

4. Selective Assessment

- Some municipalities are copying the success of SUNAT by concentrating on the big taxpayers (selective assessing).

5. Cadastre Outsourcing

- Outsourcing of cadastre maintenance or construction like the provincial Municipality of Arequipa, the districts of San Isidro and San Borja.²⁵

6. SIAF-GL

- The Ministry of Finance is integrating in the financial management software system SIAF-GL that is compulsory for municipalities a cadastre module,

25 In Latin America against experiences in countries like Japan, cadastres remain primarily in the hands of public institutions; the private sector normally participates in the processes of implementing cartographic updates and information systems, but not in the administration itself.

which is essentially a database and might raise property tax. At the moment this module is assessed as pilot in some municipalities.

Box N°2: Semi-autonomous Municipal Tax Agencies

The creation of semi-autonomous Municipal Tax Agencies (Service de Administration Tributaries - SATs) can be seen also as a management innovation within an adaptation process to the changing institutional environment created by national policies, in this case the reduction of revenues of urban municipalities in the mid 90s and consequently the necessity at the local stage of pursuing enhanced revenues out of own resource mobilization.²⁶

Favorable performances shown by the three existing SATs of the provincial municipalities: SATL of Lima starting in 12/1996, SATT of Trujillo (12/1998), and SATP of Piura (12/1999) is intended to replicate by recently installed similar agencies in municipalities like Ica (5/2003), Huancayo (10/2003). The common patterns in each of these SATs are that they are being separated from the local administrations and granted the legal status of semi-autonomous authorities.²⁷ They are responsible for the collecting of all own revenue (taxes, charges and fees). SATs are designed with a number of autonomy-enhancing features, including self-financing mechanisms, which is derived from a share of its gross collections plus its own-income from user fees. This share varies from 5% for the SATL (this share was raised to 9% between 8/2004 and 2006) and SATT, over 6% for SATP and the SAT de Ica 6%, to 10% for the SATHuancayo.²⁸ SATChiclayo was created recently in 11/2004 and is getting an 8% share.

Property Tax collection was raised from 2001 to 2003 in the case of SATL to 19 Mill. Soles or an increment of 31%, in the case of SATT to 9 Mill. Soles or 17% and

26 The mayor of Trujillo was explicitly citing the negative impacts of the Local Tax Code of 1994 for his city and the consequently reaction was the creation of SATT.

27 SATs are coping in a way the best practice from the peruvian national tax agency (SUNAT) which functions also on a semi-autonomous basis; concerning a international comparison of semi-autonomous revenue authorities at the national level, see Talierto (2004). His paper argues that from a public management perspective autonomy can be used to enhance bureaucratic performance in low capacity public sectors but remarks that the issue of autonomy should not be dealt as a question of principle.

28 The ORTT (Oficina de Recaudación Tributaria de Talara) was created and then for political reasons abolished notwithstanding the extra costs involved. One reason was probably the particular high transfers the Municipality of Talara is receiving.

SATP to 5,8 Mill. Soles or 18%. Overall collection was rising even faster (fees, charges, fines). Detracting from this apparently strong growth performance is, however, the fact that growth has been from an extremely low base.

SATs are selecting staff according to meritocratic procedures and are paying salaries competitive with the private sector. The use of electronic interactions broadened, and concerning services taxpayer is provided with increased quality.

7. Conclusions

An evolving local institutional environment - as manifested in new laws, stronger public awareness towards local administration, increase of responsibilities - is confronted with serious flaws – incentive structure of transfers, institutional parallelism, poor local administration performance, no real voice of municipalities at the central stage which results in legal surprises (residual centralist tradition).

The actual decentralization process in Peru will strengthen the position of municipalities and challenging the local administrative capacities through the transfers of new responsibilities and resources.

The fiscal base of local governments in Peru remains small for the municipalities for various reasons. These include insufficient local capacity for revenue generation in the majority of municipalities, restricted revenue bases, excessive central control over bases and rates, and substitution effects through central government transfers.²⁹

Up to now the revenues out of property tax are with 8% of total local revenues quite low for themselves and internationally compared yields are relative to GDP at the bottom end. Peru, therefore, should give serious thought of raising more revenue out of property tax, especially in view of the difficulties of raising other local revenues. The property tax can enhance accountability at the local level and is also important for the background that most charges or transfers are earmarked so that property tax yields can cover discretionary finances.

²⁹ Some evidence suggest that a substitution effect is/was widespread eg. Columbia, Guatemala, Bolivia, Ecuador, Venezuela among others (Peterson 1997; Cadena 2002; Sanchez et al. 2002).

Property tax revenues are highly concentrated on urban areas and especially the metropolitan area (high heterogeneity of municipalities). It is also noteworthy that the geographical areas mountain highlands and Amazonas basin have on average much lower revenues from property tax (correlating with the higher incidence of poverty). Rural properties might not have a big potential, in fact these are often taxed on a marginal rate or even excluded (informality in peri-urban and rural areas).

For the time being it might be if not a reasonable but understandable behavior for local authorities in Peru not to engage considerable resources to the enforcement of property tax because bases are narrow and have modest yield prospects. Passively accepting whatever revenue happens to come in might be the most reasonable approach.

Underlying poor local governance, however, are political liabilities from the autocratic Fujimori regime (1990-2000) having neglected municipalities or even having been more interested in poor governance on the local level, paralleling (partly with financing from international institutions) essential local service providing by deconcentrated specialized agencies (FONCODES, PETT, COFOBRI, PROVIAS, PRONAA etc.).

Anyhow, a stronger role for property tax blocked by vested interests is in the current system not detectable, but might be better described as relative indifference from different institutions. Even if the legal changes in the Decreto Legislativo 776, introduced in 2002 and 2004 are potentially improving the tax revenue of the municipalities there is still plenty scope of reform. Concerning the property tax the following changes are important: (i) the abolition of some exemptions, (ii) the obligation on notaries to verify the payments of local taxes before the registering of a new owner and (iii) the creation of a District Cadastre Fund, (iv) municipal own revenue collection is to be made one parameter for the transfer index (still to be applied). Further steps are necessary to increase the significance of the property tax.

The institution responsible for the valuation of property, CONATA, has made different attempts to increase the rates (up to now with little success). Modern techniques of

valuation like manual mass valuation approach, and use of CAMA (computer assisted mass appraisal) techniques are still not used in the peruvian case but have shown that they can produce more equitable, up-to-date values in a transparent, cost effective, timely and sustainable manner.³⁰

Disincentives at the local level must also be addressed. Given the inherent political liabilities of the property tax, sustained improvement is unlikely as long as more politically attractive means of increasing resources are available. The transfers of the FONCOMUN which in the past were earmarked for investment, now reduced/abolished might be the wrong way and be counterproductive for own resource mobilization as some municipalities are showing that a high share of this transfers are used for recurrent expenditure.

Given the reduced policy options for municipalities, the central government is responsible for the enabling conditions (promoting and facilitating revenues from property taxes). But because municipalities have only a restricted voice at the central level it is observable how the central government institutions are changing time after time the rules of the game (Canon, Foncomun distribution and use, regulation concerning fines).³¹

Willingness of the citizen to face their fiscal obligations is not the subject of this paper, but it is essentially for local politicians to show positive impacts through quality of investment and reduced administrative costs.³² Because charges and fees are collected for almost every service provided by the municipalities, it is especially

30 A change of calculations of the assessed value from a multi based index to a more simplified valuation methods based on m² and area index have shown in some cities good experiences, e.g. Santa Cruz in Bolivia (Rojas 2004).

31 The last legal surprise came in 2004 when the distribution of the Canon was changed in the mid of the budget year, benefiting ones and harming others.

32 Quality of investment is in Peru a big issue: municipalities have shown abundant investments with little impact, little sustainability and/or overpriced (as there is the same at the central level). A national system for public investment (the so called SNIP) is protecting against majors flaws, local governments first were exempted until a certain level to go through this process, but will progressively be integrated. Concerning administration costs, in Peru the local parliamentarians get serious money, eg. a provincial town like Chiclayo with 15 parliamentarians (so called regidores), each with an assignation of about 5000 Soles a month, meaning almost 1 Mill. Soles/year or about 15% of property tax yields.

difficult to allow citizens the identification of benefits for which one is paying property tax.³³

Notwithstanding the reduced policy options at the local level there exist a couple of innovative examples on how municipalities can increase their own revenues. Positive innovations at the municipal stage (like SATs but also by some traditional municipal tax offices or like the successful reduction of administrative barriers in the municipality of Piura) are now copied from other local authorities. Through the decentralization process there will be in future even more room for increased innovation.

The particular experience of the creation of semi-autonomous tax agencies can be seen as a result of an adaptation process in the 90s to bypass negative impacts created by national policies. The successful experience in the provincial municipalities of Lima, Piura, and Trujillo is now replicated in some municipalities.

The newly included disposition in the Municipal Tax Code that up from 2005 the FONCOMUN will be distributed also on a basis of municipal efforts of own tax collecting is a major improvement but is still not operative (incentive is not to harm those municipalities which were already embarking for some years on own revenue collection from their constituency).

Considering that it is normally not recommendable to increase municipal resources meanwhile the given revenue potential is not used satisfactorily, it should be noted that in some selected circles it is discussed whether the small business tax (Régimen Único Simplificado - RUS) should go to municipalities to enhance local revenues beyond property tax, transfers and charges.

Moreover, a betterment levy (taxing gains of increased property value through urban development) that in some countries is successfully used as an innovative finance capture at the local level could be also an option for Peruvian urban areas.

33 Municipalities' charges in Peru are mostly not covering the real cost of the service provided. Anyway, relying too much on user charges can lead to inefficient levels of service provision, because of the "public goods" nature some municipal services would be underprovided.

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