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An Example
for Other Developing Countries?

by

William C. Rhoads & Richard M. Bird

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THE VALORIZATION TAX IN COLOMBIA: AN EXAMPLE FOR OTHER DEVELOPING COUNTRIES?

By William G. Rhoads and Richard M. Bird*

I. Introduction

One of the most striking phenomena in the developing countries today is the rapid growth of their population and its rapid urbanization. Many cities grow continuously at rates seen only in boom periods in developed countries. This rapid urbanization has put a tremendous strain on municipal finances: extremely heavy investment in roads, sewers, aqueducts, street lighting, parks, and schools are needed if the city is to remain suitable for human existence, but there is no capital market from which funds can be borrowed, and the national governments cannot provide adequate assistance to finance capital investments.

In the countryside in many countries an analogous situation exists. With a rapidly growing population, agricultural development must take place at a rapid rate, often requiring heavy investment in transporation facilities to open up agricultural areas and in projects for drainage, flood protection, and irrigation to make more land productive.

A major contribution that property taxes can make to economic

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development in developing countries is to help finance the heavy burden of these capital improvements. Like most countries, Colombia has a conventional property tax which is used primarily to provide municipal revenues. This tax has not up to now been a major factor in financing economic development.[1] Rates have been low, assessment has been haphazard, and collection has been poor, with the result that total yield has been low and that, partly for this reason, municipalities in Colombia have not played a strong role in economic development. Public education, for example, is financed almost entirely by the departmental (state) and national governments.

In addition to the usual role of property taxes in providing municipal revenues, Colombia has perhaps had more proposals for special taxation of idle agricultural land to force land reform than any other underdeveloped country;[2] although one complicated scheme was actually made law a few years ago, the property tax's incentive role in economic development has also really not amounted to much. On both counts, then, with regard to its revenue productivity and with regard to its incentive use, the property tax in Colombia has not as yet made much of a contribution to economic development, though

1. For a general account of property taxes in Colombia see Richard M. Bird, "Local Property Taxes in Colombia", Proceedings of the 58th Annual Conference of the National Tax Association (Harrisburg, Pa., 1966), pp. 481-501. Additional information may be found in Harvard Law School International Program in Taxation, Taxation in Colombia, World Tax Series (Chicago: Commerce Clearing House, 1964), chapter 4, and in Joint Tax Program of The Organization of American States and the Inter-American Development Bank, Fiscal Survey of Colombia (Baltimore: The John Hopkins Press, 1965), chapters 6 and 7.

2. Albert O. Hirschman, Journeys towards Progress: Studies of Economic Policy-Making in Latin America (New York: Twentieth Century Fund, 1963), chapter 3, gives an excellent account of these proposals.

there is some hope for improvement as a result of efforts now underway.

It is an alternative tax on property in Colombia, the "impuesto de valorización" or valorization tax (similar to the "special assessment" or "betterment tax" in English speaking countries) which, though its yield is less than that of the regular property tax, has already played an important part in financing urban economic development in Colombia and may well play an even more important part in the future. This valorization tax is interesting from both a theoretical and a practical point of view, but it has been almost totally ignored in the literature on taxation in recent years, in large part because of its relative unimportance in advanced countries.[3]

The second section of this paper explores briefly the theory of the valorization tax, showing why it seems particularly suitable for use in developing countries such as Colombia. The third section then examines in some detail the operation of the valorization tax in Colombia, describing its history, revenue importance, administration, and future. Finally, the conclusion contrasts Colombian experience to that in two other Latin American countries and brings together the

3. For example, five standard American public finance texts consulted devote an average of only four pages to special assessments or land-value increment taxes. These writers tend to stress the arbitrariness and administrative difficulties of special assessments (which all too often in the U.S. were bond issues to finance improvements for speculative real estate sub-divisions) and to favor land-value increment taxes levied after the completion of the work rather than special assessments levied before the work is finished. As discussed later, the Colombian valorization tax is really a hybrid of these two concepts as usually expounded and, in actual operation, appears to suffer from few of the problems stressed by the textbook writers.

lessons we derive from Colombian experience on the extent to which the theoretical usefulness of the valorization tax can be realized in practice in developing countries.

II. Theory of the Valorization Tax

A. Urban Areas.

Since the primary purpose of a tax in a developing country is to raise revenues for public use, the revenue needs of urban areas must first be examined. In developing countries, cities typically grow very rapidly. In Colombia the average rate of urban growth is 5 percent a year and the major cities discussed in this paper--Bogotá, Medellín and Cali--grew in the last decade at average annual rates of 7.7, 6.2,[4] and 7.5 percent respectively. The rapid growth of these cities arises from their development of dynamic manufacturing and commercial sectors and also from the increasing importance of education, health, and other activities which are most efficiently carried on in urban areas.

This urban growth takes place at a time when the public capital requirements for creating efficient cities with "satisfactory" social services are very high but domestic saving is low and there is a shortage of capital. City growth in developing countries today is usually based on transport by urban buses. For efficient transportation the narrow streets of the central city--in Latin America a heritage from colonial

4. Medellín only. The growth rate of the Medellín metropolitan area was somewhat higher. Only Medellín of major Colombian cities has a significant fraction, 1/4, of its metropolitan area population living outside the central city.

days--must therefore be widened and new streets opened. On the edge of the growing city, streets must be extended rapidly to new factories and new housing, often single-family homes being developed slowly from original squatter settlements by owners lacking the organization, financing and technical capacities to build more compact multi-family structures even if they wanted to do so. If the city is to be a location of low-cost production, it needs these streets to provide rapid bus transporation. It also needs adequate water and sewerage systems to protect public health, and street lighting, parks, and schools for training and social betterment. All these investments require large amounts of capital, and yet they must be provided if the city is to fulfill its potential for economic development. This investment is desirable not only for the benefits which it gives in better living conditions and more efficient production in the city but also because it requires a great deal of unskilled labor, thus helping to ease the always heavy urban unemployment in developing countries. In addition, such public works investment generally uses few imported materials and so puts less pressure on the balance of payments than most other types of investment.[5]

There is no organized capital market where domestic funds can be borrowed for long periods at low interest rates to meet these heavy capital requirements. At best, some improvements can be financed by borrowing from international lending agencies

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5. For a forceful exposition of the position that rapid urbanization should be promoted as a means of accelerating economic and social development, see Lauchlin Currie, Accelerating Development: The Necessity and the Means (New York: McGraw-Hill Book Company, Inc., 1966). Part II of this book applies these ideas to Colombia.

(such as the IBRD, AID or IDB), but these agencies are usually reluctant to finance local currency costs of investment and, as already noted, import requirements for these urban investments are low. Some investment funds may be provided from central government subsidies but these are likely to be inadequate, given the usual fiscal difficulties of the central government in a developing country. Nor can the city rely heavily on the ordinary local property tax, for property assessments are usually out of date and inequitable and the administration and collection mechanisms are weak, while legal mechanisms to enforce payment are lacking. Finally, the city cannot call on private enterprise to finance these investments through subdivision laws which require the urban developer to provide streets, water, sewerage, etc., at his own expense. Even if such subdivision laws exist (as they in fact do in Colombia) many people purchasing lots do not have the money to pay for complete public improvements so the subdivision law must permit new subdivisions lacking street pavement, complete water services, and sewerage connections if the people flocking to the cities are not to be forced into already overcrowded existing housing or else forced to set up in shantytowns without any urban controls (or services) at all.

The same factors that lead to the financial difficulties of the rapidly growing city in a developing country--the large influx of population and the rapid growth of modern industrial, commercial and service sectors--also lead to a rapid rise in property values. This fact can be used to advantage to finance a major part of the needed municipal investment through a valorization tax on this increase in value

The rapidly growing city in a developing country always has many potential projects with such a high social productivity that the benefits to site values from which the financing is supplied may in many cases greatly exceed the costs of the project itself. While in theory the tax can recover an amount equal to the entire increase in site values, in practice something less than this is attempted, given the desirability of securing payment of the tax before the investment is made and the uncertainties of estimating what the ultimate increases in site value will be. Even allowing an ample margin for error in estimating benefits, the tax can usually recover the investment and operating costs of the public agency without exceeding the realizable benefit to any individual landowner from the increased site value of his property. This presumption in the law--a major reason for the distrust of the textbook writers--has in fact worked out quite well in Colombia, for reasons discussed in more detail below.

This valorization tax may be contrasted with a traditional property tax assessed on site value and with special capital gains taxes on increases in site value. In theory a property tax assessed on site values can collect the entire net rent of the land and may be viewed as taking away from the landowner the net revenue from all unearned increments in the site value of his property. A capital gains tax on increments in site values can also recover the total increment in site value, though payment usually takes place only when the increment in value is realized by sale. The practical difficulties of taxing unrealized gains on an accrual basis are well known. Neither the site value tax nor the gains tax on increment in site value is designed to raise the revenues to provide the public investments which will lead to an increment in site value--although if a capital market existed, they could be used to repay loans made to finance these public investments.

Another difference between site value taxation and valorization taxation is that, in theory, the valorization tax recovers only the benefits from direct public investment which enhances the value of land, while site value taxation also reaches increases in private site values that may arise in a large, heavily-populated urban area from the external economies of face-to-face contact and of the mobilization of an efficient work force. Hence, in theory, the present value of maximum valorization taxes in a growing city can never be as high as the present value of the maximum site value tax.

The valorization tax has the political advantage that it is clearly on a benefit basis. The taxpayer is making no sacrifice, for the value of his property will rise by at least the amount of the tax he must pay. This is an important consideration where political resistance to paying taxes is high, as it is in most developing countries. In practice, since the tax is paid before the investment takes place and before site values increase, the estimates of the increase in value must be sufficiently accurate or the upward trend of land values because of urban growth must be so rapid that the forecast of benefit exceeding tax will be true in almost all cases. In effect, the increment in site value from rapid urban growth and inflation provides a cushion in case the increment arising from the public investment alone turns out to be inferior to the valorization tax paid.

From urban land use and transportation theory, it may be predicted that a valorization tax, justified as it is on a benefit basis, will be successful only if the urban area is growing rapidly and if no drastic changes in transporation technology take place. The main use of valorization taxes has been to provide new or improved streets in urban areas, an investment needed to keep production costs low in urban areas with existing transportation technology, as noted earlier. Theoretical analyses of improved urban transportation providing more rapid access to the central business area show that ordinarily site values in the fringe areas of the city with improved transport will increase, and ceteris paribus, site values in the central areas and other fringe areas will fall as a result.[6] If benefit taxation is to be successful, there must be an obvious connection between the cost and the benefits to the taxpayer. For this reason it should be difficult to use a valorization tax in a static or slow-growing city since suburban and fringe urban dwellers will not be convinced that the increases in their site values are coming from improved roads located in the older central portions of the city far away. However, if increased transporation efficiency lowers production costs sufficiently in the city to attract new industry and economic activity to central areas at a rapid pace, and urban population increases rapidly, urban land values in central areas will rise also, and

6. See the different theoretical models in Lowdon Wingo, Jr., Transportation and Urban Land (Baltimore: Johns Hopkins Press, for Resources for the Future, Inc., 1961), and William Alonso, Location and Land Use (Cambridge, Mass.: Harvard University Press, 1964).

will not fall in fringe areas without improved transport. Thus, central city land owners will be willing to pay valorization taxes. The relationship between public investment and site values may be indirect, but the property owner will know from experience that better streets in front of his property or near it will increase the value of his land, and he will be willing to pay a valorization tax even though he cannot distinguish between the increases in site values resulting from particular public investments and those resulting from rapid urban growth in general.

The minor role played by valorization or special assessment taxes in the urban areas of developed countries and the consequent neglect of the tax in public finance literature may thus be accounted for in part by the slower growth of cities in developed countries, with consequently less connection visible between public improvements and increases in site values. Other factors explaining the difference between the potential usefulness of the valorization tax in advanced and less developed countries are the existence of capital markets so that public improvements may be easily financed and paid for out of regular revenues over time, and the existence of subdivision laws which force many public improvements to be made at private expense.

B. Rural Areas.

Much the same favorable situation for valorization taxes may exist in the rural areas of developing countries. Large areas of rich land may be without any transporation but horses and mules, and construction of a road or railroad may have dramatic effects on land values by lowering transporation costs, so that a large proportion of the cost of the new road or railroad can often be paid for through valorization taxes. In addition, projects to increase the value of agricultural land through dikes to prevent flooding or canals to provide drainage may have very high benefit-cost ratios in developing countries, so that financing them with valorization taxes may be feasible. In the United States, on the other hand, few if any areas still lack modern transportation, and the benefit-cost ratios of land reclamation projects are notoriously low, so that the scope for valorization taxes in rural areas is much less.[7]

C. Investment and Saving

From the point of view of stimulating saving and investment, the valorization tax also seems desirable in developing countries. The proceeds of the tax are used almost exclusively for investment and the nature of the tax is such that if it is to be successfully used the investment must be highly productive and increase land values. In fact, the valorization tax may be considered a forced investment where the taxpayer benefits from the increased site value of his land resulting from the public improvement financed by the tax. Income distri-

7. See Otto Eckstein, Water Resource Development (Cambridge, Mass.: Harvard University Press, 1958), for examples and an explanation of how benefit-cost ratios are inflated in the United States. The potential use of special assessments in the rural areas of developing countries is discussed briefly in Haskell P. Wald, The Taxation of Agricultural Land in Under-Developed Countries (Cambridge, Mass.: Harvard University Press, 1959), pp. 221-223; his appraisal is too negative because of the particular form of tax he assumes (cf. also the discussion of the CVC project in Part III below).

bution in developing countries is highly unequal, and much urban land is owned by the wealthy upper classes. While these groups could be major sources of saving, they often consume a surprisingly large fraction of their income.[8] Thus the valorization tax often falls heavily on a group which has the potential to increase its savings considerably, and might well do so to pay the tax, although this is also the group with best access to the credit markets so that they might also borrow the existing savings of others.

D. Incentive Effects.

The incentive effects of the valorization tax are also favorable to investment and development. As a tax on pure site values, the valorization tax does not penalize development of unimproved land, and in practice its use will also probably lessen reliance currently or in the future on the regular property tax, which does penalize such development.

The payment of the valorization tax itself is probably an even more important stimulant to investment, however, in practice, and perhaps also in theory. It is often stated that in theory a tax on site values should have no incentive effects on land use since it does not affect the most profitable use

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8. See Nicholas Kaldor's comments on the savings habits of Chilean property owners in "Problemas Economicós de Chile", El Trimestre Economico, No. 102 (April-June 1959), p. 495. The extent of present income inequality in Colombia is indicated in chapter 11 of the Joint Tax Program study cited earlier, where it is claimed that 1 percent of the labor force received 12 percent of the income, while at the lower end of the income scale 65 percent received only 26 percent of the income (p. 224). The upper income class may be separated economically and psychologically into a new class of industrialists who often save a great deal of their income and a traditional class of landowners who save very little.

of the land.[9] This statement, however, implicitly assumes that land is always an investment good. In fact, in developing countries much land is held idle not for speculative purposes, but to provide pleasure and prestige to its owners, so that it is in a real sense very often a consumer good. Under regular site value taxation, the income effect (there is no substitution effect) of site value taxation can be expected to lower consumption (since land is probably not an inferior good), so that land formerly used for consumption purposes may be put to productive use as a result of the tax. With the valorization tax, the analysis is different, for payment of the tax is matched by an increase in the site value of the land. The improvements financed by valorization taxes increase the value of the land for productive purposes, not for prestige consumption, however, so the valorization tax and public investment combined will increase the opportunity cost of using land for consumption purposes, and the substitution effect will in this case tend to more productive use of the land.[10]

In practice, the effect of site value taxes in forcing more intensive land use may depend most on the lack of liquidity and capital markets facing many landowners and on the common failure

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9. Among recent authors, Dick Netzer, Economics of Property Tax (Washington, D.C.: The Brookings Institution, 1966), p. 205, and Daniel Holland, "The Taxation of Unimproved Value in Jamaica", Proceedings of the 58th Annual Conference of the National Tax Association (Harrisburgh, Pa., 1966), p. 457, have accepted this argument.

10. The argument assumes that there is no "Veblen effect", that is, it is not considered more prestigious to hold out of use land whose productive value has risen. Also, if the benefit exceeds the tax, the income effect will tend to increase all consumption, including land used for prestige purposes.

of landowners to calculate carefully the most profitable use of their land.[11] Owners may under-utilize land when not faced with cash payments, but when the valorization tax must be paid, they may either realize the opportunity cost of holding the land idle, and hence put it to more profitable use or else they may have to sell it to someone else who will do so. Since the valorization tax is a relatively large tax assessed over a short period of time, its effect in forcing better land use through the liquidity and attention-to-use effects should be stronger than a regular site value tax, where the rate may be too low to threaten the liquidity or arouse the interest in land use of all but the largest landowners.

A factor as important in the underuse of land in developing countries as the existence of large estates held for prestige purposes may be the large amount of land held by absentee owners, usually professional and commercial people from the cities, who cannot find good farm managers and who do not themselves have time to provide good management.[12] The analysis is the same as in the prestige case: under pure site value taxation, the income effect might be expected to lead to greater owner work effort, probably in managing his land, while under the valorization tax the owner must supply greater effort and develop his land if he is to realize in cash the greater gross income it can now provide, or else sell the land to someone who

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11. These factors are well discussed in the paper by Holland cited earlier, pp. 457-460.

12. This point is made in a number of reports on Colombia by the Land Tenure Center of the University of Wisconsin.

will develop the land.[13] He also has the option, of course, of reducing expenditures from other income in order to pay the tax (see section C above). If the property is in fact sold as a result of the tax, the net effect on saving depends in part on the disposition of the sales proceeds by the former owner.

E. Administration

From an administrative point of view, the valorization tax may seem attractive to developing countries, for land cannot easily be hidden from taxation (though landowners can--an important factor in countries with the Latin tradition of *in personam* taxes). The tax is collected in large sums from a relatively small number of taxpayers, a fact which makes enforcement easier though it may make compliance more difficult. The crucial factor in administration is that the tax and the public improvements go hand in hand, so that if poor administration leads to badly-planned or executed projects, or projects which are not executed promptly, or poor allocation of taxes among landowners, so that a significant number of taxpayers find that the tax they have paid is more than the increase in the value of their property, the tax may easily be discredited and appear to be only an arbitrary and capricious capital levy.

F. Summary.

In summary, the valorization tax in theory seems an attractive

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13. The effect of valorization taxes on the amount of land held for speculative purposes is uncertain: if the increase in land values due to the public improvements leads speculators to believe that the land has matured and is ready for development, the amount of land held for speculation might fall; if, on the other hand, they believe that the improvements make the land more attractive for future development, the amount held for speculative purposes might increase. This question is not further discussed in the present paper.

one for developing countries. It is suitable only for financing public investments that will be demonstrably productive. It has a clear benefit justification to help muster political support for the tax. Its effects on saving should be at least neutral and may be positive. Its incentive effects should be favorable. It should be relatively easy to collect. But it will require skilled administration if it is to work in practice as the theory indicates, and skilled people are often the scarcest resource in developing countries. That this administration is not beyond the reach of an underdeveloped country is demonstrated by Colombian experience; whether it is the best use of these resources is another question.

III. The Valorization Tax in Colombia.[14]

A. History and Development

While the antecedents of the valorization tax go back to 1887, when the first law authorizing taxation of those benefited to pay for public works was passed, it is only in the last 25

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14. This part of the paper is based on personal interviews with, among others, Dr. Carlos Cardona H., Director of Valorization in Bogotá; Dr. Guillermo Martinez and Dr. Juan Velez U., Director and Financial Chief, respectively, of the Valorization Department in Medellín; Dr. Jorge Restrepo U., Director of Valorization in Medellín (1945-49), and former mayor of Medellín; and Dr. Alvaro Restrepo I. of "Valorización y Asesorias Ltda." in Medellín. We are most grateful to all these gentlemen for their assistance. In addition, for legal and other background information we have relied on Alberto Fernandez C., El Impuesto de Valorización en Colombia (Medellín: Tip. Bedout, 1948), and Rafael Mora R., Régimen de Valorización Municipal y Renovación Urbana (Bogotá: Editorial ABC, 1966), as well as on various documents supplied by the valorization offices in Medellín and Bogotá, and "Valorización y Asesorias, Ltda.". These offices have also provided many of the figures used in this section. A pamphlet by Dr. Jorge Restrepo U., El Impuesto de Valorización en Medellín (Medellín, 1957) has also been useful.

years that the valorization tax has become of practical importance in Colombia.

The first laws in 1887 and 1921 authorized valorization only for flood control and land reclamation projects. The tax could cover only the cost of the public investment, and it was assessed on the basis of appraised land values. These laws were poorly drafted and little used. In 1936 the law was extended to cover municipal improvements in Bogotá, and two years later all major cities were authorized to carry out public works and to impose the valorization tax. The laws required land valuations before and after the investment to determine the benefits and again limited the tax to the cost of the public investment. It was at this time that the first valorization activities were undertaken in Bogotá. The law was still both too vague and too restrictive for wide application, however, and it was not until 1943 that the valorization tax was established in the form in which it is found today in Colombian municipalities.

Law 1 of 1943 allowed all municipalities to charge a valorization tax on all public improvements, whether financed by the municipality, department, national government, or other public agency, up to the total amount of the benefit received, without reference to the cost of the public improvements. This law also left it open to the municipality to determine the methods by which the benefit in increased land values to the property owner would be determined; gave municipalities almost complete freedom to establish the organization and methods for administering the valorization tax; made it clear that any public improvement which increased land values could be covered by the valorization tax; and gave the municipalities clear rights to collect the tax, providing the sanctions of embargo and seizure of property if the tax were not paid. A year later the Council of State ruled that municipalities had the right to assess and collect the valorization tax as soon as the plans and budget for a project had been prepared and approved, and before actual work had begun on the improvements. An additional section in the 1943 law stated that the municipalities must give the property owners taxed the right to be consulted in the formation and execution of the project and in the determination of the way in which the valorization tax was to be distributed.

It is on the basis of this broadly drawn law, which provides almost complete autonomy to the municipalities, that the modern valorization tax has been developed in Colombian cities. The primary check on abuse of the municipal valorization tax is provided by the ability of local citizens to put effective pressure on the city government and the valorization agency rather than by legal safeguards against abuse written into the law.

While the laws of municipal valorization give great freedom of action to municipalities, the laws for flood control, drainage, and irrigation and other projects executed by the departments, the nation, or regional development authorities remained quite restrictive until June 1966. By law the valorization tax in these cases could not be assessed and collected until after the public work was completed. The total tax was limited to the cost of the investment plus at most 33 percent of the difference between the total benefit to land values and the investment cost. The tax has to be in proportion to the benefits, as calculated by special valuations of the properties before and after the work is done. In June 1966, a new law gave national and departmental valorization authorities the same freedom of action enjoyed by municipalities.[15]

In Colombia the valorization tax has been of most importance in the cities. Medellín pioneered the modern use of the tax, and most of the other major cities in Colombia have valorization programs. The major use of valorization in cities has been in the construction of new streets or widening of existing ones to form a network of main arterial roads. In connection with these programes, paving, sewers, street lighting, tree planting, roadside parks, and stream control projects have also been included. Attempts to construct schools and parks by valorization have not been successful because land values could not be reliably predicted to rise enough after the projects were completed to cover the cost of the programs. Some valorization agencies have had to drop these programs.[16].

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15. The law (1604 of 1966) and its regulatory decree (1804 of 1966) were drafted for the government by private consultants from Medellín and closely followed current practice in that city. The law explicitly allows for valorization financing of only part of a project if total benefits to property owners are less than costs. Although several departments have announced highway valorization projects under the new law, there is no practical experience as yet with the law, and we do not discuss it further in this paper.

16. This experience provides an interesting contrast to that in Minneapolis, where it has been said that "neighborhood assessments" work well for parks and playgrounds but very poorly for roads. The reason given is that "people seem willing enough to pay their share of improvements that will make their neighborhood a pleasanter place to live in, but balk at paying for improvements that will mostly make it easier for people from elsewhere to drive by". (Nation's Cities, March 1965, p. 29.) This statement ties in very well with what was said earlier about the need for rapid city growth if road works are to be successfully financed on a valorization basis. It also demonstrates that parks and playgrounds are basically a consumption expenditure in Minneapolis and could probably be better financed on a straight user-charge

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Recently, some agencies have been authorized to undertake urban renewal projects, but the first projects are only now being started, so there is as yet no basis for judging the feasibility of conducting urban renewal by this procedure.

In the rural areas, valorization was first used for swamp drainage projects, and continues to be used for water projects and highways by department and regional agencies. A recent project to be financed by valorization was the construction of dikes to protect lowlands near Cali from floods by the CVC (Cauca Valley Corporation), a regional power and water agency modeled on the TVA. Although in the end fruitlessly, serious consideration was also given to financing part of the Magdalena Valley railroad by valorization, and the use of valorization to finance new intercity highways was the main reason for the enactment of the new national valorization law.

B. Revenue Importance

Considered in relation to other sources of taxation in Colombia, the valorization tax is a very minor tax. In 1963, the latest year for which data are available, the yield of municipal valorization taxes in Colombia was only 81.4 million pesos, or slightly less than 2 percent of all tax revenues, which in turn were about 10 percent of GNP.[17] Related to total

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16. (Cont.) basis, except insofar as the provision of such amenities is a part of redistributive policy. Incidentally, the municipal planning office in Medellín recently proposed that a city park system be developed with valorization financing.

17. The Colombian peso is now worth 5.7 and 7.4 U.S. cents at the most important exchange rates. Its value has dropped from about 15 U.S. cents in 1960, and 25 cents in 1955.

assessed property values, the rate of the tax was only 1.5 mills. Since assessments on an average are something like 50 percent of market value, the true rate is about half this. Table I shows valorization taxes for all Colombian municipalities in 1959-1963, in relation to property taxes, total taxes and total current revenues. During this period valorization tax collections have been from 22 to 67 percent as large as property tax collections, and the tax has provided from 12 to 23 percent of total municipal tax revenues. For the three years, 1956-1958, statistics are available only for the 24 largest municipalities in Colombia. During this period valorization tax collections were about 50 percent of their property tax collections, and provided about 20 percent of their total tax collections.

Bogotá has been the next most heavy user of the valorization tax, as shown in Table IV. The implied mill rate of the valorization tax in Bogotá has been, however, only about one-third to one-half of the implied rate in Medellín. In Cali, the third largest city, with a population about equal to Medellín's, the valorization tax has been weak. In 1963 the yield of the valorization tax in Cali was only 2.0 million pesos. This was less than 7 percent of total municipal tax revenue, and represented an implied rate of less than one million taxable assessed valuation.

It is possible to test crudely whether the valorization tax tends to substitute for other taxes in Colombia or to be a net addition to municipal revenues. Table V contains per capita revenue data for the three cities, which tend to indicate that the valorization tax may add to total tax revenues, rather than

TABLE I

Use of Municipal Valorization Taxes, by Department, 1963.

Department	Valorization Tax (Millions of pesos)	Mill Rate[5]	Percent of Municipal Taxes (%)	Percent of Municipal Current Revenues (%)
Antioquia[1]	32.9	3.7	29.7	9.9
Atlantico[2]	7.5	3.9	27.0	13.2
Bolivar	0.2	--	1.8	0.4
Boyacá	0.1	--	1.1	0.5
Caldas	2.0	0.4	5.9	2.6
Cauca	--	--	--	--
Córdoba	0.1	--	1.5	0.8
Cundinamarca	0.3	--	1.8	0.7
Chocó	--	--	--	--
Distrito Especial[3]	28.5	2.5	21.1	6.1
Hila	0.4	0.4	6.4	3.0
Magdalena	0.8	0.4	9.5	5.4
Meta	--	--	--	--
Nariño	0.3	0.2	6.7	3.6
Norte de Santander	1.4	1.2	12.5	5.4
Santander	3.7	1.6	18.2	10.4
Tolima	0.7	0.3	4.7	2.7
Valle[4]	2.5	0.3	4.6	1.4
TOTAL	81.4	1.5	17.0	5.9

Notes:

1. Contains Medellín
2. Contains Barranquilla
3. Contains Bogotá
4. Contains Cali
5. Based on the total assessed property value, including property exempt under the property tax, some of which is taxable under the valorization tax. These mill rates in relation to assessed values are therefore on the low side.

-- Negligible

Sources: Revenue data from Banco de la Republica; assessed valuations from Instituto Geografico "Agustin-Codazzi", Departamento de Planeación Departamental (Antioquia), and Departamento de Planificación Distrital (Distrito Especial).

TABLE II

Importance of Municipal Valorization Tax, 1959-1963[1]

Year	Valorization Tax (millions of pesos)	Percent of Property Tax (%)	Percent of Municipal Taxes (%)	Percent of Municipal Current Revenues (%)	Implied Mill Rate[2]
1959	75.7	66.8	23.2	10.4	2.5
1960	44.5	35.0	15.0	5.7	1.3
1961	38.9	22.0	12.3	4.4	1.0
1962	49.7	29.0	12.9	4.8	1.0
1963	81.4	40.3	17.0	5.9	1.5
AVERAGE		44.3	17.3	6.1	1.4

Notes: 1. Excludes Department of Chocó

2. See note 5, Table I

Sources: As in Table I

These aggregate figures are somewhat misleading, however, in view of the wide variation in the degree to which the tax is used. A better idea of the importance of the valorization tax to large cities may be obtained from the data for Medellín, Bogotá, and Cali. In Medellín, the city which pioneered widespread use of the valorization tax in Colombia, the valorization organization has regularly budgeted income about equal to the total regular income of the city government (the public utility enterprises are not included in this comparison) as shown in Table III. In recent years however the valorization organization has only raised and spent about half of the amount budgeted, while general fund income has been close to the budgeted levels. Although the 1966 budget is 67.7 million pesos, by May 1966 the estimate of income for the year had been reduced to 52 million pesos. The valorization department plans to make future budgets more realistic. It is not known if the budget shortfalls were this large before 1956. In any event, the valorization tax has supplied from around one-third to perhaps one-half of the total income of the city of Medellin, and a rather higher percent of the total tax revenues of the city. In Medellin the average mill rate for the regular property tax in the last ten years is slightly less than six mills, so the valorization tax, with its average mill rate of 8.0 for the last ten years, is actually a larger source of revenue than the property tax.[18]

18. Properties under 10,000 pesos are exempted from the property tax, but not from the valorization tax. The implied mill rate for the valorization tax on the broader base is about 7.5 mills. (See also note 5, Table I.)

TABLE III

Medellín: The Importance of Valorization Taxes, 1956-1966
(Millions of Pesos)

Year	Valorization Investment Expenditure	Valorization Operating Expenses	Valorization Taxes and Other Current Income	Implied Mill Rate (Taxable Property)	Total Income	Total Budgeted Income	Total Budgeted Income Medellin General Fund
1956			8.9	(6.5)	18.4	20.0	20.1
1957			16.0	(10.0)	18.0	24.9	24.8
1958			17.2	(9.8)	19.6	24.7	27.8
1959						28.9	36.2
1960	19.4	1.6	19.7	(6.7)	19.7	38.4	36.2
1961	14.5	1.8	19.5	(6.7)	19.7	37.3	42.1
1962	16.8	2.7	16.5	(4.9)	19.9	50.1	50.0
1963	55.6	4.2	36.7	(9.5)	52.6	87.1	66.9
1964	51.7	5.1	54.7	(11.8)	59.6	88.4	82.1
1965	24.9	7.1	36.9	(6.8)	44.5	88.1	96.6
1966			50.0*	(8.0)*	52.0*	67.7	

Source: Departmento de Valorización, Medellín; J. Restrepo, El Impuesto de Valorización en Medellín; Departamento de Catastro, Medellín.

* Projected.

TABLE IV

Bogotá: The Importance of Valorization Taxes, 1959-1965

Year	Valorization Tax ('000 pesos)	Percent of Property Tax	Percent of All Taxes	Implied Mill Rate
1959	21,585*	69.5		3.2
1960	15,304	37.4	21.0	2.5
1961	17,906	44.0	25.3	2.4
1962	16,379	28.6	14.3	2.0
1963	33,562	54.2	24.8	3.7
1964	22,122			2.1
1965	21,793			

*National statistics show valorization taxes of 39.2 million in 1959 for Bogotá. No explanation is available.

Source: Departamento de Valorización, Bogotá, for valorization data; Agustin Codazzi Geographic Institute for Property tax revenues; Special District Planning Office for Property assessments.

TABLE V

Municipal Tax Revenues Per Capita, 1963
(Pesos)

	Medellín	Bogotá	Cali
Valorization Tax per Capita	54	22	3
Property Tax per Capita	42	40	28
Total Tax per Capita	115	88	50
Taxable Real Property per Capita (assessed values)	5,750	5,950	4,230
Estimated Population (thousands)	675	1,540	600

Source: See Tables I, III, IV; "Cali en Cifras", D.A.N.E.; "Anuario Estadistico de Medellín, 1963" substituting for other taxes.

C. Valorization in Medellín.[19]

The administration of the valorization tax is most highly developed in Medellín, which will therefore be taken as a basis for describing Colombian practice. Brief comparisons will then be made with the operation in Bogotá and other cities.

Medellín is a city of 700,000 population located on both sides of a river in a narrow valley. It is a manufacturing city, diversifying from a base of textile industries. Because of growth, the urban area now spreads into four or five other municipalities in the valley, and all the familiar problems from fragmented jurisdiction are beginning to arise. Medellín has not solved them yet, but through the semi-autonomous Institute for the Development of Antioquia, attempts to form municipal compacts and joint organizations are underway.

The valorization department of Medellín is independent of the municipal government in most respects. It is controlled by a nine-man board composed of city officials, city council members, and two private citizens. The department itself has about 150 employees. All projects are originated by the department staff, which prepares preliminary reports on all aspects of a project and recommends it to the board for approval. Under Colombian law, all large cities must have city plans, and while some do not comply, Medellín has had a long-

19. Medellín is the capital of the Department of Antioquia, whose citizens are widely known as energetic businessmen. See Everett Hagen, On the Theory of Social Change (Homewood, Ill.: The Dorsey Press, 1962), chapter 15, for an account of Antioquia and the Antioquenos.

range plan since 1948. All valorization projects are selected and planned in accordance with the city plan, and with the advice of the city's planning department. The major and most visible achievement of the valorization department has been to construct a network of broad streets and boulevards throughout the city. In conjunction with the boulevards, sewers, street lighting and landscaping have also been provided.

Since the projects must increase land values by the amount of the tax, at least, if the valorization plan is to be successful and enjoy continued support, careful attention is given from the beginning to this aspect. Thus benefit-cost analysis is an integral part of planning all projects. There is a tendency to make projects large, so that sections can be included in the project which would not be justified by themselves, but which can be covered by other parts of the project which are more attractive. For example, parks, as noted above, can only be included as part of major street development projects.

After the Board has given preliminary approval to a project, the department prepares the detailed plan for the project. The residents of the area involved must be included in the planning and execution of the project by law, so the Board calls an election for them to elect a representative. No quorum is required for the election. If no one is elected, the Board appoints a representative. If the elected representative fails to act on any matter, the Board can go ahead and make decisions without him. This representative has the right to appoint an expert to intervene in all technical questions of the project, particularly the assigning of the tax among property owners. If a disagreement arises between the property owners' expert and the department, it must be settled within less than thirty days, or the Board has the right to make a final decision, which cannot be appealed. In effect, the property owners' representative has only the weapon of the voice of reason or politics in influencing the development of the valorization project.

The procedures for determining the area of benefit and assigning the valorization tax are aimed at finding formulas that will seem fair to the taxpayers, rather than "scientific formulas." The most important consideration in determining the area of benefit is that it seem reasonable to most people, and that it be large enough so that the tax on properties at the edge of the area will be low, so the marginal taxpayer will not get angry because his neighbor next door or across the street is not in the benefit area and does not have to pay any tax; yet the area must not be so large that the taxpayer feels he gets no benefit from the distant public improvement. Once the area of benefit is determined, several methods may be used to assign relative taxes. One formerly used, and perhaps used still, is to prepare a number of maps of the area, and assign an arbitrary number to the value increment per unit area in the point of highest benefit and a similar index at the lowest point. A number of other points are marked on the map, and perhaps half a dozen persons who are familiar with property values in the city are asked to independently assign relative numbers to the other points on the map on a scale between the two arbitrary values. When all have done so, they get together, examine their results, and work out a final set of arbitrary value increment numbers. By interpolation and extrapolation from these numbers, each property is assigned a value increment number which is then multiplied by the area of the property to obtain its "equivalent area". No attention is paid to buildings or improvements in carrying out these calculations.

At other times, a distinction is apparently made between the "zone of direct benefit", and the "zone of reflected benefit", and an attempt is made to allocate the cost between the two zones first, before assigning the tax to each property. When the public improvement is a road, the benefit may be assumed to be constant along a line parallel to the road, with some modifications. For simple improvements such as paving existing streets, the cost is often assigned on a frontage basis alone. Valorization officials admit that public improvements may lower site values for some properties near the improvement (for example, commercial properties on side streets when a main street is improved), so that occasionally they must adjust the tax downward to reflect this when complaints come in from property owners. In general, however, the Medellín valorization officials state that there is such a large backlog of needed public improvements, and property owners are sufficiently anxious to have them built because they believe they will increase property values, that taxpayers protests are minor and have no limiting effect on the volume of valorization projects undertaken. They feel they must be careful in their approach and flexible in their methods when assigning valorization taxes, but that all property owners will be willing to pay at least a small tax to obtain the improvement.

Although the city regulation permits a tax of up to 75 percent of the total increase in land values, in practice the total tax is set equal to project cost (including 10 percent for contingencies) plus 20 percent for administrative costs.[20] Property used for religious purposes is exempt from the tax. The departmental government pays valorization tax on its property. By law, the municipality is also supposed to pay on its property, but in fact the transfer is really the other way as the valorization department pays 1 1/2 percent of its budget to the municipal government for compensation of taxes on properties it has acquired and for municipal services. Other public properties are generally exempted and if the project warrants it, the entire cost may be placed on the non-exempt properties. When the total amount of tax to be collected is determined, it is divided by the total "equivalent area" of all properties to obtain the tax rate per unit of "equivalent area", and the tax bills are prepared.

When the project receives final approval from the Board,

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20. As seen in Table III, operating expenses (not including interest payments on loans) in Medellín have been over 12% of current income in recent years. Much of operating expense is design and engineering expenses for projects, so administrative expenses for the valorization tax itself are much less than 12%. However, administration costs for local taxes in Colombia are high; for example, the operating expense of the cadastral office in Medellín is 6% of property tax collections.

the terms for payment of the tax are also set. The Board may allow up to 100 months to pay and may set down-payment requirements as it wishes, in accordance with its opinion on the ability to pay of the people in the area. Areas with poorer property owners get a longer period to pay. Interest of 8 percent per year is charged on unpaid balances, and the taxpayer, if he wishes, may pay the entire amount at once, with a discount of 3 percent for each year paid in advance. Since interest rates in private markets start at about 12 percent and go on up in Colombia, there is little incentive for advance payment. A typical payment requirement is 20 percent down and two years to pay the remainder. If the taxpayer is short of cash, he may arrange to pay his tax in whole or in part in land, though this is seldom done. Taxpayers who can prove financial stringency can make special payment arrangements with the Board at its discretion. Flexibility is the essence of the whole payment system in Medellín. All payments go into the Rotation Fund of the valorization department, and construction of the project must start within two years of the final approval of the project, or payments are refundable. This Valorization Fund is completely separate from the General Fund of the Municipality.

To provide working capital, the valorization department can issue bonds, or borrow money from private banks; at the end of 1965 its debt was 27 million pesos. At that time its cash on hand was less than 0.2 million pesos. The department plans to issue 34 million pesos in bonds in 1966. Since these bonds sell at a discount of 10 percent, pay interest of 9 percent on the face value, and are exempt from all taxes, they are occasionally purchased by well-off people who cannot otherwise hide their income from the tax authorities. They are also purchased by insurance companies in order to satisfy legal obligations on their portfolio composition. But in general, the valorization bonds will be bought only by those who expect to have to pay valorization tax in the near future, since one year after purchase up to 50 percent of the valorization tax obligation may be met by bonds at their face value.

While, in the short run, the scale of operations of valorization is limited by the lack of working capital, the more important limits seem to be set by the amount of tax which the Board estimates can be collected in a year without overstraining the finances of the taxpayers (or arousing strong opposition from them), and by the quantity of projects which the department staff can successfully prepare and administer in a timely fashion. The department staff state they would like to expand their operations somewhat, but that a major increase would be undesirable. It is not clear what in their opinion the major limiting factor is.

In addition to its regular program, the valorization department administers two other funds. One is a newly established program to provide light, water, sewers, paving, etc., to poor neighborhoods. (Under Medellín's subdivision law, the poorest new developments need not have paved streets and only a communal water supply need be provided.) The beneficiaries of these works will repay the department over a ten-year period. The working capital will consist of 12 million pesos from municipal sources. The 1966 income is budgeted at two million pesos for this fund. The third fund, for urban renewal, is not operational yet, although the department has hopes of selling 25 million pesos of bonds to finance its working capital in 1966.

While the principle of valorization taxes is well established in Medellín, the administrators seem very sensitive to public attitudes toward the tax, and are careful to maintain public support. At this time, a major project in downtown Medellín is to tear down a number of buildings and build a wide boulevard. Because the project has aroused some criticism from influential citizens, the Board is now proceeding extra carefully in selecting its new projects in order to avoid losing any further support for its program. Partly because [illegible] the high value put on voluntary taxpayer cooperation and the flexible way in which payment periods may be fixed, relatively few taxes are collected by coercive action. Less than 1 percent of the accounts are passed to the enforcement section of the municipal Treasury for action, and almost all of these settle before formal action is taken, usually by making informal arrangements to pay over the rent of the property until the tax debt is satisfied. In 1965, perhaps 15 properties (out of 18,000 affected) were sold at auction as the ultimate sanction.

The success of valorization taxation in Medellín seems to depend on a law free from procedural roadblocks, a competent permanent staff, and an administration which is sensitive to popular attitudes towards the projects it undertakes. A major fight was necessary to establish the valorization tax in Medellín against the opposition of large landowners who wanted to avoid paying for the public improvements benefiting their land,[21] but when valorization proved able to provide a much larger number of well-planned and executed projects than had been possible previously, this opposition largely ended. The administrators in Medellín emphasize the importance of carefully building up the valorization program over time, starting with small works that can be completed on time and as promised, and avoiding any dishonesty or financial mismanagement in the program.[22]

D. Valorization in Bogotá.

The other city in Colombia where the valorization tax is used extensively is Bogotá, the national capital of some 1.8 million population. In addition to being the financial and governmental center of Colombia, Bogotá is also the largest manufacturing center. The city is governed as part of a special district, which cover a large enough area so that problems of overlapping jurisdiction in the metropolitan area

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21. One leading citizen (and landowner) even wrote a book against valorization called The Robber Municipality (El Municipio Ladrón). Valorization officials claim he died a very rich man from the increases in his property values brought about by valorization projects.

22. The failure of valorization programs in London in the late 19th century, for example, appears to have been due mainly to poor management, rather than to any basic defect of the program or to the less favorable conditions for valorization in developed countries cited earlier. Ralph Turvey, The Economics of Real Property (London: George Allen and Unwin Ltd., 1957), chapter 9, notes that the Municipal Board of Works, which handled valorization in London, was popularly known as "The Municipal Board of Perks".

are only now arising and are still very minor. The Valorization Department was established in 1959 (replacing a Valorization Office established in 1944), and with 150 employees is the same size as that in Medellín. Valorization in Bogotá is devoted mainly to construction of the "Plan Vial", a long-range plan to provide the entire metropolitan area with boulevards and highways. The valorization department also opens up many short new streets to rationalize the street pattern left by private developers, and a separate fund is used to pave existing streets in the poorer neighborhoods. A fund for urban renewal is only now being implemented.[23]

Valorization in Bogotá is similar in many respects to Medellín in its organization, but the requirement that the city council approve all projects is an added hindrance. In fixing zones of influence, and coefficients to be applied to properties in the zone, Bogotá takes on the whole the same pragmatic approach as Medellín, although the use of zones of equal value parallel to new highways seems to be more popular than in Medellín. The total tax is determined as the cost of public works plus 20 percent for administration.

Like all valorization offices, Bogotá has faced difficulties in raising working capital, and its rotating fund has issued valorization bonds, of which 24 million pesos were outstanding in December 1965; in addition, bank loans of 9 million pesos

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23. The law establishing this fund has an interesting provision for "voluntary renewal", according to which the owners of 70 percent of an area may get the city to expropriate the rest of the area in order to combine large properties for approved urban development projects. This power is now undergoing its first test in Bogotá.

had been obtained. All payments of valorization taxes <u>must</u> be made in valorization bonds, which are sold at a stabilized price of 91. The bonds are received in payment of the tax at 110 during the first three months after the tax is payable, at par for the next three months, and thereafter at the market value. The taxpayer has the option of paying the tax in installments if he so requests. Taxpayers with incomes of less than 50,000 pesos are allowed by law from 6 months to 5 years to pay the tax, depending on the size of the tax assessed compared with their income, while the higher income taxpayers receive from 6 months to 20 months to pay.

In Bogotá the Valorization Department has attempted to secure payment from the city for municipal property, but has been unsuccessful; at present the city owes the Valorization Fund 40 million pesos for valorization work, and failure to pay has severely hampered the operations of the Valorization Department. Construction of the city's only limited access expressway by valorization was held up for several years because the neighboring Hotel Tequendama, owned by the Military Retirement Fund, was exempt from the tax and the Valorization Department lacked alternate sources of revenue to finance the expressway. The Department does receive one-half of one mill of the property tax collections, however, in contrast to Medellín. In addition, the Department has decided that some costly works, such as expressway interchanges, cannot be charged to the neighboring properties, and must be financed from general funds. It is argued that taxpayers cannot bear the burden of constructing major portions of the road system all at once, so that the interchange costs might successfully be spread over a large number of taxpayers, and that when the system is constructed a small section at a time, a limited number of taxpayers cannot absorb the tax. Apparently, the Department is afraid that it cannot declare a very wide zone of benefit for expressway interchanges to cover their costs by valorization, for taxpayers would protest at an apparent lack of benefit to them from some works.

The valorization office reports no difficulties in enforcing payment. If the tax is not paid, the Office has the right to seize the property and collect rents until the tax is paid, or to sell it. Many properties are apparently embargoed but fewer (1 or 2 a year) are sold than in Medellín. The Department has its own judge to handle seizures to enforce payment, and the volume of taxpayers is small enough that enforcement is prompt and effective, though more formal than in Medellín, in part perhaps because of the greater impersonality of large metropolitan areas. (The city has four tax judges for enforcement purposes, but they cannot keep up with a workload covering all city taxes, with the result that property tax collections in particular lag badly.)

The major limitation on the volume of valorization work in Bogotá is lack of working capital, caused in part by the failure of the city to contribute its full share to the valorization fund, but also by past difficulties in managing the valorization bonds which weakened the financial strength of the fund.

The separate fund for paving streets in Bogotá requires that local "community action" councils in the neighborhood pay 30 percent of the cost of the paving job before the pavement work is started. The other 70 percent of the cost will be paid by the city (except in the case of bus routes in poor areas, where the city bears the whole cost). This work is supported by an annual grant from the city government. The local councils use their own private methods to get all householders on the street to be paved to pay their share of the 30 percent down-payment. This program is paving streets in short stretches, with little plan or reason. When paved, the job is guaranteed against failure for four years by the contractor, and the local public works department is responsible for maintenance for the next six years. Only after ten years can valorization be used to repave streets.[24]

E. Other Colombian Experience with Valorization

We were not able to investigate the operation of the valorization tax in Cali, the third largest city, where it has been much less successful. The following reasons have been offered by various sources for the lower level of valorization in Cali. First, the valorization rotating fund has been unable to obtain working capital to finance its operations. This in turn is attributed in part to the fact that a fully independent valorization department with a competent staff has never been established in Cali. This in turn is attributed to the fact

24. The Harvard Tax Program study (p. 135) states that valorization taxes are paid more or less continuously in Colombia for what would usually be considered to be municipal maintenance expenditures. We have found no real evidence for this statement. (See, however, the discussion on Mexico City below for some evidence of such practices).

that the owners of large amounts of vacant land on the edges of Cali are unwilling to pay valorization taxes for the new roads needed to open up their land, and have had the political power to prevent establishment of a strong valorization program in Cali. They apparently expect these improvements to be financed from general funds, even if it means a much lower rate of construction.

Although the municipality of Cali has had little success in financing capital improvements by special charges, the independent municipal utility enterprise has done much better, partly because of its operating success and consequent ability to obtain initial financing from the international lending agencies.[25] Given some initial funding, the municipal utilities have found it quite feasible to recoup capital costs along with consumption charges on a user charge basis. In fact, the initiative for requesting the extension of water or power lines has been in large part left to the inhabitants of the areas affected, who must get together (under the auspices of the community action groups mentioned earlier) and agree on a financing plan acceptable to the enterprise. Piecemeal provision of services has been avoided, it is claimed, by only acceding to the requests of different neighborhoods--all of which are said to want services--in accordance with the general development plan of the service. The only sanction

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25. This information is largely based on an interview with Hernán Borrero, Manager of Municipal Enterprises of Cali. The scope of the Cali enterprise is similar to that in Medellín described in note 15 above. It is not known whether the enterprises in Medellín and Bogotá (where there are 4 separate enterprises) follow the same financing system as that outlined in the text.

possible under this system is to cut off the service once the work has been done, but there are said to be very few problems since the idea of purchasing water or electricity service on the installment plan is now well understood and accepted. Only community services are charged for on this scheme; thus water pipes more than 12 inches in diameter, electricity substations, and the like are charged to the general funding of the enterprise. The Cali municipal enterprise also makes some use of the municipal valorization office, for example, in financing a major extension of the water network at the present time; but it feels unable to do so on a wider scale both because of the present weakness of the office and because of the confused land title situation in many of the poorer areas of the city. The financing system actually employed is in many ways an acceptable substitute for valorization and could perhaps be more widely used in connection with the "worker's subdivisions" mentioned earlier in which the urban developer is not at present required to provide most urban services.[26]

The valorization program has also been rather small scale in Barranquilla, Colombia's fourth largest city, according to a recent report.[27] Revenues from valorization in 1964 amounted

26. A recent analysis of pricing for electric utilities in Colombia by Prof. Ralph Hofmeister of the University of Minnesota points out that the costs of local distribution systems for utilities are joint costs that cannot be assigned to individual users, and that the local distribution system is best considered a "Samuelsonian" public good whose costs should be covered by taxation. He recommends use of special assessments. See "Observations on the Tariff Policies of the Electricity Supply Companies Affiliated with 'Electraguas'" Los Andes-Minnesota Project (Bogotá: May 14, 1966).

27. Lauchlin Currie and Associates, Plan Socio-Económico para el Atlántico (Bogotá: Imprenta Nacional, 1965), pp. 200-209.

to about 3.3 million pesos, an implied rate on the property tax base of less than 1.6 mills. The Currie report attributes the low level of valorization activity in Barranquilla to lack of working capital and to continuous political interference. The Valorization Board lacks independence, and taxpayers can petition the City Council for exemption from the tax, petitions which are apparently frequently granted. (If true, this is a violation of a national law stating that exemptions for private citizens can only be granted to properties valued, <u>after</u> the assumed increase in benefits, at less than 30,000 pesos, which are the sole asset of the owner.) Dilatory court procedures are also used to delay or evade payment of the tax.[28] Currie recommends that the valorization program be made a part of the autonomous Public Utility Enterprise of Barranquilla in order to escape the present political interference in the program.

The experience of the Colombian cities indicates that the freedom of action provided by the national laws allows Colombian cities to have successful valorization tax programs, <u>if</u> the valorization agency can be created with sufficient autonomy to withstand political interference and to build up a technically competent staff. Pragmatic methods of successfully selecting projects and assessing the valorization tax have been worked out, but the financial management of even the most successful programs seem weak, for the shortfall from budgeted operations is large, and working capital for operations is lacking. It has not been possible to examine the financial

28. The slower growth rate of Barranquilla, only 4.5 percent per year in the last decade, may also have made valorization difficult in Barranquilla.

self-sufficiency of the valorization funds to see if they will be adequately financed from valorization tax payments and budgeted public contributions, or if they are using up their working capital, but there is reason to doubt the financial soundness of many of the funds. The main limitation to successful valorization programs in Colombia, however, is the lack of the trained personnel to run them.[29]

The difficulties of applying valorization taxes under the most stringent laws for non-municipal agencies are well illustrated by the attempts of the Cauca Valley Corporation to collect valorization taxes from a dike project which, by preventing seasonal flooding, opened up much new land for urbanization on the outskirts of Cali.[30] Although the project was authorized in 1958, and by 1962 the work had been substantially completed and over 10,000 people were living in the formerly flooded areas, no valorization tax had yet been collected by the middle of 1964. The difficulty lies in the fact that the law required special property valuation surveys before and after the dike was built, and these surveys were not

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29. A private consulting firm has recently been established in Medellín to help set up valorization offices in other cities. So far its activities have been confined to Colombia, though there was apparently one inquiry from Caracas in Venezuela (on the absence of valorization in Caracas, see Carl S. Shoup, C. Lowell Harriss, and William Vickrey, The Fiscal System of the Federal District of Venezuela (New York, 1960), p. 65.

30. The project, and the attempts to finance it by valorization are described in detail in Antonio J. Posada F. and Jeanne de Posada, CVC: Un Reto al Subdesarrollo y al Tradicionalismo (Bogotá: Ediciones Tercer Mundo, 1966), pp. 189-190. At the present time, a movement is on foot to make more use of valorization at the departmental level. New roads on the edges of large cities which cross several municipalities are proposed. New valorization offices have been set up in Antioquia, Valle, and Santander.

completed until mid-1964. Only then could the tax per property be determined and collections begun. The interest rate charged to the taxpayer on the investment between the time it is made and the time the tax is assessed is only 6 percent, whereas the purchasing power of the currency has dropped by about 10 percent per year during the period since construction, so the tax cannot cover the total costs of the work in real terms, and the delay in collection forced the CVC to finance works to be recouped eventually through valorization taxes for three or more years from other sources in a situation of a chronic shortage of credit.

IV. An Example for Other Developing Countries?

A. Valorization in Ecuador[31]

Finally, by way of contrast, we shall briefly describe the valorization tax systems in two other Latin American countries--Ecuador and Mexico.

In the past, special improvement taxes have not been very important in Ecuador. A new Municipal Law passed early in 1966 is intended to expand the number of public works that may be financed by valorization. This new law has several features of interest in relation to the Colombian system outlined earlier. Like the Colombian tax, the Ecuadorean tax is levied on the benefit (increase in value) presumed to be derived by property owners whose holdings border on the work or lie in the

31. The information in this section is based on the law and on discussions held in Quito, particularly with Lic. Carlos Davalos, R., former Director Técnico de Administración in Ecuador.

zone of influence laid down by the municipal council. Also more or less like the Colombian system are the funding and payment systems prescribed for this "special improvement levy" as it is known. There appears, however, to be no provision for the establishment of independent valorization offices responsible for both the execution and the financing of projects, on the Colombian model. The proposed Ecuadorean system also differs significantly in other respects, such as in the treatment of exempt property and the treatment of different types of public works.[32]

All properties, taxable or exempt, must be included in the initial distribution of the special improvement levy. The share allocated to National government properties exempted from the property tax must be met by direct payments from the national budget. Other exempt properties must be paid for from the common municipal funds. This treatment seems logical, though, given the usual pressure on both national and municipal budgets, it will probably not work well in practice, as witness

32. Three minor differences might also be mentioned: (1) In no case may the total tax exceed 50 percent of the increase in value of the property between the period immediately before the work and that in which the tax due is determined; this looks considerably more restrictive than the municipal system in Colombia; (2) Municipalities are also empowered by the new law to levy a tax at rates ranging from 10 to 42 percent on capital gains arising from the sale of real property, provided that no special improvement levy has been imposed. If it has, only the excess of the capital gains tax over the valorization tax is payable, a procedure which may be contrasted with the deduction of valorization taxes from the capital gain for purposes of the national capital gains in Colombia; (3) Municipalities may also make agreements among themselves to allow each other to collect valorization taxes or to do so jointly, or the national government may require some joint arrangement to be made; this would seem a desirable provision in the Medellín area, for example.

the failure of Bogotá to live up to its own laws in this respect. The Medellín practice of sometimes allocating the costs properly attributable to exempt properties to non-exempt ones has little to be said for it in theory, though it may be practically acceptable if the benefit-cost ratio of the project is high or the cushion provided by rapid urban growth is large enough. The Ecuadorean tax is a charge on the property rather than on the owner (like the new national tax in Colombia), thus avoiding some of the difficulties of _in personem_ taxes in areas of confused land titles like so much of Latin America, both urban and rural.

The other interesting feature of the new Ecuadorean system--for which there is apparently no parallel in Colombia (except perhaps the Cali municipal enterprise's system of technical division of projects into general and local components)--is the different treatment of different kinds of public works. These are classed in eight groups, in each of which the cost is to be allocated in a different manner. In the case of urban paving, for example, 30 percent of the cost of the work is to be met from the general municipal budget, 20 percent pro-rated among bordering properties on a frontage basis, and 50 percent pro-rated on fronting properties in proportion to the cadastral value (of land and improvements). Similar specific formulas are used for the other seven types of improvements.

A number of comments may be made about this system. One is that there is no logic in the use of the cadastral value base for a valorization tax since there is no reason at all to suppose that the increase in value due to the improvement will be related in any systematic way to the initial value of the properties benefited, even supposing what is hardly ever true in Latin America--that these initial values are themselves rationally distributed. Another point is that there is some reason for different treatment of different kinds of works, and particularly, in some cases, for the allocation of some of the cost to the general fund.[33] The case for general fund financing probably becomes stronger as urban areas become more developed. However, it is most unlikely that rigid specification of different percentages, as in Ecuador, is desirable since relevant circumstances will vary so much from project to project. Partly for this reason, greater flexibility in allocating benefits, as in Colombia, seems desirable. One might argue that the Colombian system could be improved by a more explicit recognition on the municipal level of the fact that the local benefits of projects do not always exceed their total cost--a fact which is clearly already recognized in practice. On the whole, however, it seems clear Ecuador has more to learn from Colombia than the reverse.

B. Valorization in Mexico City.[34]

Taxes similar to the valorization tax have long been used in Mexico City. In 1961, the "planning tax" yielded 10 percent

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33. The report by the Advisory Commission on Intergovernmental Relations, Performance of Urban Functions: Local and Areawide (Washington, D.C., 1963), contains an interesting (non-operational) discussion of the degree of "localness" of the benefits from different kinds of public improvements.

34. This section is based largely on work done several years ago by one of the authors and therefore may not be fully up to date. This work was part of a project on urban financing in developing countries undertaken by the Harvard Law School International Tax Program under the direction of Professor Oliver Oldman.

as much as the real property tax, or less than 2 percent of total municipal revenues.[35] This tax apparently applies to all properties benefited by major public works, including government and religious properties, although as usual there is often a losing fight on the question with such public bodies as the railroads. The only explicit exemption in the law is for foreign diplomatic missions when reciprocity is granted (as in Colombia, where, however, the nation is supposed to pay for such properties). In addition, properties classified as of special historical interest get a reduced rate (as they do under the property tax), presumably because in this case it is not desired to induce more profitable use of the land.

The planning tax due on any particular property is devised by means of rather complicated formulas to determine the affected zone and the allocation within them. These formulas appear to be rigidly applied in all cases, even though their arbitrariness virtually assures that no public improvement will actually affect property values in the precise, specified

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35. This tax replaced an earlier form of increment value tax in 1950. The earlier tax was supposedly unsatisfactory because, (1) it was difficult to calculated and arbitrary in any event; (2) it was felt that the property tax reached the increments in land values anyway; and (3) it was a cause for taxpayer resentment when more money than the cost was collected in connection with some project and the surplus used elsewhere. This explanation of the change seems improbable, however, since the same remarks could be made about the present Mexican tax.

pattern.[36] The virtues of more flexibility in these matters, so apparent in the operation of valorization in Medellín, are thus completely lost in Mexico City. The notification and payment systems are rather similar in both countries, with some discount being allowed for advance payments. This discount procedure seems more acceptable for valorization works, where otherwise money would have to be borrowed and interest paid, than in the case of regular property taxes.

Many works which are financed by the planning tax also give rise to the so-called cooperation fees, which yielded a little over 1 percent of total current revenues in Mexico City in 1961. These fees are levied on a flat frontage basis for sewers, sidewalks, water lines, street lighting, and street paving when the street is part of the internal road network of the district. Occasionally, such works have been financed by assigning the proceeds of these charges to the lending institutions and empowering them to collect their money directly.

On the whole, the system of financing public works by benefit taxes does not appear to have worked well in Mexico's

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36. This is probably in part the explanation for the finding in various U.S. studies in the early part of this century that special assessments were badly correlated with value increments (see Harold M. Groves, Financing Government (5th ed.) (New York: Holt Rinehart and Winston, Inc., 1958), p. 376. See also International City Managers' Association, Municipal Finance Administration (5th ed.)(Chicago, 1958), chapter 10. Incidentally, to the other reasons for lack of use of valorization financing in the U.S. today we might add the traumatic experience of the 1930's when land values generally fell, public improvements or no public improvements. Since Keynesian thinking is now accepted, it is unlikely this experience will be reproduced in the U.S., but it remains true that valorization will work much better in prosperous times. In developing countries, inflation may play the role of prosperity for our purpose.

capital up to now, as is indicated both by the small revenue yield and by the number of complaints made about those taxes that are levied.[37] It has been argued, for example, that taxes must be paid several times on the same increase in value--through the planning tax, the cooperation fees, and increased property taxes. The basic property tax is apparently usually increased because of the interchange of information between the valorization office (in the public works department) and the property tax office (in the treasury). There is no such formal notification procedure in Colombia so far as we know. Assuming a real property base has any rationale at all for tax purposes, one would suppose that property taxes should in fact be increased as a result of public works which increase land values, whether or not the work itself is financed by taxes on the value increments. But as a matter of public relations, the issue is not so clear, and it may be worth foregoing the smaller benefit for the greater one.

It has also been said in Mexico City that the operation of the valorization tax system has had undesirable effects both allocationally and distributionally. The existence of these taxes may make property owners in certain areas less desirous of having public works than would otherwise be the case. We saw that an analogous situation has also held back the operation of the system in Cali. This effect is not necessarily bad if

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37. In Mexico, unlike Colombia, the national government has traditionally subsidized the capital city, and much of the public investment in Mexico City, including highways, has been financed from National Government revenues. Opposition to valorization in Mexico may simply reflect realistic expectations that the city can escape the tax burden for improvements if a little pressure is put on the National Government.

the existence of taxpayer resistance means that works to be financed by this system must have high benefit-cost ratios and be clearly beneficial to all, as is more or less true in Medellín and Bogotá. It is less desirable if it leads to underspending on such works owing to "spite" resentment of taxes, to ignorance of the full benefits, or to the belief that a good enough cover up of true preferences for public goods will eventually lead to the provision of the improvements from the general funds. In addition, where, as in Mexico City, rent controls prevent landowners from reaping higher returns from their property, they are unlikely to favor improvements to benefit their tenants at their expense.

The distributional effect of financing ~~a~~ work by benefit taxes rather than general taxes is clearly to favor the general taxpayer at the expense of those benefited. In some instances, this shift may be considered socially undesirable. This argument has been used against benefit financing in Mexico City. It has, for example, been claimed that heavy transit traffic has led to continuous works being charged to areas inhabited by poor people rather than to the well-off fringe districts.[38] It has also been suggested that the poor inhabitants of the small villages swallowed up in the course of the growth of the metropolitan area were forced to sell out (though presumably at higher values) in order to meet the heavy charges connected with the extension of the urban service network. As always,

38. In fact, there is generally no benefit financing of repaving in Mexico, although it is presumably as logical to finance the maintenance of existing values as the creation of new values in this way.

the distributional argument for the provision of some particular consumption good, whether it be food, housing, or urban services, at subsidized prices is weak unless the general benefit is assumed to outweigh the local benefit (in which case all the improvement cost should not be financed by valorization) or the specific subsidy is the only politically or economically feasible way of providing an income subsidy (as may indeed be true in developing countries characterized by very unequal income distributions and by the political power of the better-off).

Without discussing the not-so-happy Mexican experience further, we may sum it up by saying it shows again the overriding importance of careful planning and good taxpayer relationships if the valorization tax--no matter what its theoretical merits or its real relation to increments in land values--is not to be perceived as a harsh and arbitrary charge by those it reaches.

C. An Appraisal of the Valorization Tax

1. Taxing on the basis of benefit.

The valorization tax appears to have been most successful where the greatest efforts have been made to put it on a true benefit basis, in Medellín. To do this seems to require the following elements: (a) freedom from any fixed formulas for distributing the tax among property owners; (b) careful study of projects at the initial stage to determine those which will truly bring increased site values equal at least to the cost of the project; (c) participation of property owners in the planning and execution of projects without giving obstructionist or veto powers; (d) careful costing of projects; (e) prompt construction of projects; (f) prompt and complete collection of all taxes assessed on the property owners while the project is being built; (g) extensive publicity of valorization construction projects; (h) a general statement of the rules for hardship cases permitting, but not requiring, reduction in tax or delayed payment in certain circumstances. The development of a valorization system is also a matter for careful planning: Medellín's experience indicates the importance of starting with small projects which can be completed quickly and with certainty and thus earn taxpayer trust; at a later stage it might be better to concentrate on large multi-faceted projects. While there are no empirical studies available to show how closely valorization tax assessments have corresponded to subsequent site value increases in value in Medellín, there is a general feeling by officials and observers that the tax has been on a basis proportional to benefits. Preserving a popular identification between the tax and the benefits by all possible means is repeatedly emphasized in Medellín. If one believes Abraham Lincoln's dictum that "you can't fool all of the people all of the time" the valorization tax over the long run must have approached a benefit basis in fact as well as in belief. This means also that, as was noted above in discussing the proposed Ecuadorean system, some explicit recognition should be given to the likelihood, especially at later stages of urban growth, that the benefits from works projects capitalized in private property values may not always suffice to pay for the project, though its general social productivity may still be very high. It is important for effective functioning of the tax, however, that any such provision be coached in general rather than rigidly specific terms.

2. Exemptions.

There is little reason for exempting any property from the valorization tax. The exemptions of government property have given windfalls to private interest public groups such as military pension funds.[39] Failure of other governments to pay assessments has seriously hurt the financial soundness of valorization in Bogotá. Exemption may be justified for small landowners who are illiquid and cannot raise the cash to pay their assessments, but this problem can usually be solved in practice by giving small landowners longer periods to pay, in effect requiring them to pay less, especially in inflationary periods, and by making special arrangements in hardship cases. Valorization may force improvements on some owners, which they do not want, forcing them to sell out and move elsewhere, but in theory at least they should sell out at a profit and suffer no financial harm, although there may be some loss of consumer surplus from valorization, as from any change in supply and demand conditions.

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39. The exemption of publicly-owned property is sometimes justified on the ground that this property has no commercial value. While this position may recognize the realities of political life, it has no base in economic analysis. The use of land for public rather than other purposes has an opportunity cost equal to its highest value in alternative uses, and increases in this cost due to public works should, in theory, be explicitly recognized in making decisions on the location of public facilities.

3. Earmarking of revenues.

Public finance textbooks tend to condemn earmarked revenues because they limit the flexibility of budgeting in a government, glutting some activities with too much revenue while other activities starve. This can only be avoided if the rate of the earmarked tax is changed regularly to bring it in line with actual revenue needs. This is the case with the valorization tax. Further, the financing of investments from the earmarked valorization tax gives an added incentive to examine the prospective benefits of projects more closely than would otherwise be done and hence promotes good budgeting and project appraisal procedures.

Benefit taxation may be made politically popular in the way outlined in point 1. above. A charge may then be made, however, that those activities which can clearly be financed on a benefit base will receive too much support, at the expense of other activities which for technical reasons cannot be benefit financed. Too much emphasis on benefit taxation may also limit the scope for income redistribution from taxation. The force of these charges is lessened to the extent that benefit taxes can be shown to be in addition to other taxes, expanding the size of the public sector, rather than substituting for other more general taxes. On the basis of admittedly crude and impressionistic evidence, the valorization tax does seem to be a net addition to public financing in Colombia. The need in Colombia is for additional technically sound benefit taxes to expand the public sector, not less use of those now existing.

4. Relation to other taxes on property.

As discussed above, the valorization tax is supposed to be applied on the basis of the assumed increases in pure site value, and the continued popularity of the tax when well administered seems to indicate that this aim is achieved.[40] The valorization tax is compatible with a capital gains tax on increments in site values, provided the valorization tax is included in the original cost of the property when calculating capital gains, as is in fact done in practice in Colombia. Assuming that the valorization tax and the capital gains tax together recoup for the public sector the increment in land values, it may seem unfair to have a regular property tax which taxes site values and improvements, since valorization projects raise site values and hence property tax on the site. On the other hand, public improvements have maintenance expenditures, and the cost of maintenance should be paid by those who benefit. Also, it will rarely be the case that all increments in land value can be taxed away by the valorization and capital gains taxes, so some scope will be left for site value property taxation. Finally, it must be recognized that most property taxes go to finance municipal services for people, who in turn live in and use buildings and other improvements, and if taxes are to

40. As noted earlier, such authorities as Groves and Netzer appear to favor a land-value increment tax over the valorization tax recommended here, that is, a tax assessed on benefits actually received as a result of the work to one on benefits that it is presumed will arise in the future. The valorization tax is preferable in developing countries because of the lack of a capital market for financing public works, the more favorable attitudes of taxpayers to benefit taxes, and the growth-inflation cushion of rising property values.

be at least in part, benefit based, much of the property tax should be on improvements, so that development will pay its proper share of taxes. In the face of ignorance as to the relative weight of these points, it would seem *a priori* best to tax land and improvements at the same rate, especially since site value is already reached by the valorization and capital gains taxes.

In practice in Colombia the values of valorization-financed improvements are not automatically included in the assessed values of properties. Owing largely to the continued inflation, the municipalities now are pressing for more regular reassessments anyway. If the target of a four-year cycle or less is achieved, the lag between completion of a project and an increase in the assessed value will not be a long one. In any event, as noted earlier, if real property is a rational base for taxation in developing countries--as it would seem to be on both benefit and distributional grounds--there is every reason for taxing increases in site value, however caused, under the regular property tax as soon as possible.

5. Effects on Income Distribution.

In terms of the usual definition, the valorization tax is probably a progressive tax, since it is in proportion to property, and property ownership is more unequally distributed than income in almost all countries. Using the more inclusive concept of the "fiscal residuum", the tax is neutral, for all taxpayers would receive benefits equal to or greater than the payment. Compared with probable alternative ways of financing public improvements if valorization is not used, the valorization tax probably favors the poor over the wealthy and yields a more equal income distribution. This presumption is somewhat confirmed by the fact that the strongest opposition to valorization taxes in Colombia has come from some of the wealthier groups in the country.

D. Conclusion.

The valorization tax as it exists in Colombia seems to have a useful, but limited role to play in economic development. It is effective in financing certain specialized types of public investment at a certain stage in the economic development of a country. For the tax to be useful, the country must have reached a stage where urbanization is proceeding at a rapid rate and large modern cities are being formed, and where modern agriculture and transportation are rapidly being introduced. The country must also have developed capable administrators, real estate men, and engineers who can handle the complicated machinery of the valorization tax. City planning must also have become feasible.[41] Yet the country must not have yet reached the stage of maturity where capital markets have developed which can take over the job from valorization, and where the city has become so large and intricate that the relation between public investment and increases in site value

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41. It is of course essential to relate the works financed by valorization to a coherent city plan if the full benefits of this form of financing are to be realized without the disadvantage of "piecemeal" improvement. The financing and execution of the work should be under the responsibility of a single entity, for reasons discussed earlier. This entity should be as autonomous as possible (except for its relation to the planning department), in order to enable it to hire and retain the capable skilled people success requires, free of the usual fiscal and political constraints of public administration in developing countries.

is too complex for valorization financing to work. This stage probably will not be reached in Colombia generally for many years, although there are signs that it may already be approaching in Bogotá.[42]

There are many other countries in the stage of development Colombia is now in, or soon to be there, and Colombia's experience may be of interest and use to them. At present in Colombia, the interest in extending the valorization system to new uses and increasing its importance in current uses is high. Colombians feel that the experience in Medellín and elsewhere in the last twenty years has established both the general principles and the specialized methods needed for successful valorization programs. The success of the present attempts to extend the valorization tax will probably depend more on the quality of administration of the new programs than any other factor. While there is little information available on the effects of valorization taxes, on the basis of what little we know, it may be safely concluded that the expansion of valorization taxation in Colombia and in other similar countries should be favorable for general economic development.

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42. Even at this more advanced stage there is still a role, though a lesser one, for valorization taxes in the financing of works with an irregular local-general benefit split. Possibly land-value increment taxes might by this time be more suitable, as argued by Netzer, p. 213.