Shahrukh Wani

Shahrukh Wani is associated with the International Growth Centre's "Cities that work" Initiative, Blavatnik School of Government, University of Oxford.

Q. How do you see increased property taxation as a source of better public service delivery in Pakistan? If introduced, can it have a subsequent impact on economic activities?

A. It is important for us to recognize that increasing tax revenue - through any means - can pave for more delivery of public services, as tax revenue is instrumental in determining state capacity to deliver public services. Of course, low tax revenue isn't the only constraint to better public services and it also matters what kind of economic loss those taxes collect but low tax revenue is a constraint. Claiming otherwise is incorrect.

What makes land and property taxes particularly important for service delivery is that they're very visible and spatially-bound. Let me expand on the two.

First, they are a particularly visible form of taxes: that is unlike the tax deducted at the source or that added to the end price of an item you buy at the supermarket, you pay for property taxes directly, usually in lump sum payments. This creates a clear line of accountability between the people and the government. For example, we have experimental evidence from the Democratic Republic of Congo that property tax collection drives people to demand accountable governance. I argue that if we expand property taxation, this will lead to people demanding better public service delivery.

This links to my second point that property taxation is a local tax, unlike most other forms of taxation. That is, it is spatially-bound so you can create those lines of accountability between taxpayers and providers of urban services clearly and at a smaller spatial scale. This is even more important considering how easy it is for rich people to move capital between borders that makes taxing it hard. The big thing missing for us is local urban governments that can both tax properties and provide corresponding services to the taxpayers.

On its economic impact, we need to study the welfare consequences and incidence of the tax based on its exact design and where it is applied, but in theory such a tax is economically less distortionary. Here we need to make a distinction between taxes on land and those that consider the improvements on land too, like the structure of the house. As land's supply is fixed, a tax on it will not reduce the land's supply (which would be a bad thing to do). This is a stark contrast from almost all forms of taxes that create some form of bad consequences, usually by lowering supply. For example, you tax people's income, people might work less. Land is instrumentally different so we can tax it without creating these bad consequences. A tax that also considers the construction on the land (that is, the property as a whole) will create some bad consequences: typically, by lowering investment on properties. So ideally such a tax should give more weight to the value of the land, than on the buildings on it - although the latter may be important to distribute wealth properly.

Q. You suggest the expansion of taxation jurisdiction to independent/authorized urban governments. Given the lack of local government, and vertical disbursement of funds; how do you think Pakistan can use this as an instrument to strengthen local governments?

A. It is a two-way relationship here. You need local governments to actually make this tax work, and you need this tax for local governments to work.

The reason we need local governments is because, as I said earlier, we need that link between the tax and the corresponding public services clearly. An added dimension here is that landlords are a powerful lobby and there is going to be a very strong backlash if we expand this tax. To counter this we need a coalition of beneficiaries of the people who will benefit from better public services. Reforms are hard to manage and without a clear reformist coalition it won't get done, or sustained.

Then we also need this tax for local governments to work. We see this tendency in many countries that local governments are set up half-heartedly, usually they're given mandates to provide services but not the necessary fiscal powers to pay for it (these are called 'unfunded mandates'). Giving them power to tax land and properties is a great way to make sure that they're truly empowered to provide public services. This also gives them a stake in the economic progress of their jurisdiction: if the local economy does well, they get more tax revenue, so they are more incentivised to make productivity-enhancing investments.

Q. The financial management in Pakistani cities is top to bottom, with minimum revenue generation by cities? Do you think this model is sustainable?

A. Cities need two broad fundamentals for proper financial management: first, they need to have predictable expectations of how much money they will get from national or provincial governments. Even with lots of local taxes, this will remain a major source of revenue (as it is everywhere). But these transfers shouldn't be ad-hoc because cities need predictable and transparent fiscal transfers to plan for and invest in large scale investments and also borrow money from the private market, if they're legally allowed to do that in the first place. Second is that they need to complement that significantly with local taxes and user fees. Land and properties are the biggest source of local taxes while user fees can be charged where the government can easily exclude people from using a service, such as in the case of public buses.

Q. There is an emerging case for de-densification in wake of COVID. Can cities manage the densification and agglomeration, and still manage to provide better health facilities in health emergencies?

A. Two things to ask when people talk about de-densification: what kind of density do they mean? And, what is the cost of reducing density? On the first, what actually drives COVID19 infections is mainly indoor density. That is, when a large number of people live together in close quarters. This is more prevalent in informal settlements where large numbers of people are confined to small houses and there aren't enough open spaces between households. So it is important to exactly determine the type of density that is most worrying in the spread of diseases. On the second, we need to recognize that density broadly is a very good thing when there isn't an infection. Density is good for productivity and it is good for the environment.

On managing density, of course, cities need to do that. All urban policy effectively exists in a two-way tension between expanding the upsides of density (like, allowing people to share ideas) and downsides of density (contagion, crime, and congestion). For example, investing in a public transport system is a great way to manage this tension: you help people connect with each other and firms, and decrease congestion. Many cities are able to do this well, others not so well.

Q. You recently suggested that there is a higher rate of return on investments in the stock market than property, can you elaborate on this? Also, how can we deconstruct our fascination with the rent-seeking property market?

A. So the suggestion was made by the State Bank of Pakistan comparing index-fund return and the return from Zameen.com's database. There are problems with that data but it does give a broad indication that the rate of return on real estate is significant. This isn't an exception either: we have long-run data that shows that return on housing is significant across modern history, so we're not an exception here.

What is interesting to ask is the implications of such high-returns from real estate. Most fundamentally, it creates incentives for people and firms to invest in real estate, as a way for them to park and increase their wealth. It might be a self-fulfilling prophecy: people invest in real estate expecting high-returns, the expectations also crowds-in more investment and pushes up the value of real estate. Hence, delivering high-returns. The question is then, is this a good thing? Is it coming at the cost of investment in other sectors of the economy, perhaps that can increase our exports? We need to think about these questions analytically and produce some evidence to inform these discussions. My big fear is that the current system effectively means that the real estate sector absorbs a lot of speculative investment that crowds-out people who want to buy land for housing.