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**Designing a Property Tax Reform
Strategy for Sub-Saharan Africa:
An Analytical Framework
Applied to Kenya**

Roy Kelly

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Abstract

Countries throughout Sub-Saharan Africa are exploring options to improve local property taxation. Using the case of Kenya, this paper provides an analytical framework for designing an effective property tax reform strategy. Part One presents a general conceptual model of property tax revenues, identifying four critical ratios that ultimately determine the effectiveness of any property tax system—namely, the coverage ratio, the valuation ratio, the tax ratio and the collection ratio. Part Two applies this conceptual framework to the property tax system in Kenya, focusing on the status of these four ratios and outlining possibilities for improving each ratio. Part 3 concludes by summarizing five basic lessons for successful property tax reform, and applying these to develop a set of parameters for a successful property tax reform strategy in Kenya.

The paper shows that the property tax in Kenya is an underutilized revenue source for local authorities. Potentially property tax revenues could be increased by 60 percent through effectively improving the four critical ratios of coverage, valuation, tax rates and collections. Improved property tax revenues could contribute critical resources necessary to enable local authorities to provide the level and quality of services required to sustain and promote further economic and social development in Kenya.

JEL Codes: R51, H71, H29

Key Words: Property Tax Reform, Local Government Revenue Mobilization, Kenya, Africa

Roy Kelly is an Associate at the Harvard Institute for International Development and the Director of the HIID Program on Fiscal Decentralization and Financial Management of Regional and Local Governments. Dr. Kelly's research and teaching focus on public finance, with emphasis on intergovernmental fiscal relations, local government finance, and property taxation. He is currently working as a senior resident advisor with the Ministry of Local Authorities in Nairobi, Kenya. He received his B.A. in History from West Virginia, a Masters in City and Regional Planning, and a Ph.D. in Urban Planning from Harvard University.

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INTRODUCTION

Developing countries everywhere are undertaking fiscal decentralization and local government reforms to improve government service delivery, economic efficiency and government accountability. These fiscal decentralization efforts start by fundamentally reviewing expenditure and revenue responsibilities by level of government. Rationalizing these expenditure and revenue allocations, together with establishing an intergovernmental transfer program, are the first steps towards creating a fiscal structure that can enable governments to better fulfill their stabilization, distribution and allocation functions (Inter-American Development Bank, 1997; Ter-Minassian, 1997; and Litvak, Ahmad and Bird, 1998).

In most developing countries, due largely to the extreme lack of local level revenue alternatives, the intergovernmental fiscal analysis begins by focusing on revenue allocation (Bahl and Linn, 1992, Kelly, 1999). Thus, in addition to establishing a system of enhanced central-local revenue transfers, governments are forced to mobilize and improve existing local level revenue sources. Virtually all countries focus attention on the property tax—the most common revenue source for local governments throughout the world (Dillinger, 1991).

Developing countries in Sub-Saharan Africa are no exception. As one writer recently noted, property taxation is

“one of the most lucrativeyet least tapped sources of tax revenue to support urban government in Africa...” (Charles, Mou, 1996).

However, despite this recognition, the property tax in Africa continues to be plagued by problems. In several countries, the central government is reticent to devolve policy and administrative authority over the property tax to local authorities, while at the same time remaining indifferent in terms of promoting property tax reform. In other cases, even when authority is granted to the local level or when the central government is interested in property tax reform, progress is slow due to perverse incentives, inappropriate property tax policy and the lack of property administrative systems, trained personnel and synchronization of improved local service delivery with enhanced revenue mobilization (Municipal Development Programme, 1996).

In an effort to address these various problems, policy makers and donor agencies are evaluating the options for appropriate property tax reform strategies. Designing and implementing these property tax reforms requires evaluating the fundamental policy and administrative questions such as:

- (1) What should be and not be included in the tax base?
- (2) What are the valuation standards and valuation methods to be employed?
- (3) What should the tax rate and tax assessment structure include?
- (4) What is the role of the local and central government in tax policy and administration?
- (5) How should the administration system be structured?
- (6) What is the proper role of computers?
- (7) How should appeals, collection, and enforcement be handled? and
- (8) How can taxpayer service be enhanced?

The answers to these questions provide the key determinants for structuring a country's property tax policy and administration.

Different countries throughout the world have been forced to answer these questions for themselves—each with extensive experience on the consequences of their choices. This breadth of international property tax experience provides an opportunity for developing countries to learn and adapt the key lessons to the unique legal, political, economic, social and institutional environment in their countries. It will be through designing and implementing appropriate property tax reform strategies that will ultimately provide the funds necessary for effective local governance and improved service delivery.

The first step in any property tax reform effort is to undertake a thorough analysis of the existing property tax system, identifying the major constraints and opportunities for improvement. Based on this analysis, an appropriate reform strategy must be designed, focusing on the policy and administrative dimensions as well as the implementation strategy itself. The final step of the reform is the actual implementation of the proposed strategy. Ultimately the reform success will depend on effectively combining these three steps.

This paper focuses specifically on the first two steps—that is, identifying the major constraints and opportunities for property tax reform and developing an appropriate reform strategy for implementation. The country of Kenya is used as a case study to provide a framework for analyzing and developing an appropriate property tax reform strategy for developing countries, especially those in Africa.

The paper begins by presenting a general conceptual model of property tax revenues, identifying four critical ratios that ultimately determine the effectiveness of any property tax system—namely, the coverage ratio, the valuation ratio, the tax ratio and the collection ratio. Using this

conceptual framework, Part 2 analyzes the current property tax system in Kenya, focusing on the status of these four ratios and outlining possibilities for improving each ratio. Part 3 concludes by summarizing five basic lessons for successful property tax reform, and applying these to develop a set of parameters for a successful property tax reform strategy in Kenya. It is hoped that this analytical framework as applied to Kenya will serve as a useful tool for designing appropriate property tax reforms in other developing countries.

CURRENT GENERAL SITUATION

Property taxation plays a major role in financing local governments throughout the world (McCluskey, 1991; Youngman and Malme, 1994; Kelly, 1995; IMF, 1996; and OECD, 1997). Although comparative data is scarce, property taxes account for between 40-80 percent of local government finance, 2-4 percent of total government taxes, and about 0.5-3.0 percent of GDP. In contrast to developed countries, developing countries tend to generate significantly less property tax revenue—typically generating a maximum of 40 percent of local government revenue, 2 percent of total government revenue and about 0.5 percent of GDP.

Compared to other developing countries, Kenya appears to be underutilizing its property tax capacity. Rates (property taxes) provide an average of 22 percent of the total recurrent revenues for local authorities and represent 1.3 percent of total government tax revenue and 0.3 percent of GDP (GOK, 1995, 1996a; 1996b). The property Rates in 1994/95 provided K£ 60.2 million and K£ 5.1 million to the Municipal Councils and to Town, Urban and County Councils, respectively (See Table 1). As expected, the property tax is a more important revenue source for municipalities due to the existence of valuation rolls that capture the larger, more valuable tax base.

Table 1: Local Authority Revenue Structure (1990/91 - 1994/95)
Nominal (million of Ksh pounds)

Municipal Councils	1990/91	1991/92	1992/93	1993/94	1994/95
Direct Taxes (Rates)	32.8	43.6	51.6	55.0	60.2
Indirect Taxes (Licenses and Cesses)	2.17	9.8	10.8	8.4	7.5
Income From Property	9.16	9.8	12.9	14.1	23.1
Current Transfers	0.2	0.0	0.0	0.1	0.0
Sales of Goods and Services (Service Charge)	56.16	73.1	89.9	134.0	152.2
Total Recurrent Revenues	100.5	136.3	165.2	211.6	243.1

Town, Urban and County Councils	1990/91	1991/92	1992/93	1993/94	1994/95
Direct Taxes (Rates)	1.8	1.7	1.7	3.0	5.1
Indirect Taxes (Licenses and Cesses)	6.1	6.2	7.8	16.0	15.2
Income From Property	0.2	0.3	1.8	13.6	2.2
Current Transfers	0.1	0.1	0.2	0.4	0.2
Sales of Goods and Services (Service Charge)	26.7	27.6	26.0	21.9	37.4
Total Recurrent Revenues	35.0	35.8	37.3	54.9	60.1

Combined Local Authorities	1990/91	1991/92	1992/93	1993/94	1994/95
Direct Taxes (Rates)	34.6	45.2	53.3	58.0	65.4
Indirect Taxes (Licenses and Cesses)	8.3	16.0	18.5	24.4	22.7
Income From Property	9.4	10.2	14.7	27.7	25.3
Current Transfers	0.3	0.1	0.2	0.6	0.2
Sales of Goods and Services (Service Charge)	82.9	100.7	115.9	155.9	189.6
Total Recurrent Revenues	135.5	172.1	202.5	266.5	303.2

Source: Government of Kenya (1996) Economic Survey (Nairobi: Central Bureau of Statistics, 1996)

In nominal terms, property Rates have grown annually by 17% since 1990/91. However, in inflation-adjusted real terms, property Rates revenues have remained stagnant. As a percent of local authority revenues, property Rates have declined in importance from 26% in 1990/91 to 22% in 1994/95, while revenue from property Rates has fallen from 0.37 to 0.30 percent of GDP. Thus, not only are the property Rates in Kenya under-performing relative to other developing countries but the

revenue productivity has (1) remained stagnant, (2) declined in relative contribution to total local authority recurrent revenues and (3) declined as a percent of GDP.

These conclusions are not surprising since the property tax by its structure is not automatically a buoyant revenue source. That is, the property tax relies extensively on active government participation to ensure that changes in tax base information and property values are kept up-to-date and that taxes are properly assessed, billed, collected and enforced. In contrast to sales taxes that are paid upon each purchase, or to income taxes where the majority can be collected through a pay-as-you-earn (PAYE) withholding process, the property tax depends on more direct and active government administration for its revenue buoyancy.

What are some of the reasons for the stagnant property tax revenues?

Property tax revenues stagnate primarily because of lags in maintenance and completeness of the tax base coverage, inaccurate valuations, and inadequate collection/enforcement. Although tax policy concerning tax base definitions, exemptions, valuation standards, and collection/enforcement provisions can improve revenue yield, the key to increasing revenue buoyancy is largely improved administration. That is, the government must ensure that all property is on the tax rolls, that property is valued close to market value, that the tax is assessed accurately, and that the revenue is collected and enforced. This relationship can best be illustrated through the following property tax revenue model:

$$\mathbf{Tax\ Revenue = Tax\ Base * CR * VR * TR * CIR}$$

Where,

- CR = Coverage Ratio is defined as the amount of taxable land captured in the fiscal cadastre, divided by the total taxable land in a jurisdiction which taxes land only, such as Kenya. This measures the accuracy and completeness of the property information in the valuation roll.
- VR = Valuation Ratio is defined as the value on the valuation rolls divided by the real market value of properties on the valuation roll. This measures the overall accuracy of the property valuation level (i.e., what percent of market value is being captured through the valuation process).
- TR = Tax Ratio is defined as the “rate struck” for the taxing jurisdiction. This measures the tax amount per value of the property that is to be paid as tax. The tax ratio (or tax rate) is determined through the annual budget process.
- CIR = Collection Ratio is defined as the tax revenue collected over the total tax liability which has been billed for that year. This measures the revenue collection efficiency. The collection ratio is affected by the collection of both current liability and tax arrears (i.e., enforcement efficiency).

As this formula indicates, potential tax revenue is a function of the accuracy and level of the coverage ratio, the valuation ratio, the tax ratio and the collection ratio. In fact, as Box 1 indicates, these four ratios ultimately determine the effective tax rate and tax burden for each property, thus affecting the revenue yield, economic efficiency and overall equity of the property tax system.

Box 1: Applying the Four Property Tax Ratios: An Example

The use of these ratios can be illustrated through the following example:

Town A has a “true” potential property tax base (or property tax capacity) of \$100,000. Under ideal circumstances, Town A could collect \$4,000 with a tax rate of 4%. However, due to administrative difficulties, Town A may have a coverage ratio (CR) of 40 percent, a valuation ratio (VR) of 50 percent, and a collection ratio (CIR) of 40 percent. With a tax rate (TR) of 4%, Town A would generate a revenue yield of \$320 per year (i.e., $100,000 \times .4 \times .5 \times .4 \times .04$). This would represent 19 percent of the “real revenue potential.” The average effective tax rate would be only 0.003 (0.3 percent).

Assuming that the property tax reform could increase the coverage ratio (i.e., the accuracy of the tax roll information) to 0.8, the valuation ratio (i.e., the accuracy of the valuation level) to 0.7, and the collection ratio (i.e., the collection efficiency) to 0.7, Town A would generate a revenue yield of \$1568, an increase of 390%. The average effective tax rate would be 0.016 (1.6 percent). At these levels of administration accuracy/efficiency, Town A would be able to capture close to 40 percent of the “real revenue potential.”

Due to market dynamics, the “property tax capacity” would keep fluctuating over time depending on the demand and supply factors affecting the price of land. This fluctuating property tax capacity would change both in absolute terms on the aggregate and in relative terms among the individual properties based on location. This reemphasizes the importance of active government effort on the administration in order to ensure that the various ratios affecting the property tax are up-to-date and accurate.

Thus, , the solution is to develop policy and administrative systems that can maintain the accuracy and timeliness of the coverage ratio, the valuation ratio, the tax ratio and the collection ratio.

Unlike the tax ratio (i.e., the “rate struck”) which is determined politically once during the annual budget process, the coverage ratio, valuation ratio and collection ratios are affected by the level of administrative capacity and political will continuously throughout the year. The following section will review the current situation in Kenya vis-à-vis these four critical ratios.

CRITICAL RATIOS FOR IMPROVING PROPERTY RATES IN KENYA

A property tax system involves six major functions: (1) tax base identification, (2) tax base valuation, (3) tax assessment, (4) tax collection, (5) tax enforcement, and (6) dispute resolution and taxpayer service. As summarized in Table 2, each of these functions is linked to the four critical ratios of coverage, valuation, tax and collection that were identified in the conceptual model of property tax revenue. This section will describe each of the four ratios, their situation in Kenya and possible actions for improving each ratio. This background analysis provides the necessary foundation and context upon which to develop an appropriate property Rates reform for Kenya.

Coverage Ratio (Property Information)

The first step in property tax administration is to assemble and maintain information on the tax base. This compilation of property-related information is called the “fiscal cadastre” which can include information on land, land and improvements, or land, improvements together with machinery/equipment depending on the policy choice regarding tax base definition (both what will and will not be taxed). The challenge is to ensure that this basic information is up-to-date and accurate—that is, to maintain the coverage ratio as close to 100 percent as possible.

Table 2: Property Tax Administration Functions and the Four Critical Ratios

Property Tax Function	Objective	Action	Critical Ratio
Tax Base Identification	To determine what will be taxed	Identify the tax base (land, building and/or machinery and equipment). Identify the exemptions from the tax base.	Coverage Ratio
Tax Base Valuation	To determine how the tax burden will be distributed among the taxpayers	“Weight” the tax base (either by area, other characteristics or value) Influence the distribution of the tax burden among the taxpayers	Valuation Ratio
Tax Assessment	To determine how much tax will be levied To determine how the tax burden will be distributed among the taxpayers	Determine the overall tax level Influence tax burden distribution among taxpayers through varying effective tax rates	Tax Ratio
Tax Collection	To collect the tax	Issue and Deliver the Tax Bills Collect the tax	Collection/Enforcement Ratio
Tax Enforcement	To determine how much revenue will be collected through enforcement	Enforce against noncompliance (sanctions and penalties)	Collection/Enforcement Ratio
Tax (and Valuation) Appeals Resolution	To ensure that the tax is equitably administered	Resolve disputes concerning the property information, valuation or tax assessment	(linked to Coverage, Valuation, and Tax Ratio)
Taxpayer Service	To provide service to the taxpayer	Taxpayer Education Taxpayer Service	Linked to Collection Ratio (i.e., good taxpayer service will encourage higher collection ratio)

In Kenya, the Rating Act allows the local authorities to tax either land or land and improvements (e.g., buildings). Although the first application of “Rating” in Mombasa in 1921 was based on land and improvements (i.e., the annual rental value of occupied premises), all property Rates in Kenya are currently levied only on land.¹ Improvements (e.g., buildings and structures) are not taxed. Although taxing only land can limit revenue potential and buoyancy and introduce a number of equity issues, it can be argued that taxing improvements will discourage investment and thus encourage underutilization of land.²

Although variation in rating is allowed under the law, in practice, all local authorities limit their assessment to area rating and valuation rating³. Out of the 165 local authorities in Kenya, there are 92 which are “rating authorities.” Of these 92 rating authorities, 73 use valuation rating, 38 use area rating, while 20 use a combination of both area and valuation rating. As Table 3 indicates, municipalities and towns tend to rely on valuation rating while counties tend to use area rating or a combination of area and valuation rating. Area rating tends to be used for rural or agricultural properties while valuation rating tends to be used for urban properties.

¹ The Government of Kenya, *The Rating Act (cap 267)*, 1972 and *the Valuation for Rating Act (cap 268)*, 1972 provides for three types of rates: area rate based on the size and use of the land; unimproved site value rate is based upon the capital value of the bare land and the site value and improvement rate is based on the land and improvements separately.

² The extent of this inefficiency, however, depends on the returns to the investment in improvements relative to the tax burden. The efficiency gains from only taxing land in developing countries is often overstated since the effective property tax rates on improvements in most developing countries compared to other capital investments is quite low. These low effective tax rates result from the coverage, valuation, tax and collection ratios. Some countries have combined the benefits of a pure land tax with the benefits of taxing improvements by either introducing a land tax combined with a luxury housing tax (e.g., Barbados) or through introducing a land and building tax with a building valuation deduction (e.g., Indonesia).

³ *The Rating Act, 1972*, provides extreme flexibility in defining the tax base. Rating authorities may use either an area rating, an agricultural rental value rate, a site value rate or a site value rate in combination with an improvement rate. For area rating, *The Rating Act* (Section 5) again provides flexibility to use one of five different options, including the use of a flat rate or a graduated rate upon the area of land, differentiated flat or graduated rates according to land use or any other method of rating upon land or buildings that the rating authority may resolve.

Table 3: Breakdown of Property Rating in Kenya (1995)

Type of Local Authority Councils	Rating Authorities	Local Authorities using Valuation Rating	Local Authorities using Area Rating	Local Authorities using both Area and Valuation Rating
Municipalities	37	37	4	4
Towns	16	14	6	4
Counties	38	22	28	12
Total	92	73	38	20

Source: Ministry of Lands and Ministry of Local Authorities, 1997.

In Kenya, the fiscal cadastre information can be broken into two components. **First**, there is a valuation roll that contains land information and values for properties taxed under an ad valorem rate. This valuation roll is broken into the private valuation roll and the public valuation roll and typically only covers land located in the established, gazetted area of local councils. **Second**, there is property tax information that is used for area rating purposes for land outside the gazetted area of town and municipal/town councils. This information covers the peri-urban areas that are taxed under a system of area rating. Although this area rating roll can contain both private and public land, it is used primarily for government forests and large farms. These two primary sources of property information create the basis for a broader, comprehensive fiscal cadastre.

The valuation roll is legally to include information on all private land and on all public land located within the gazetted area of the councils with the exception of those few cases enumerated in the Valuation for Rating Act. Although some private land is exempted from taxation under Section 27 of the Rating Act, all exempted land is to be included in the valuation roll. According to the law, therefore, the coverage ratio for land in the valuation roll should be close to 100 percent.

The Valuation for Rating Act originally stipulated that a valuation roll be issued once every five years (or longer if authorized by the Minister of Local Government). This was changed to once every ten years in 1991. In addition to the general revaluation, a supplementary valuation roll is to be issued annually to account for changes in the property information, valuing those properties, as they would have been at the date of the original valuation roll. These valuation rolls are subjected to an appeals process, after which the valuation roll is officially accepted by the Town Clerk. Tax bills (demand notices) are then sent to each ratepayer in accordance with the legal provisions in the law.

In general, the fiscal cadastre information in Kenya is neither up-to-date nor complete. It is estimated that the fiscal cadastre coverage ratio may range between 30-70 percent of the total taxable land. In addition to the outdated information, most local authorities exclude “freehold” land on the valuation or the area rating rolls (e.g., Nyeri, Kerugoya, Murang’a and Kwale local councils). They also exclude agricultural land less than 12 acres in the area rating rolls (e.g., Kilifi Town Council), and most private land in the area rating rolls.⁴ Public land (both central government land and council trust land) which is not yet “registered” is also excluded from the private valuation roll (*Valuation for Rating Act*, Section 7 (2))—although technically this land should be listed on the public valuation roll and be liable for Contributions in Lieu of Rates.⁵ In addition, allocated council trust land not yet registered is not liable for either rates or Contributions in Lieu of Rates.

⁴ Most local authorities do not tax freehold land. This is especially true for agricultural freehold land. The arguments given are (a) that these properties are already taxed through the agricultural cess, (2) that these properties do not receive local authority services and (3) that these properties are not legally obligated to pay property taxes. Much of the peri-urban land is not included in the tax base because the *Agricultural Act* which exempts farms less than 12 acres. The only exception is when an agricultural plot is subdivided into residential use, at which time, the local authority will include the property on the valuation roll.

⁵ The Rating Act (Section 23) stipulates that the Government must pay an annual “contributions in lieu of rates” (CILOR) to the local authority. This CILOR is, in essence, the property rates owed by the government for its property.

Local authorities do not have the capacity to systematically maintain and coordinate their fiscal cadastre information. With the exception of Nairobi, Mombasa, Nakuru and Kisumu, local authorities depend on the Rating Department under the Ministry of Lands to create and update their valuation rolls. All fiscal cadastre information is maintained on a manual basis—computers are not used at all for fiscal cadastre maintenance. As Table 4 confirms, these various rolls are not kept up-to-date—many of the current valuation rolls date back to the early 1980s, with a sporadic and ad hoc issuance of incomplete supplementary valuation rolls. Nairobi Municipal Council, for example, uses a valuation roll from 1982, accompanied by sporadically issued annual supplemental rolls. There are at least 18 local authorities using valuation rolls over ten years old.

Table 4: Current Status of the Valuation Rolls in Kenya

Year of Valuation Rolls	Number of Local Authorities
1982-1985	18
1986-1990	31
1991-1995	19

Source: Ministry of Lands, 1996

The legal basis to ensure a full coverage ratio is adequate—the problem is with administration. The government must systematically maintain the fiscal cadastre information. Maps should be used to ensure that all properties are listed. Various property-related information sources should be used to ensure that those listed properties have complete and accurate information necessary for rating purposes. It is then imperative that this various information be systematically maintained in light of changes in physical size (through amalgamations and divisions), tenure (i.e., ownership), and land use. Due to the dynamic nature of land markets, this is a continual process, requiring a systematic and rigorous administrative system to ensure that the information is kept up-to-date and accurate.

Although legal mechanisms can facilitate the systematic flow of property-related information, coverage ratio improvement is largely a matter of establishing the appropriate administrative structure and operating procedures, providing the training and incentives to the administrative staff, and ensuring that the procedures are maintained in a systematic manner. Given the dynamic nature of the land markets, this is a continuous and information intensive activity. Therefore, most countries throughout the world are increasingly depending on computers, linking the administrative procedures with the data processing capabilities of computers (Kelly, 1996 and Montes, 1996).

Valuation Ratio

Once tax base information has been collected, a property tax system must determine how this property information will be “weighted” in order to distribute the tax burden among the properties. The most common “weighting systems” are by property physical characteristics such as land area or by property value. The key objective of any weighting system is to determine the relative proportion of total tax that will be paid by each property.

In Kenya, the Rating Act and the Valuation for Rating Act provide extreme flexibility in how the property tax burden will be “weighted” and distributed among taxpayers. In practice, most county councils allocate the tax burden based on area, while the municipal and town councils allocate based on value. For those properties weighted by property value, the law provides that the valuation can be on either unimproved site value or a combination of site value and improvement value. The Valuation for Rating Act allows the valuer to adopt any suitable method of valuation.

In practice, all local authorities using a value-based system use unimproved site valuation. Except for the four councils of Nairobi, Mombasa, Kisumu and Nakuru, all valuation rolls are

prepared with the assistance of the Ministry of Lands Rating Department. All valuation rolls are constructed using a parcel by parcel individual valuation of each property which creates a backlog of out-of-date valuation rolls, due to the lack of trained rating valuers, financial resources for revaluations and the lack of institutional and personal incentives. Mass valuation techniques are not used by any rating authority in Kenya.

Unfortunately there are few empirical studies that have analyzed the level and accuracy of the individualized property valuations.⁶ From the limited information available, it is estimated that the valuation ratio ranges between 20-80 percent of real market values. In addition, it is estimated that the dispersion between the valuation on the rolls and the real market value is high, heavily correlated with the age of the valuation rolls. Although valuations may be accurate when first produced, this accuracy erodes overtime due to the shifts in relative and absolute market values. These low valuation ratios and the variation among the property values create efficiency and equity distortions, which impact the compliance level and the overall revenue yield from the property tax in Kenya.

The low valuation ratio (and the increasing inequity among properties) is due largely to the tremendous lag in maintaining the valuation rolls. As previously discussed, revaluations are supposed to take place every 5 years (recently changed to every 10 years). Therefore, to compensate for the lag in revaluations, the Government has allowed local councils to increase nominal tax rates. In Nairobi, for example, the tax rate for residential property increased from 2.25 percent in 1982 to 5 percent in 1991 and to 13 percent in 1996. This increase has almost equaled the rate of

⁶ Typically tax departments conduct assessment/sales ratio studies to evaluate the accuracy in the valuation level and the relative valuation among properties. Ideally, the valuation level should be close to 1 while the coefficient of dispersion (which measures the variation around the median should be less than 20 percent.

inflation thereby holding the average real tax burden per residential property almost constant over the past fifteen years.

Although tax rates can be adjusted to maintain increased tax revenues, they do not readjust the relative tax burden distribution among taxpayers. Relative equity is not readjusted to reflect differential changes in property values within a taxing jurisdiction. An analysis of the 1981 revaluation in Nairobi, for example, suggests that residential values increased by 600 percent, commercial values increased by 250 percent and industrial land decreased by 225 percent (Daudi, 1986). From 1982 to 1991, the average tax burden shifted from the commercial and industrial sector to the residential sector. The tax burden for residential land increased by 15.6 percent while the commercial contribution declined by 35 percent and industrial contribution declined by 20 percent. The residential land assessment increased from 64 percent to 74 percent of the total tax burden while commercial land decreased from 20 to 13 percent and industrial decreased from 15 to 12 percent (Rihal, 1991).

In addition to differential value increases between sectors, market dynamics cause major shifts in the relative value of different geographic areas. For example, residential land in Westlands increased by 370 percent, Eastleigh, Kamobangi, Mathare Valley Estates increased by 692 percent while Buruburu, Herabee Kemanthi Estates increased by 594 percent from 1971 to 1981 (Daudi, 1986). These differential increases in property values shifted the average tax burden among these regions as follows: Westlands decreased their relative contribution by 17 percent, Eastleigh, et al. increased their relative contribution by 41 percent while Buruburu, et al. increased by 23 percent (See Table 5).

Table 5. Changes in Property Tax Burden by Region, Nairobi, 1971 and 1981.

Region	Sample Size	Relative Tax Burden Contribution 1971 (%)	Relative Tax Burden Contribution 1981 (%)	Change in Tax Burden (%)
Westlands	5	66	55	-17
Eastleigh Kamobangi Mathare Valley	5	17	24	+41
Buruburu Herabee Kimanthi	4	17	21	+23
Total	14	100	100	

Source: Table is reworked from information contained in the Nairobi City Council Rolls, 1971 and 1981 as contained in Daudi, "Rating: A Case Study of the 1981 Nairobi City Valuation Roll", 1986, p.42.

The rapid urbanization rate in Nairobi over the past 18 years (1981-1999) would have further exacerbated the relative shifts in market values between sectors and location. If these relative shifts were captured in the valuation rolls, there would be a major reallocation of tax burden among ratepayers. Regions with rapidly increasing land values would be required to pay a higher proportion of the tax burden while regions with less rapid growth would reduce their relative contribution. The current approach of relying on increases in nominal tax rates does not pick up these relative changes in values and the resulting shifts in tax burden. The current tax burden distribution in Nairobi is still based on the 1982 allocation of property values—creating a major source of inequity. Unless these relative property value changes can be captured through frequent revaluations, taxpayer equity cannot be maintained.

In addition to the equity implications, infrequent revaluations typically cause massive political outcry as newly assessed values typically cause dramatic shifts in relative values and thus relative tax

burdens. During the 1981 revaluation in Nairobi there were dramatic shifts in property values which caused tremendous public outcry and apparently required the intervention of the Ministry of Local Authorities and the Ministry of Lands and two cabinet papers before the roll was finalized (Rihal, 1996). The more recent revaluation of Mombasa in the early 1990s caused a similar public outcry due to the dramatic shifts in market value. The Mombasa valuation roll created in the early 1990s was only certified and used in 1995/96. More frequent revaluations, accompanied by an effective public relations campaign would increase equity and considerably reduce possible political costs.

The only way to improve the accuracy and level of the valuation ratio is to systematically update the valuation rolls to reflect changes in the relative and absolute changes in property market values. This can be done through a combination of simplifying the valuation system (shifting it to mass valuation), computerizing the maintenance of the fiscal cadastre and the valuation process, and increasing the amount of manpower and financial resources allocated to rating roll maintenance.

Tax Ratio

Using the property information and values contained in the fiscal cadastre, the property tax system must apply the legally-mandated tax rates, exemptions, deductions, and credits guidelines in order to correctly assess the tax liability to each individual property.

There are two basic tax rate structures used by local governments throughout the world. **First**, some local governments apply a uniform tax rate to all properties in their taxing jurisdictions. For example, local governments in Indonesia apply a uniform 0.5% tax rate on all property (e.g., commercial, residential, and agricultural) (Kelly, 1992, 1993). **Second**, some local authorities apply differential tax rates, depending on the land use, land tenure or tax base. This

system “classified tax system” is practiced in most US jurisdictions and in the Philippines, which apply differential rates based on land use (Youngman and Malme, 1994 and Kelly, 1995) and in South Africa, where provinces apply differential rates based on whether the land is public or private or where taxing jurisdiction can apply a “composite rate” which taxes land and improvements differentially (Bell and Bowman, 1997).

Taxing jurisdictions also employ a variety of assessment-related policy variations. Some jurisdictions use differential tax rates on vacant land, specified “tax assessment ratios”, tax rate surcharges, tax exemptions, tax credits, valuation deductions, and other forms of tax relief. These different assessment variations are used with the hope of achieving a variety of policy objectives such as improving land use efficiency, capturing betterment, and providing specific tax relief. The use of differential tax rates, in combination with the various deductions, credits and exemptions, create differential effective tax rates which affect the revenue potential, equity, efficiency and the ease of administration of any property tax system.

In Kenya, the Rating Act gives the local authority the power to set the tax rate. The tax rate can be set either as a per unit rate in the case of area rating or as a per value rate in the case of valuation rating. The unit area or the value rate can be either uniform or differential. The differential rates can either be proportional or graduated based on land use, value, or size. Local authorities are allowed to choose a valuation rate of up to four per cent without central government approval. The Minister of Local Authorities must approve all tax rates higher than 4 percent—as a precautionary measure to protect the interests of the taxpayers.

In general, local authorities in Kenya tend to use a uniform area rate or a uniform tax rate structure. As Table 6 indicates, the tax rates range from 0.02 to 0.13 percent applied to the values contained on the valuation rolls. The median tax rates are 7 percent for municipalities and

5 percent for both towns and counties. Those jurisdictions with the higher tax rates tend to be those with the oldest valuation roles. There are only a few local governments that apply a classified tax rate structure. The most notable is Mombasa that differentiates tax rates by location—those properties located on Mombasa Island are taxed at a higher rate than those properties located on the mainland.

Table 6. Range of Tax Rates by Type of Local Authority, 1996/97

Type of Local Authority	Range of Tax Rates (%)	Median Tax Rates
Municipality	4% to 13%	7%
Towns	4% to 10%	5%
County	2% to 8%	5%

Source: Ministry of Lands and Ministry of Local Authorities, 1997.

In addition to the tax rate structure, the assessment function must correctly deal with the exemptions as identified in the Rating Act and Valuation for Rating Act. In addition, Section 16 of the Rating Act provides the option for local authorities to grant a discount of up to 5 percent for early payment of property rate liability. Nairobi was the first local authority to grant these discounts, beginning in 1996. Property tax payers can receive a 5 percent discount paying their taxes in January, a 4 percent discount paying in February, a 3 percent discount paying in March, a 2 percent discount paying in April and a 1 percent discount paying in May. Several other local authorities are now considering the application of the discount option.

In Kenya, there are only a few local authorities that currently use computers for the assessment and billing process (e.g., Nairobi, Mombasa, Thika and Nakuru). These systems are stand-alone billing systems, not linked to the broader property information management, property valuation, and tax collection or enforcement functions. Major improvement could be realized

with the introduction of computerized property tax information management systems to assist both in the assessment function as well as in the administration of all other aspects of the property rates system in Kenya.

Collection/Enforcement Ratio

Following property identification, valuation and assessment, a property tax system must collect the tax and enforce against noncompliance. Strategically speaking, tax collection and enforcement against noncompliance are the most important components of the property tax system since the property tax is a fiscal instrument designed to provide government revenue.⁷

If revenue is the primary objective for property taxation, it is clear that identifying and valuing the tax base are only supportive activities—important as they may be. Maps, property information and property valuations are only intermediate outputs used to obtain the revenue objective. This emphasizes the prime importance of the collection and enforcement function.

As with many countries, Kenya has a major problem with tax collection and enforcement.⁸ It is estimated that the most effective councils collect about 70 percent of the rates due, while the least effective councils collect as little as 20 percent (World Bank, 1992). This low collection efficiency can be attributed to such factors as (1) lack of taxpayer's confidence or understanding in how the tax is

⁷ The property tax can also be used to improve efficiency (e.g., through using vacant land taxes or betterment taxes), and/or improve equity (e.g., through taxing real estate capital equally). These objectives can only be obtained however if the property tax is uniformly and effectively collected and enforced. That is, the various property tax objectives (i.e., revenue, efficiency and equity) in law cannot be realized unless the revenue is actually collected and enforced.

⁸ Although statistics are scarce, a few representative countries indicate that tax delinquency is a common problem. For example: In 1975, La Paz, Bolivia collected property tax from only 25 percent of the properties (37,500 of the property units out of 150,000 units) (Musgrave, 1981). The collection rate for rural and urban property taxation in Indonesia was about 65 to 79 percent (Kelly, 1992). In Senegal, Nigeria, Ivory Coast and Liberia, property tax delinquencies averaged at least 50 percent and were sometimes as low as 10 percent in 1980. In Abidjan (Ivory Coast), the collection rate was only 18 percent. (World Bank, 1984) In Ibadan, Nigeria, the collection rate was only 9 percent (Dillinger, 1991).

levied, collected, and enforced, and used, (2) lack of legal and administrative collection and enforcement mechanisms, and/or (3) lack of political will.

Theory and experience show that a comprehensive collection and enforcement system relies on a combination of (a) incentives, (b) sanctions and (c) penalties. The key to an effective collection and enforcement system is the creative combination of all these options—not the sole reliance on any single alternative.

Although substantial changes could be made to improve taxpayer education and rationalize the collection and accounting systems, it would appear that the primary reason for the poor collection in Kenya is the lack of effective enforcement. Despite having a variety of options under the Rating Act, the rating authorities have taken a largely passive role in enforcement, relying almost exclusively on rate clearance certificates. This clearance certificate option relies on taxpayer initiative to clear outstanding debt and thus is only effective when the property is being transferred or when a local business license or permit is being requested from the local authority.⁹

Active enforcement (through fines, tax liens and foreclosures) by the government is virtually non-existent. Several local authorities such as Nairobi and Mombasa occasionally publish the names of delinquent taxpayers in the newspaper. Other local authorities initiate court cases against delinquent taxpayers, with mixed results. To date, no local authority has applied the legal option of tax caveats to titles or used property foreclosures as a means to enforce tax payment.¹⁰ To improve tax compliance, political will must be mobilized, administrative systems must be rationalized and improved, and local officials must be made aware of the legal and procedural provisions for enforcement.

⁹ Tax clearance certificates are only valid when linked to a service from the local authority. It is apparently not possible for the tax clearance certificate to be required by the banking system, electricity, water, or other property-related services and transactions.

¹⁰ Although the *Rating Act, 1972* (Art. 19) and (Art. 17) provide the government with the powers to place tax liens and to conduct property foreclosures, these options have never been used in Kenya.

As this section indicates, successful property tax reform hinges around how to improve these four critical ratios. The key to successful property tax reform in Kenya is to develop an appropriate mix of policy and administrative reforms to ensure that the tax roll information is complete and up-to-date, that the valuation ratio is accurate, that the tax ratio and related assessment procedures are correctly administered, and that the tax liabilities are collected and noncompliance enforced. This calls for the development of a strategic action plan which will effectively link the policy and administrative components, train the policy and operational staff, and develop tax administration and taxpayer awareness of the obligations and responsibilities for tax compliance.

BUILDING A PROPERTY RATES IMPROVEMENT STRATEGY FOR KENYA

Compared even to other developing countries, Kenya appears to be underutilizing its property tax as a source of local government revenue. Through a series of policy and administrative reforms aimed at improving the four critical ratios, Kenya should be able to increase its property tax yield up to 0.5 percent of GDP, generating a 60 percent increase in property tax revenues. This 60 percent increase would enable the property tax to contribute close to 35 percent of total recurrent revenues for local authorities. The key will be to design and implement a comprehensive Rates reform.

Prior to outlining the parameters for a Kenya Rates reform program, let us briefly review the international lessons for successful property tax reform. Essentially there are five key lessons which will help structure the property tax reform program in Sub-Saharan African countries such as Kenya.¹¹

¹¹ These lessons are drawn from Kelly, 1992, 1993, 1994, 1995, 1996; Montes, 1991, 1996; Dillinger, 1989, 1991; and from work undertaken by the author done under the auspices of the Harvard Institute for International Development (HIID), US Treasury Department, USAID, and the World Bank in such countries as Albania, Russia, Poland, Argentina, Mexico, Dominican Republic, Indonesia, Kenya, Uganda, South Africa, and Nepal.

Lesson One: Property Tax Reform Requires Strong Political and Operational Support

Strong political support is a necessary prerequisite for successful property tax reform. By its very nature, the property tax is perhaps the most politically sensitive tax because it is visible, requires lumpy payments on a periodic basis and is most closely linked to the delivery of local services. The property tax usually affects a larger and broader group of citizens than the other dominant taxes. And assuming effective administration, the property tax will tend to fall most heavily on wealthier property owners who tend to be politically active.

Strong political commitment is necessary to enact policy and administrative reform. Senior policymakers must be able to mobilize the necessary political, financial, managerial and technical resources to sustain a successful reform. Experience shows that policy reform does not occur solely with the passage of a new law or the issuance of new procedures. Rather, reform is an ongoing process that is realized only through the subsequent development of effective tax administration. Consistent, steady, and sustained political support, complemented by effective operational support for administration, is essential if new policy and procedures are to be formulated, enacted and implemented.

Strong operational support is also essential in order to realize the benefits of revised policy and procedures. In short, the quality of tax administration determines effective tax policy. Thus strong operational leadership must be mobilized in order to motivate and guide field staff. All policy reform must be ultimately implemented by operational staff to effectively realize results.

Lesson Two: Property tax reform must be undertaken on a comprehensive basis, integrating policy and administration.

Most countries have undertaken property tax reform in a piecemeal fashion, producing counterproductive or unintended efforts which offset expected revenue increases. Reforms have largely failed to systematically integrate tax policy with the administrative aspects such as identification and management of the tax base, property valuation, assessment, collection and enforcement. In short, there has been a failure to approach property tax reform in a "systems approach."¹²

Most property tax reform efforts have not been comprehensive. In fact, most have failed to systematically evaluate the interaction of policy and administration or have tended to focus narrowly on one administrative aspect such as property valuation to the neglect of collection and enforcement. Other reforms have focused solely on policy issues, aimed at developing optimal property tax systems. Unfortunately these optimal property tax systems are usually so complex as to be impossible to administer. In fact, the primary obstacle to property tax reform in most countries is poor or ineffective administration.

Lesson Three. Property Tax reform must be implemented strategically.

In light of scarce political, administrative and financial resources, property tax reform must be approached in a comprehensive manner, combined with a clear strategy for implementation. A systematic strategy must be developed to maximize the likelihood of immediate success and subsequent long-term sustainability. Prerequisites must be carefully identified, obstacles creatively removed or bypassed, and limited resources efficiently utilized.

¹² In addition to the failure to integrate the components of property tax policy and administration, most property tax reforms have also failed to be synchronized with other ongoing economic and fiscal reforms. To be effective, property tax reform must be carefully structured to harmonize with other political and fiscal reforms such as the intergovernmental expenditure and revenue assignment and intergovernmental grant policy. Property tax reform

Although numerous variations exist, there have been two basic approaches for property tax administrative reform--those which focus initially on property valuation (i.e., "valuation-pushed") and those which focus initially on the collection and enforcement components (i.e., "collection-led") (Kelly, 1993, 1994). Although both approaches may include a legal reform component, the implementation strategy focuses priority on two entirely different administrative functions. The valuation-pushed strategy places primary emphasis on improving property valuations based on the premise that improved valuations will increase the revenue and equity in the short- and long-run. The collection-led strategy, on the other hand, places first priority on improving the overall collection and enforcement system based on the premise that improved valuation accuracy in the absence of improved revenue collection will not realize either short- or long-term revenue or expected equity objectives.

Lesson Four. Property tax reform must involve a simplification of policy and administrative procedures.

Successful property tax reform must adopt policies and administrative procedures which are appropriate to the administrative capacity of the tax department. Simplification of policy and administrative procedures will facilitate both administration and compliance.

Countries face a number of operational difficulties in the administration of the property tax. In addition to the lack of accurate base maps and property information within the tax administration, there is often an absence of supporting institutional structures capable of providing supporting data, managing information, collecting the tax and dealing with objections and appeals. Thus the tax administration system must often administer the property tax system without the support from established institutions such as a Registry of Deeds, Ministry of Lands, a Valuer General, mapping

in isolation can also produce counterproductive and unintended results.

agencies, a professional real estate sector, reliable revenue collection agencies or administrative legal courts. To overcome these internal and external constraints, a tax reform must creatively adopt appropriate methods, standards, procedures and technology. Procedures and methods from other countries must be carefully adapted to the specific conditions within each country. Overly complex and ambitious systems should not be adopted since the expected equity and efficiency objectives can only be translated into "realized" equity and efficiency gains when effectively implemented.

Lesson Five. Property tax reform should effectively utilize computer technology.

Property taxation is an ideal tax for utilizing computer technology to support administration. The property tax base usually covers a large number of tax objects, and requires extensive, ever-changing information on each property. Computers can be used to facilitate all aspects of administration--managing individual property information, property valuation, tax assessment, billing, collection and enforcement.

Successfully utilizing computerization depends on the ability to link the data-processing activities with the administrative components of property taxation. These two components must be effectively integrated to form a comprehensive property tax administration management system. The operational procedures such as the assignment and maintenance of unique property identification numbers, mapping, field data collection, valuation, bill delivery and monitoring, collection monitoring, enforcement and taxpayer service must be integrated with the data processing components such as data entry, verification and validation, valuation and assessment, tax billing, collection monitoring, system control and information retrieval. Ignoring the administrative components is a guarantee for computerization failure.

Simple, narrowly-focused systems focused on basic operations tend to do better than complex systems. The purpose of property tax information management systems must be to support the administration of property taxation. It is not to provide extensive geographic information on regional planning, urban redevelopment, transportation, the environment, or marketing information to the neglect of basic property tax administrative functions. Unfortunately, there is a tendency to use property taxation to justify tremendous investment into computerized geographic information systems, which emphasizes the graphical components of digitized parcel mapping often based on a Global Positioning System (GPS). These systems are usually supply driven by the technology rather than demand driven by real needs of the property tax administration system. Expectations are usually not realized because these expensive high-technology solutions fail to consider all aspects of property taxation, especially its administration interface with tax officials and taxpayers.

Adapting these five basic lessons to design an appropriate reform strategy for Kenya is now the challenge. The key will be to creatively adapt the basic components of property tax policy and administration into a reform that can be implemented within the unique legal, political and institutional conditions of Kenya. The reform strategy must build on the current property Rates structure and incorporate policy and administrative changes geared towards increasing the four critical ratios previously discussed, cognizant of the constraints and opportunities available to ensure immediate implementation as well as long-term sustainability.

SPECIFIC PARAMETERS FOR THE REFORM STRATEGY IN KENYA

First, the property tax reform must be linked within the broader intergovernmental fiscal reforms being undertaken under the auspices of the ongoing broader Kenya Local Government

Reform Program (KLGRP).¹³ Synchronizing the property tax reform to the overall fiscal decentralization effort will provide the proper context for the reform itself and build on the existing political support and reform momentum.

Second, within the context of the overall local government reform, the Rates reform program must be structured so as to mobilize strong and sustained political, policy and operational support. In Kenya this means mobilizing the support of the Ministry of Local Authorities, Ministry of Finance, and the Ministry of Lands and Settlement at the central government level; mobilizing the support of the local authorities including the councilors, the Town Clerk and the administrative staff at the local government level; and mobilizing the support of the rate payers including the business community and the residents. Without the strong support of these various groups, the property tax reform will not be successful. Strong and sustained political and operational commitment is necessary to enact and implement the property rates reform.

Mobilizing this level of political, policy and operational will require a well-structured strategy to rationalize the institutional and personal incentives for all stakeholders. Priority needs to be placed on mobilizing ratepayer support through an enhanced taxpayer education program and improving the link between revenue mobilization and local expenditure and service delivery.

Third, the central and local authority capacity must be strengthened to implement an improved property tax system. At the central government level, the Ministry of Local Authorities must develop a core of experts in property rates who can monitor the property tax situation, issue consistent and appropriate regulations, and provide technical assistance to guide the property rates reform. In

¹³ The Kenya Local Government Reform Programme (KLGRP) which began in 1996 is to strengthen local authorities in order to improve local service delivery and to enhance economic governance. The KLGRP reforms are focused on (1) rationalizing the central-local financial relationship, (2) strengthening local financial management and revenue mobilization and (3) increasing public participation in the planning process. This

addition, capacity must be strengthened within the Ministries of Finance and Land and Settlements. At the local government level, it is important to ensure that the policymakers (local councilors, mayors, council chairmen, clerks, and treasurers) understand the various policy and administrative aspects of the property tax. The local authority operational staff must also be strengthened to administer all aspects of the property tax system (e.g., property information, valuation, assessment, collection, enforcement and taxpayer service).

Fourth, the property Rates reform must address both policy and administration and comprehensively cover all administrative components. The current legal framework in Kenya provides the basic necessary structure for designing and implementing improvements in administration. Although there may be minor changes to the property tax policy, the key priority for the property Rates reform must be on improving basic administration. The policy and administrative systems must be kept simple.

Fifth, the property rates reform must be implemented in a strategic manner. Kenya should not adopt a pure “valuation-pushed” strategy—rather the reform must comprehensively focus on all aspects of property tax administration. Attention must be focused on building an accurate fiscal cadastre and strengthening the collection and enforcement components. Without the political will and administrative mechanisms to properly collect and enforce the tax in an efficient and equitable manner, any improvement from better property information and valuation will not be realized. **Sixth**, a computer-assisted rates administration system should be introduced to assist with fiscal cadastre maintenance, valuation, assessment, billing, collection and enforcement, dispute resolution and taxpayer service. This computer-based Rates Administration Management System should be introduced through a pilot project approach to (1) enable the system to be thoroughly field tested and modified as

KLGRP reform is being conducted under the auspices of the Ministry of Local Authorities, supported with

necessary; (2) provide on-the-job training for tax officials; and (3) furnish a demonstration model for the reform.

The pilot projects must be structured to extend over at least a full two-year period to incorporate and field test all aspects of property tax administration--from the initial data capture to the enforcement against non-compliance. A sustained administrative reform will enable the complete system to be developed and fully tested through the complete property tax cycle. Once successfully tested and proven, the pilot project model and the accompanying policy and administrative procedures should be strategically replicated to other local authorities.

Seventh, as part of the property Rates reform, computer-assisted mass appraisal (CAMA) techniques should be introduced to simplify and reduce the costs and delays of producing valuation rolls. Relying on an individual parcel-by-parcel valuation approach continues to be a major obstacle to achieving an equitable property Rates system in Kenya. The creative use of CAMA techniques must be phased-in as part of the pilot project approach.

CONCLUDING COMMENTS

The property Rates in Kenya is an underutilized revenue source for local authorities. Potentially these property Rates revenues could be increased by 60 percent through effectively improving the four critical ratios of coverage, valuation, tax rates and collections. These improved property tax revenues could provide the critical resources needed by local authorities to provide the level and quality of services required to sustain and promote further economic development in Kenya.

The analytical framework as outlined in this paper provides the basis for designing an appropriate reform strategy. Through an effective combination of policy and administrative

improvements, the property Rates system in Kenya could be dramatically transformed. The next step involves the actual field implementation of the reform strategy, phasing-in the policy and administrative improvements in order to realize the reform objectives. As with all countries, this will be the real challenge for Kenya, as it is usually during actual reform implementation that most countries face their greatest challenges.

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