The 43rd European Congress of the Regional Science Association
Jyväskylä, Finland
August 27 - 30, 2003.

Land and property taxation in the Baltic States

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Abstract

The paper is focused on developments of property taxation in the Baltic States in the last decade. During this period tax and budgeting reforms became an integral part of transformation process in these countries. Devolution of central government functions to the local level means more autonomous decision-making by sub-national governments, thereby also autonomous powers to raise their own revenue. The property taxation clearly stands out as traditional revenue source collected by the local governments. Together with land privatization and establishing of land markets, the Baltic governments are becoming more interested in the prospect of using property tax as a powerful instrument for revenue collection. However, property tax systems are still limited to allow local governments to use them as important raisers of revenue. The most pressing list of problems includes issues of municipalities' limited tax autonomy, improper land valuation and poor tax administering

Introduction

During the last decade, Baltic countries have created new public institutions, democratized system of local governments and settled foundations for a pluralistic and democratic society. Nevertheless, there are still essential reforms are waiting for implementation. One of the main problems is limited fiscal autonomy and inadequate revenue bases the local governments. As soon-to-become members of European Union, local governments have to increase revenue mobilization capacity to fulfill their tasks.

Therefore, Baltic local governments are looking actively for opportunities to increase their tax revenues. A good local revenue system would generate tax income stream, which is adequate and stable over time. Efficient tax is also neutral on its impact on taxpayers' economic decisions. Relative to those criteria's, the property tax suits well as local governments' revenue source.

Following article analyses land and property taxation developments in the Baltic countries[1]. The main interesting aspects to be explored on the paper are:

- Is property taxes' potential fully explored as a revenue source for local governments?
- What is the efficient tax base – land only or total property?

The first part of the paper gives general overview of the land and property taxation principles in general. In the second part the developments in the Baltic estimated against principles of tax theory and the last part considers each country's particular developments on property taxation issues.

1. Land and property taxation: general overview

Land and property taxes are natural part of local governments' revenues in many countries. Somehow, it is considered almost as the perfect tax. It provides a predictable and durable revenue source for local budgets; fosters local autonomy and provides fiscal mechanism for decentralization. The property tax is especially attractive when compared with other potential sources of local taxes. Particularly, "property tax would provide an answer to the fiscal needs of local authorities in transition economies"

[1] Property tax considers land and immobile property taxation

("Reform Toward Ad Valorem Property Tax in Transition Economies, p.2., Mauer; Paugam, 2000).

Tax theory considers property taxes from different aspects. "A standard test" to evaluate a tax includes estimating its revenue generation ability, incidence on taxpayers' decisions and complicity of administration. In addition, one aspect of taxation is equity or "tax fairness" ("An optimal property tax: concepts and practices", Bell, 2000). By those aspects should be valued also the property taxation developments in the Baltic countries.

A stable tax generates revenues that are predictable and relatively inelastic to short term changes of income or other factors. In that sense, land and real property markets reflect long-term asset values, which tend to respond more slowly to the current changes of economic activity. Also, it is difficult for taxpayers to avoid paying the property taxes they are charged. The government could easily control immovable property rights and authorities have instruments to force taxpayers pay the tax. Therefore, the property tax is regarded as relatively steady revenue source when compared to other local tax sources like income or consumption tax.

There is no common understanding how property taxation influences the efficiency of land use. Some economists argue that local property taxation promotes efficient location and fiscal decisions on part of households ("Local Property Taxation: An Assessment", Oates, 1999). On the opposing side, economists (Mieszkwoski, Zodrow) view local property taxation as having a distorting effect on local decisions. As a result, such a tax tends to discourage the use of capital, land and property improvements (Oates, 1999).

Taxes that are difficult to avoid have less impact on private economic decision. Therefore, tax distortions are measured by the extent that economic subjects adjust their behavior to the decrease or increase of the tax burden. In the short run, real estate property is immobile and there is little that owners can do to avoid the tax. In this respect, the property tax tends to distort private economic decisions less than other local taxes. In other words, by creating an "excess burden" property tax does not introduce more distortions into the economic system than the general burden of taxes does.

The third aspect of property taxation concerns its administration. Usually the property tax is easy to collect and understandable for taxpayers. However, main concern of property taxation relates to two aspects. First, what should be taken as the tax base?

Second, how to tighten the link between the properties's assessed value and its real market value.

There might be several bases for the property tax. In simple way, property tax[2] may include following objects:

- Land only
- Real property only
- Land and real property

In case of transition economies land tax is usually easiest to administer and it is also often politically less offensive than property taxation. Otherwise, taxing land only limits local government revenues. Nevertheless, taxing only land has other definite advantages. It is more neutral. Excluding property and its improvements from the tax provides an incentive for more investment and maintenance in both residential and commercial development. It is also less costly to value land for tax purposes. In opposite, low administrative cost on land tax is offset by reduced transparency. Taxpayers have no information about their site real market value. Such a situation can be considered as a factor that infringes individuals' horizontal equity principle.

Including other immovable property beside land on property tax base can increase local governments' revenues considerably. On the other hand, immovable property taxation requires much more sophisticated valuation mechanisms. Property owners are not eager to reveal their property value to avoid increasing tax burden. As was indicated earlier, total property taxation may have a negative impact on local property owners and businesses – it limits property improvements and new capital investments.

Every property tax system grounds on property value. Property valuation is a very complex issue. There are several valuation systems, which use different value definitions.

In *capital value system* the tax base is defined as the assessed value of land or property, according to its expected sales price or the basis of rent a property would be expected to yield. The assessed property value therefore includes different factors like its real market price; property size; its location; physical possessions and many other factors. Theoretically, taxable value should be close to market price of the property. However,

[2] Here are ignored other type of personal assets

in real life it is difficult to implement such a principle. Improvements and investments will increase the property value and consequently level of property tax. Therefore owners are not interested to report improvements or there is a threat that they avoid making improvements at all. For this reason, property valuation process requires sophisticated techniques and trained evaluators, which eventually increases the cost of tax administering.

Another main valuation system - site value or *ad valorem* tax system takes the tax base as recent transaction price. Its positive aspects are related with its potential to support the efficient use of land and may lessen administrative cost. If property improvements and capital investments are not taxed, the owner will have an incentive to use the land in most efficient and profitable way. There are also disadvantages of site value taxation. The first is an assessment problem. Land and houses are sold relatively infrequently and therefore it is difficult to indicate properties "real market value". Therefore it raises the problem of discrepancy between real market value and assessed value and makes it "a more subjective exercise than total property valuation" (("Land Taxes versus Property Taxes in Developing and Transition Countries", p. 144, Bahl, 1998).

Second disadvantage of site valuation is lessened tax base in case then taxation includes also immobile property and improvements. The value of land is a much smaller tax base and therefore expected revenue might be insufficient for municipalities needs. Therefore, the fiscal importance of the property tax is limited.

Even in countries with well-developed property tax systems, discrepancies arise between assessed values and market values within classes of property and between and across municipalities. Since taxpayers can easily compare their property taxes with those of similar properties in their neighborhood, such discrepancies lead to appeals. The more the property markets are underdeveloped or inactive, the higher is the potential for those differences.

Some other aspects related to property tax should be also mentioned. Municipal taxation system usually serves several objectives – from collecting revenues to finance local government activities to implementation social an economic purposes. A right to establish land tax rates puts local governments on a delicate position. One hand, fiscal aspect of property tax collection is definitely essential, which motivates governments to establish tax rate high as possible. Another aspect is related with local elected bodies' behavior to maximize their political position. Hence, increase of taxis for your primary electorate is not very popular idea.

Public choice approach to the property taxation focuses attention on tax role of promoting effective decision making in the public sector. Tax system is to provide an accurate set of signals or "tax-prices" that make clear to local taxpayer-voters the cost of public programs. The local tax system therefore should be highly visible and so that individuals have a clear understanding of the financial commitment implied by the proposed programs of public expenditure. Such a linkage promotes citizen involvement in the local budget process and strengthens accountability. In general, the property tax is a visible tax. Tax bills provide clear information of the cost to the property owner of community services provided by the local government. A jurisdiction will offer a certain set of public goods with proposed costs. Property owner will compare public goods and services received and compare the tax prices they pay.

Another issue should be mentioned relating to equity issues in property taxation. The equity or fairness concern with the property tax has two dimensions - equity across jurisdictions and equity across individuals. There is a concern that property tax bases vary across the municipalities putting some at a disadvantage. The risks are that property taxation increases disparities between municipalities in provision of public services. Particularly, such risks are substantial if the tax revenues are related to special issues – education, healthcare or social programs.

The second concern is the distribution of the tax burden across income classes. The property tax generates the revenue to fund services that benefit the entire community and they are not linked to consumption of specific services. Different analyses show that tax rates "behave" differently depending on the nature of property. Traditional understanding is that property taxes are like excise tax and therefore are regressive compared to ones incomes. Other approaches argue that the property tax is as a tax on capital and therefore its incidence is likely to be quite progressive. To the extent that the property tax on housing consumption, it is generally considered to be relatively proportional across income classes.

2. Land and property taxation in the Baltic countries: general trends

In the Baltic States taxes on land and real property were introduced on early 90-es and currently present a substantial source of municipalities own tax revenues. Continuous changes still characterize property tax systems in the Baltic States. Such taxes encouraged privatization of government owned land and property and increased the land use efficiency. Also it should be stressed that land taxation is emotionally sensitive issue. Land reforms in the Baltic States introduced millions of new landowners. Many of these new landowners are likely to resist any changes in the taxation of their property.

Concentrated summary of property taxation details and related institutions in the Baltic countries are presented on Annex I. The most part of area of Baltic countries counts as agricultural land, particularly in Latvia and Lithuania. Also the area of forestland is considerable.

As a first step of property taxation reform land taxes were introduced in all three countries. Later on, Latvia and Lithuania have also developed immovable property taxes; in Estonia only single land tax exist. In Estonia the opinion is divided about whether only land value or total property value should be the tax base.

In spite of that there are similarities in property taxation principles between those countries. At the same time “each country has followed a somewhat different path, adopting strategies that reflect its unique set of past traditions and current circumstances” (“Taxes on Land and Buildings”, p.4; Malme, 1999). Below some similar features concerning property taxation in the Baltic countries are drawn.

First, property and land privatization still continues in all three Baltic countries. That is a considerably complicated and slow process. The countries use different methods to privatize land. In all three countries as a main principle of privatization was used the land restitution to former owners. As a result, land use rights are assigned rather than purchased.

Massive land restitution in the Baltic countries created a somewhat unique situation. Formal restitution made many people land and forest owners, who actually have no particular interest to cultivate the land or who are not very interested to find beneficial use of their land parcels. Landowners and their properties are often found in different jurisdictions and far from each other. New landowners are frequently trying to get rid of property by selling it at whatever price or have just left land unused. In fact, the land tax amount is still small enough not to force landowners use their land in most efficient way.

The situation in Estonia where land owners and it property locate separate administrative units has led to another peculiar situation. Namely, the tax burden export from municipalities to other communities is very wide. Actual landowners are not participating in decision-making processes over tax rates and public spending despite them having to pay a property tax in a particular municipality.

Second, land and property markets are clearly underdeveloped and land is undervalued in comparison with European Union countries. Land markets are not opened to foreigners and residential housing rents are still controlled or subsidized. All those factors limit land and property value as a tax base. Municipalities' revenue increase from property tax depends on the growth of property values. Considerable land and property price growth is expected after Baltic countries join the EU.

Third, property value is regionally very different. Meaningful value growth has taken place in urban areas or municipalities around capital cities. In rural regions due to depressing situation in agriculture the land price remains relatively low. Municipalities' fiscal autonomy is also very limited to exercise discretionary land tax strategy and design suitable tax schemes for particular municipality. In Latvia and Lithuania land and property tax rates are established by central governments. Estonian municipalities could set land tax rate within the brackets given by the central authorities.

Fourth, administration and property valuation need enhancement. Effective administration requires identification of property and liable taxpayers; valuation of each parcel subject to tax and efficient collection of property taxes.

Identification of property and taxpayers are inadequate due to continuous land and property privatization and incomplete ownership records. Such a situation makes it harder to identify taxpayers for tax purposes.

Valuation is the major technical challenge in property tax administration and is especially difficult in transition countries ("Land Taxes versus Property Taxes in Developing and Transition Countries", p. 154, Bahl , 1998)

A proper valuation requires a clear definition of taxable property value, adequate evaluators and reliable data on property values. Still the land markets are underdeveloped and not transparent enough, it is impractical or difficult to use market information as a valuation base.

In following table 1 property taxes for years 1996 and 2002 as municipalities' revenue source is given. Those taxes are compared with municipalities' total revenues and the countries' GDP level.

Table 1. Property taxes in the Baltic countries, million euro

	1996	2002	Change 2002 from 1996
Estonia			
Local governments' total revenue	320	672	110%
Tax revenue	170	308	81%
Land tax	13	27	100%
GDP level	3,433	6,465	88%
Land tax share on local governments	4%	4%	
Land tax compared with GDP, %	0.4%	0.4%	
Latvia			
Local governments' total revenue	397	831	109%
Tax revenue	315	462	47%
Land tax	22	0	
Immovable property tax	32	76	140%
GDP level			
Land tax share on local governments	13%	9%	
Property taxes compared with GDP, %	1.1%	0.9%	
Lithuania			
Local governments' total revenue	863	1,056	22%
Tax revenues	598	448	-25%
Land tax	3	8	119%
Land rent tax	17	22	31%
Real estate	33	68	108%
GDP level	9,177	14,732	61%
Land tax share on local governments	6%	9%	
Property taxes compared with GDP, %	0.6%	0.7%	
Source: Statistical departments of relevant countries and authors calculations			

The first clear difference among the Baltic countries is the foundation, taken for property tax base. When during the selected years in Estonia only land tax existed then in other Baltic countries real estate was included in the tax base. In Latvia land tax and immovable property tax are merged to one single property tax. In Lithuania there are even three types of property related taxes. Taxes on land are separated to basic tax and land rent tax.

In year 2002 different property taxes covered about 9% of municipalities' total revenues in Latvia and Lithuania, in contrast to Estonia, where land tax revenue covers only 4% of local government incomes. Therefore for Estonian municipalities land tax revenue is relatively minor income source compared to its southern neighbors. Such a comparison supports the assumption, that wider property tax base, which includes also immovable property beside land, increases municipalities' revenue level. Thus in Estonia the discussions over establishing property tax is going on but nothing if all has been achieved in the progress of implementation.
As table presents, property taxes share in local revenues during the selected years remained stable in Estonia, increased in Lithuania and decreased in Latvia.

Compared to all tax revenues property tax revenues have increased faster in all three countries, particularly in Latvia and Lithuania. In Lithuania local governments total tax revenue decreased 25% in 2002, after personal income tax became a shared tax between central and local governments' budgets. Until that year personal income tax was solely local budgets revenue.

Municipalities land tax revenue in Estonia has increased less from 1996 to 2002 than have increased the total revenues. At the same time, in Latvia and Lithuania the property tax revenues have increased significantly faster than municipalities' revenues in total. Again, faster growth of property taxes in Latvia and Lithuania is related with their large tax base, which includes also immovable property. Real estate prices have increased faster in all three Baltic countries than land prices.

Despite the substantial increase of property tax amount, when compared to GDP level they have decreased in Latvia but increased in Lithuania. In Estonia such a ratio remained unchanged.

2.1 Land taxation in Estonia

The land tax in Estonia was introduced in 1993. Its purpose was to stimulate more productive use of land and mainly as a revenue source for local governments. Since then only land tax exists in Estonia. Other property like real estate is not taxed, what is a major difference from its other Baltic neighbors, where also other property related taxes were established. The Parliament decided to establish only tax to encourage lands efficient economic use and to avoid increase a tax burden on residents. Also, when the land tax was established was difficult to collect proper information to value both land and real estate within a reasonable time due the underdeveloped property markets ("The Land Tax in Estonia", Malme; Tiits; 2001).

In following table 2 Estonian municipalities land tax revenues are given. In comparison to land taxes, also personal income revenues are given as biggest part of municipalities' incomes.

Table 2. Land and income tax in Estonian municipalities revenues, million euro

	1996	1997	1998	1999	2000	2001	2002
Land tax	13	17	19	20	24	25	27
Land tax in total revenues	4%	4%	4%	4%	5%	4%	4%
Land tax in tax revenues	8%	8%	8%	8%	9%	9%	9%
Income tax	154	187	222	234	235	252	278
Income tax in total revenues	48%	48%	49%	47%	47%	36%	41%
Income tax in tax revenues	90%	90%	91%	91%	89%	89%	90%

Source: Estonian Ministry of Finance and authors calculations

As presented in the table 2, total amount of land tax during the selected years has doubled (see also Table 1). It covers about 4-5% of all Estonian municipalities' revenues. Generally, such a tax presents still relatively small part of municipalities' revenues, but importance varies very significantly by local governments (see Appendix II). Calculated as unweighted average, the land tax covers 6.8% of municipalities' revenues. In particular local governments land tax share reaches up to one third of municipalities' revenues.

At the same time, land tax share in municipalities' total tax revenues remained quite stable during the period and covered about 10% on all taxes. In recent years the amount of specific grant transfers to Estonian municipalities has increased significantly, which relatively decreased tax income share on local government revenues.

Similarly to Latvia, the land tax base value is calculated on market price basis. The Estonian Land Board is responsible for valuation of land for tax purposes. Valuation of land parcels based on information about property transactions and other information like rental information, location and land quality. First years after the land tax was established, different simulation models were used to calculate lands' taxable value in situation of lack of information due to absence of really existing land markets. Land values for taxation are estimated periodically within 3-5 years. The recent valuation was accomplished on year 2001.

Land tax is the only tax in which Estonian municipalities have certain autonomy to decide over tax rates. Estonian Parliament sets the land tax rates to municipalities as certain frames. Actually, the tax range is established within 0.5-2.5% Average tax rates across Estonian municipalities are presented on Appendix II.

Land tax is collected and administered by central authorities and afterwards transferred to local municipalities' budgets.

All used land is classified into 11 different groups (zones)[3]. Estonian municipalities have the right to establish differentiated tax rates among the zones. Usually governments separate from all the zones only arable land and tax them with lower rates then all other zones. Productive land (arable and forest land) covers the biggest share of al land use. In mainly rural communities agricultural land receives a preferential tax treatment on social and economic grounds. Low tax rate provides benefits to farmers, who otherwise could not remain in agricultural activities. There are relatively few exemptions on the land tax subjects. Some municipalities allow exemptions for retired individuals on their residential lands.

Generally, tax rates and eventually land tax revenues for the municipalities are still relatively low. Thus, establishing correlating rate levels is not very strategic question from the local governments' revenue aspect. Nevertheless, after Estonia joins EU membership, significant increase of land price is expected. Higher land price level will raise also taxable value of land, which in turns increases municipalities revenues.

There are also discussions over introducing the wider property tax and including buildings and improvements to the tax base. By estimation, there might be positive and negative consequences ("The Land Tax in Estonia", Malme, Tiits, 2001).

For municipalities it means increase of property tax revenues up to five times more compared with today's incomes from the land taxation.

[3] Those land zones are: residential land, commercial land, production land, mining area land, social purposes land, land under wetlands, land for transportation purposes, sewage area land, land for national defense purposes, environmentally protected land, agricultural land and land without a use

The negative impact is related with disproportionately greater administrative cost, and potential discouraging of property improvements and investments. Specific Estonian problem is concentration of tax base in capital city area (e.g. region with highest property values), what increase the revenue disparities between the municipalities even more.

2.2 Property taxation in Latvia

Land and real property taxation principles in Latvia have been modified continuously during the last decade. Differently from Estonia, there are separate taxes on land and property since 2002. Land tax has been gradually merged to single immovable property tax.

The State Land Service officially assesses value of land on the basis of approximate market value. In order to determine the real estate tax to be applied to a given real estate object, the government uses the cadastral valuation system. Cadastral (or general) valuation is based on a consistent, neutral and predictable valuation system applied to real estate throughout the country. A general valuation is cheaper to administer than individually valuing each parcel of property ("Review of Baltic States Real Estate Market: Latvia", 2000).

Once the cadastral valuation of both land and buildings is introduced, there will be a comprehensive cadastral value of real estate in Latvia, from which the applicable real estate tax will be derived.

Property taxation principles in Latvia have changed periodically during a last decade. In 2002 land and real estate tax were merged into one single immovable property tax. Before that year separate taxes existed on land and buildings. Currently property tax includes land and also nonresidential and individual residential buildings and apartments in multi-apartment houses, if these are used for commercial activities. The previous rate of real estate tax is 1.5%, what was decreased to 1% starting from January 2002. From 2004 the property tax will include land and all buildings.

The property tax or more precisely, real estate tax is levied on things with physical existence situated within the territory of the Republic of Latvia. The taxable property cannot be moved from one place to another without causing harm on land, buildings or constructions. The tax is charged both from individuals and businesses, but includes long list of exemptions. Such exemptions include some municipal property and diplomatic representations owned possessions, highways, real estate of religious organizations, and objects of massive recreations, objects of cultural significance. Interesting exemption is property of individual residential houses and apartments, if such property is not used for commercial purposes[4]. Therefore, property tax is imposed mainly on different businesses and land users for agricultural purposes.

The real property tax is the only tax, which is received directly by the local government on whose territory the real estate is located.

In following Table 3 property tax revenues and their share on municipalities' revenues is given.

Table 3. Property and income taxes in Latvian municipalities, million euro

	1996	1997	1998	1999	2000	2001	2002
Property taxes total	53	62	80	72	80	82	76
Land tax	22	28	36	32	4	2	0
Immovable property tax	32	33	45	40	68	78	76
Property taxes on total revenues	13%	11%	12%	11%	10%	10%	9%
Property taxes on tax revenues	17%	23%	23%	21%	19%	18%	16%
Personal income tax	262	220	263	275	334	362	379
Income tax in total revenues	66%	40%	40%	42%	42%	44%	46%
Income tax in tax revenues	83%	81%	77%	79%	80%	81%	82%

Source: IMF Staff Country Report No. 00/100 pp.71-72,
Latvian Monthly Statistical Bulletin, 2002 (12) p. 40 and authors calculations

During the recent year the land tax was merged to general immovable property tax and therefore from 2002 those taxes are presented as one single property tax. Despite the property tax amount have risen during the period, their share has decreased as municipalities' revenue source. In 2002 property tax amount fell due to decreased tax rate.

Property tax in general increased during the selected years faster than other taxes but less than municipalities' revenues in total. Differently from Estonia, property tax represents considerably bigger part of Latvian local communities' total and tax revenues. Despite their share declining in municipalities' revenues, they cover about one tenth of all municipalities' incomes.

[4] The exemption is valid until 31st December 2003

2.3 Land taxation in Lithuania

In Lithuania there are several established taxes relating to land and property. Land taxes are split into land and rent tax. Land tax is applicable to private landowners, both individuals and legal persons. The taxation object of the land tax is a private land estate or a part of such land estate in co-ownership, registered in compliance with the established procedure. Land tax includes some exemptions like commonly used roads and plots of land owned by diplomatic missions, which are exempt from land tax.

Another land related tax is land rent tax. Rent holders pay the similar tax rate as landowners. Land taxes are deducted from gross revenue for the purpose of computing taxable profit (income). Both legal and natural persons in Lithuania pay land rent tax. Local government councils have the right to reduce the amount of land tax or to grant exemption from the payment of land tax compensating the sums from their respective budgets.

Real property tax in Lithuania is calculated separately for land and for buildings or premises. Only buildings owned by enterprises are taxed so far. Property owned by individuals other than land, is not taxed. The possibility to levy taxes on buildings and premises owned by private people is under discussion in the Parliament.

Tax on immovable property is applicable to both domestic and foreign legal persons and organizations that own such a property. The law establishes tax concessions and local government councils have the right to reduce the tax rate or exempt from it. The tax rate is 1.5% for land and 1% for buildings and premises.

In following table 4 the property tax revenues are presented for the selected year.

Table 4. Property and income taxes in Lithuania, million euro							
	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Property taxes	53	65	70	74	77	85	98
Land	3	5	5	6	6	7	8
Land rent	17	16	15	14	14	14	22
Real estate	33	44	51	53	57	63	68
Property taxes on total revenues	6%	7%	6%	8%	8%	9%	9%
Property taxes on tax revenues	9%	11%	9%	8%	9%	10%	22%
Personal income	454	458	725	771	750	752	334
Income tax in total revenues	53%	52%	65%	80%	76%	78%	32%
Income tax in tax revenues	76%	78%	88%	89%	88%	90%	75%
Source: Lithuanian Ministry of Finance and authors calculations							

During the period the property taxes' amount has doubled. This is mostly related to the increase in the total value of the whole real property stock and to the increase in the number of private land parcels due to the land reform. The importance property tax in local revenues has steadily increased during the period and covers about 9% of all municipalities' incomes. Most of property tax is coming from real estate tax, which has increased more than twice during the period. Property taxes' share sharply increased on 2002 in total tax revenues due to restructuring of Lithuanian municipal financial scheme. In that year personal income tax became a shared tax between local and municipal governments instead of being wholly local budget revenue as it was previously. As a result, municipalities' tax revenues decreased 25% and shortfall will be covered by central government grants.

However, land and real estate value is expected to increase in Lithuania and therefore accordingly property tax income will gain more importance as a source of municipalities' revenues.

Conclusion

During the last decade tax and budgeting reforms became an integral part of reform process in the Baltic countries. Decentralization of government functions to the local level means more autonomous decision-making and adequate budget resources. The property tax clearly stands out as of the traditional local governments' income source.

The Baltic countries have developed their land and property taxation systems significantly fast. They have built modern and reliable institutions for handling land and property tax issues.

Currently property taxes cover from 4-9% of all local revenues. When in Latvia and Lithuania both land and real property value is taken as base for taxation, in Estonia only land is taxed. Property tax might be more capable revenue source and stimulator of efficient property use. However, municipalities' autonomy to exercise discretionary tax policy is still very limited. Nevertheless, property taxation methods are improving. Weaknesses and problems occur mainly on basis of lack of experience and continuing land privatization processes. The aspects that should be improved include adequacy of property valuation; motivating efficient use of land and improvements in tax administering.

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Appendix I Fact sheet on Baltic countries

	Estonia	Latvia	Lithuania
Area, thousand km^2	45,0	64.6	65.0
Population, million	1.4	2.4	3.5
Urban population	69%	69%	69%
Real property cadastre	National Land Board	State Land Service	State Land cadastre and register
Real property rights registration	Title Book Office	Title Book Office	State Land cadastre and register
Mortgage	Title Book Office	Title Book Office	Mortgage institution
Property valuation principles	Land market value	Cadastral value	Estimated value by formula
Land tax administration	Central Government National Tax Board	Local	Central
Revenue receiver	100% local governments	100% local governments	100% local governments
Tax rate	0.5-2.0% (differentiated by zones)	1.0%	1.5% (Land) 1.0% (Immobile property)
Foreigners right to own land	By special permit	By special permit	No
Exemptions of property tax	Yes	Yes	Yes

Appendix II Land tax by Estonian municipalities, 2001					
	Unweighted average*	Tallinn	Max	Min	StanDev
Land tax total, million EEK	1,109	124,079	13,591	0	1,293
Land tax in municipalities revenues	6.8%	3.2%	29.3%	0.0%	4.8%
Land tax per hectare (total area), EEK	224	7,840	3,503	0	486
Land tax per capita, EEK	491	311	2,056	1	354
General land tax rate	1.6%	1.2%	2.0%	1.0%	0.3%
Land tax for arable land	1.0%	1.0%	2.0%	0.5%	0.3%
Land tax rate for forest land	1.6%	1.2%	2.0%	1.0%	0.3%
Personal income total	9,292	1,669,920	290,663	57	24,082
Personal income per capita	1,999	4,191	5,465	564	799
Taxes total, thousand EEK	10,500	1,856,984	307,207	57	25,354
Revenues total, thousand EEK	28,234	3,928,865	725,069	1,826	62,353
Territory total, HA	17,654	15,827	54,382	176	12,223
Productive land, HA**	12,010	227	45,556	0	8,766
Arable land	3,236	0	13,636	0	2,671
Forest land	6,729	0	36,298	0	5,976
Residental land	190	2,671	1,395	6	162

*Tallinn excluded
** Filed on Estonian Land Cadastre
Source: Estonian Ministry of Finance
Estonian National Land Board