The Limits of Government Outsourcing: Property Tax Re-Assessments in India

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Introduction

- Should governments produce goods and services themselves, or outsource?
- Classic tradeoff as in Hart, Shleifer, and Vishny (1997):
  - Private sector is more efficient at producing goods and services
  - But contracting frictions and multi-tasking mean that the private sector may not have the same goals as the public sector
- Prisons is the classic example
- But is this necessarily the right tradeoff?
- Can there be cases where the public sector may actually be more *efficient*?

Property tax assessment

- We study property taxes in Chennai, India
  - Property taxes levied formulaically, based on residential and commercial area, multiplied by a fixed street-specific rate
  - Government believed over 280,000 properties were substantially undervalued, either from areas being too low, or having the wrong type of property classification (i.e. residential instead of commercial)
- Government sought to re-assess these properties
  - Key task: measure properties, and determine square footage by property usage
  - Commonly done by both government and private sector
    - Government - property tax assessors
    - Private sector - for commercial transactions and bank underwriting
  - Indeed, many local governments outsource property tax valuations to private firms (e.g. US, Australia, New Zealand)

Can assessment for tax collection be outsourced to private firms?

- Randomize all 198 property tax wards – over 200,000 properties – in Chennai into
  - Reassessment by government tax collectors
  - Reassessment by private assessing firms
- Private firms procured by government through normal tendering process, but with two different contacts
  - Fixed fee contract - firms paid a fixed fee per property re-assessed
  - Incentive based contract
  - Wards randomized to private firms sub-randomized by contract type
- Entire re-assessment exercise was unexpectedly halted on June 3, 2023 due to political sensitivities! Firms were paid by only 18 months later.
- Measure outcomes through administrative data, supplemented with property, firm, and inspector surveys

Government Raises More Revenue than Private Firms

	Reassessed (Apr. 2024)	Tax Demand (Rs.)	Tax Collection (Rs.)
	(1)	(2)	(3)
Panel A: Reduced Form Estimates			
Assigned to government	0.471***	2835.14***	1849.01***
	(0.042)	(360.65)	(269.28)
Assigned to private	0.377***	1450.73***	792.64***
	(0.022)	(188.45)	(99.15)
Government = Private	0.050	0.00	0.00
Panel B: Instrumental Variables Estimates			
Reassessed by government		6013.83***	3922.35***
		(527.41)	(424.10)
Reassessed by private		3849.03***	2104.53***
		(372.92)	(226.11)
Government = Private		0.00	0.00
Control Mean	0.001	7120.43	5654.41
Observations	206255	206255	206255

- Government assessors conduct more assessments (in half the man-days!)
- Increase in tax demand: 84% government compared to 54% private
- Increase in tax revenue: 69% government compared to 37% private

The Government is More Accurate than the Private Firms

	Inaccuracy
	(1)
Assigned to private	0.138***
	(0.038)
Government = Private	0.00
Government Mean	0.28
Observations	1,499

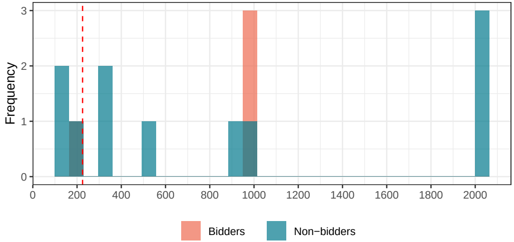
- Higher tax demand is not necessarily better - only unambiguously better if it's also more accurate
- Compare official new assessments to those from our independent survey
- Government is more accurate
- In general, this stems in part from the government being better at more complex properties: finding mixed use or commercial space, more floors, more abnormally shaped properties, those that are larger at baseline

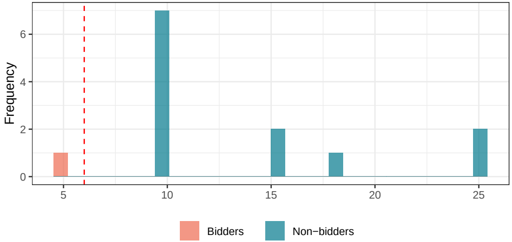
Mechanisms: Why does the government outperform?

- It is not a temporary advantage of the government with more soft information about which properties are higher value
- Nor is it about high power incentives: the results look near identical for flat versus incentive contracts
- Instead, we find two major factors:
  - Broader procurement and contracting issues
  - Private sector has authority challenges

Broader Procurement and Contracting Issues

- Standard Procurement Process: Notice of tender published, information meetings, government negotiates with lowest-price bidder to reduce price further; once final price reached, all qualified firms offered opportunity to match this price
- Ultimately, 23 firms attended a bidding meeting, but only 5 firms bid. 1 firm was disqualified, 1 firm found prices too low, leaving 3 firms
- Firms did not bid due to low prices and hassles with past government dealings





Firm Type, Employee Effort and SKill

- This led to a different selection of firms (e.g. bigger, more government experience) that could perhaps take on the risk
- Firms hired workers who were less skilled and less experienced than the government (and paid them very little)
- Private workers exerted little effort, e.g. spent less time than public workers in assessing properties
- Note that this environment is not unusual: Tamil Nadu routinely subcontracts a variety of tasks, and the procedure used is very similar to what is used worldwide – So is a feature of subcontracting in the world.

The Nature of the Task: Authority

	Authority				Revisits/Action
		Owner requested change to...			Number of revisits when owner denied permission for re-assessment
	Share of refusals	Property area	Property usage	Number of floors	
	(1)	(2)	(3)	(4)	(5)
Assigned to private	0.04*	0.28***	0.12*	0.06	-1.42***
	(0.02)	(0.08)	(0.07)	(0.07)	(0.30)
	[-0.00, 0.12]	[0.17, 0.48]	[0.06, 0.32]	[0.01, 0.22]	[-2.05, -0.26]
Government = Private	0.069	< 0.001	0.100	0.340	< 0.001
Government Mean	0.15	0.35	0.20	0.16	2.01
Observations	137	147	147	147	147

- In principle, private surveyors had full authority to conduct inspections.
  - Official letter allowing them to enter properties; official jackets, caps, and badges.
- Nevertheless, they had more refusals, more citizens requesting changes, and were hesitant to go back when they had refusals

Cost-benefit analysis

	Duration (in years)		
	1	5	10
Net Benefit Per Property			
Government	5758.08	29930.47	60145.96
Private Firms	3748.56	19663.18	39556.46
Optimal Assignment Mix	5092.91	26494.78	53247.12
Random Assignment Mix	4753.32	24796.83	49851.21

- Government has highest net benefits, but regardless of what you do, this policy has very high net benefits: Assuming 5 year lifespan, net benefits are 29,930 for government vs. 19,663 for private, so government is more effective
- But, note that if the government workers do not have the time to do all assessments, one can do better by giving them the complex, larger properties and outsourcing the smaller, simpler properties

Conclusion

- A common view of outsourcing is that the private sector is more efficient, but there are multitasking concerns where the firms do not have same incentives as the government
- For tax assessments, we find government actually is more efficient
  - Government is more accurate and generates higher tax revenue
  - Key mechanisms seem to include:
    - Broader procurement challenges, which one cannot just band-aid with a more highly incentivized contract. Issues around selection mechanisms and contract stability may be selecting in the wrong firms.
    - Authority issues that suggest that certain types of task (which have more adversarial interactions with citizens or firms) may be better handled by government