A Dutch perspective on added value capture: how far can you go?

Erwin van der Krabben

In 1879 Henry George advocated, in his famous work *Progress and Property* (George 1879), the introduction of a land value tax – also referred to as a 'single tax' on land. Before him, Adam Smith had already called it 'the perfect tax' (Smith 1776; Webb 2013) because of its economic effects. George argued that because the supply of land is fixed and its location value is created by communities and public works, the economic rent of land is the most logical source of public revenue. While most taxes distort economic decisions and suppress beneficial economic activity, land value tax is payable regardless of how well or poorly land is actually used. Noble Prize winner William Vickrey believed that

> removing almost all business taxes, including property taxes on improvements, excepting only taxes reflecting the marginal social cost of public services rendered to specific activities and replacing them with taxes on site values, would substantially improve the economic efficiency of the jurisdiction.
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> (Vickrey 1996: 603)

Despite the strong economic arguments in favor of land value tax as the main – or single – revenue source for public finance, and despite (ongoing) debates in many countries around the world to introduce land value tax, only few countries actually implemented land value tax (but never as a single tax), including some states in Australia, Hong Kong, Taiwan, Colombia, Denmark, and Mexico (Andelson 1971).

The introduction of a land value tax in Switzerland can be related to these theoretical discussions. The Swiss case is interesting from at least two different perspectives. First, the introduction of – or better, attempts to introduce – a land value tax has led to political controversy in other countries as well. To place the Swiss case in an international context, I will briefly refer to the (political) objections that arose after related proposals to 'cream off' the planning gain, which arises when permission to develop land is granted, in the UK and the Netherlands. Second, the Swiss case of introducing a land

value tax system provides an interesting insight into the practical aspects of implementing such tax.

Before introducing the UK and Dutch political debates with regard to taxing development gain, it is useful to distinguish this tax on development gain (or land value tax) from (1) developer contributions (or obligations) to plan-related infrastructure costs (from which the developer will benefit directly) and (2) property tax. Most countries use some kind of system to make developers contribute to the infrastructure costs related to a plan. They are often discussed in a technical sense, but the political dispute about them is usually limited. Property tax is a general tax based on property value and is not meant to cream off development gain (although they do to a certain extent, if there is a property value increase because of a development).[1] Perhaps the most documented dispute over taxing development gains took place in the 1940s in the UK after publication of the Uthwatt Report in 1942. The Uthwatt Committee discussed among other things the introduction of a betterment levy to capture the planning gain – quite similar to the Swiss land value tax. A betterment levy was introduced in the 1947 Town and Country Planning Act. However, the political controversy about the new regulation became clear soon after, when the subsequent Conservative government immediately decided to abolish it by passing the 1954 Planning Act. Internationally less known is the political crisis that developed in the Netherlands in 1977, after incompatible views had arisen with respect to land policy between the Labour Party and the Christian Democrats that formed a coalition at that time. The debate was not about introducing a land value tax, but about a related theme: the compensation to be paid in case of expropriation. While the Labour Party wanted a compensation based on the value of the land in its original use (the planning gain as the result of the government decision to change the use of the land would go to the state), the Christian Democrats did not want to change the existing regulation that prescribes compensation based on the market value of the land (the planning gain would remain with the owner that would be expropriated). The coalition partners couldn't agree on the method to define compensation (which added up to some other disagreements within the coalition) and decided to step down. Compensation for expropriation would continue to include planning gain. Since then the issue has hardly been touched upon in Dutch politics. In 2008 a new land law was introduced, but this land law was meant to offer a legal basis for charging developer obligations and did not touch upon the issue of taxing development gains.[2] Political debate regarding the present revision of the expropriation law – as part of the law on land and property ownership (*Aanvullingswet Grond en Eigendom*), which will replace both the 2008 land law and the current expropriation law, which will be, in turn, part of the new Law on the Environment (*Omgevingswet*), expected to be implemented in 2019, also ignores this topic. My impression is that in the Netherlands – though the country is sometimes considered a

planning paradise, with strong planning legislation – a similar proposal to introduce a land value tax, as in Switzerland, is unthinkable, because of the legal view that all value increase, including planning gain, rightfully belongs to the property owner.

The implementation of a land value tax – as probably any other tax – also raises questions with respect to the practicability, effectiveness, efficiency, and legitimacy of such a tax. The Swiss case illustrates quite convincingly that these aspects may cause problems. For instance, it seems to me that the practice in some places to informally negotiate a lump sum contribution to finance infrastructure beyond land servicing costs makes the value capture system quite inscrutable. Moreover, an efficient and fair land value tax system requires precise information on land values before and after a change in the zoning plan. According to Viallon, such information is not systematically available in Switzerland, and high administrative costs will be involved when a more standardized system would be introduced. And finally, it is claimed that legitimacy issues may appear. The use of land value tax may bring local authorities to prioritize land uses with a high added economic value, because it will give them higher revenue compared to uses with lower added value.

The 'solution' sought in the Netherlands with respect to practicability issues regarding charging development contributions (which is different from a land value tax) has been to make it as transparent as possible. All types of costs that can be charged to private developers have been described. Before plan approval can take place, all plan-related costs must be covered. The extent to which private developers must contribute to these costs depends on three criteria: profitability, proportionality, and accountability. In addition, a maximum has been set to the size of the contribution: it can never exceed a level that would lead to a financial loss for the private developer. In such a situation, the municipality must find other ways to cover these extra costs (or decide not to approve the plan). Developer contributions to plan-related infrastructure can be forced, according to the law, but only when a voluntary agreement cannot be reached. This provides possibilities for negotiations between the municipality and private developers (which are not very transparent), which may include adjustments to the real estate program (density, housing mix, etc.) and/or adjustments to the infrastructure. After the introduction of this legislation in 2008, both municipalities and private developers seemed to be more or less happy with the system. It wasn't until a few years later that the first problems arose. While the traditional comprehensive development plans usually made it possible to calculate all infrastructure costs in advance, the 'organic', bottom-up developments that have become more dominant now in urban transformation projects often do not allow calculating these costs in advance because it is frequently unknown at the start of the plan what will be developed. Another problem is that, even if the municipality would be able to define all necessary infrastructure works, it would be obliged to guarantee covering the

costs itself because it is unknown who will develop. The aforementioned 'land and property ownership law' offers some solutions to this. However, as the minister responsible for spatial planning has stated herself in the explanatory memorandum for the draft version of the law, another problem remains to be solved. Where Dutch cities in the past usually were able to raise sufficient revenue for covering infrastructure costs by relying on the combination of income from land sales, contributions by private developers and national government subsidies, this has become quite uncertain for the future (with possibly large variation among cities regarding the size of the problem). Income from land sales is substantially lower than it used to be, national subsidies for urban renewal are no longer available, and with (less profitable) urban transformation projects now becoming more dominant, contributions by private developers may decrease as well. The minister acknowledges the problem, but has not yet suggested any solutions to it.

Notes

1 There is also much international debate about property tax, particularly in developing countries, mainly in relation to public finance and municipal fiscal health, but I leave that aside.

2 Dutch municipalities, however, made use of another strategy to capture planning gain. By the commonly used public land development model they were able, as landowners, to keep most of the planning gain. Since 2008 (the global economic and real estate crisis), municipalities have become much more reluctant to use this development model because of the financial risks involved.

References

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