

# **Land-Use Regulations and Property Values**

## **The “Windfalls Capture” Idea Revisited**

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## CHAPTER 33

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# LAND-USE REGULATIONS AND PROPERTY VALUES: THE “WINDFALLS CAPTURE” IDEA REVISITED

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Few issues in land-use planning are as universal as the bipolar relationship between regulation and property values. This issue carries deep economic, social, and distributive-justice implications. Do governments have the right to reap some of the increment in value attributable to planning decisions? And the corollary: Do governments have an obligation to compensate private landowners for value decline due to land-use regulations? Two American scholars have whimsically tabbed this issue as “windfalls” and “wipeouts” (Hagman and Misczynski 1978). This topic has trailed planning policy for a long time, yet is no closer today to being resolved in a politically or legally sustainable manner.

This chapter revisits the upward side of the land-value coin: How relevant is it today around the world, and especially among advanced-economy countries? The idea that landowners should share some of the increased value of their land with society encompasses a wide range of situations and policies. I will first address the issue broadly and then focus on one specific type of value capture—where the rise in property values is due to land-use regulations or public works. This ubiquitous topic has not benefited from enough comparative research.<sup>1</sup> By analyzing the

1. Despite the ubiquity of the land-value issue, it has not benefited from much systematic comparative research. The only major academic work that looks at both sides of this issue

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experiences of a large sample of advanced-economy countries, this chapter seeks to contribute to knowledge sharing on this important issue.

My argument is structured in seven sections. The first two introduce the debates over real-property rights and the history of value capture policies. The subsequent section proposes a theoretical distinction between macro, direct, and indirect instruments for value capture. I then proceed to focus on direct value capture and to survey the laws and policies in thirteen advanced-economy countries. Finding that only three countries practice direct capture, I draw out the lessons that may be gleaned from their experiences. The section that follows explains why the idea of value capture has been incrementally transformed into a plethora of indirect value capture instruments with growing popularity around the world. The concluding section set some challenges for future cross-national learning.

## THE DEBATE OVER REAL PROPERTY AND ITS IMPLICATIONS FOR VALUE CAPTURE

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Before delving into the issues and instruments related to value capture, one should take a brief look at the underlying debate: Is real property the epitome of private rights, or is it a social good? And what are the implications of this debate for the issue of windfall capture?

### The Role of Real Property

Why is the nexus between government regulation and economic value especially contentious when it comes to land? After all, government policies may affect the value of nonreal property as well. Does the public deserve a share in the rise of land values more than other types of private property? In countries where there is a general capital gains tax, real property is sometimes included. However, when policy makers try to single out real property through special legislation or a higher tax rate, an intensive public debate is likely to be triggered. This sensitivity indicates the special role that land plays in the system of social values of many societies.

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comparatively is the seminal book by Hagman and Misczynski (1978). It surveyed five English-speaking countries (the United States, Canada, Australia, New Zealand, and England) and contributed considerably to the theoretical framing of the issue. Another book, by McCluskey and Franzsen (2005), focuses mostly on developing countries. The “wipeouts” side—called “regulatory takings” in American lingo—has recently benefited from greater comparative attention. My recent book (Alterman 2010) presents an in-depth comparative analysis of the laws and policies of thirteen countries. Alexander’s 2006 book analyses four countries in depth.

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Philosophers, economists, legal scholars, and planners have long debated the role that real property should play in society. Land draws special attention because of its well-known special attributes: land is essential for physical human survival, it provides the essential context for social and political life, it often embeds symbolic or religious values, it is largely irreplaceable, each location is unique, and the supply of land is almost finite.<sup>2</sup> A long lineage of thinkers has debated the proper role of real property in society. Their ideas are complex. The following is a brief and inevitably simplified account of a few key arguments.

According to the famous seventeenth-century thinker John Locke, private real property preceded the civil state and deserves its protection in law. The social rationale is that landownership is closely linked to human autonomy. The work invested by individuals in obtaining and cultivating land is the basis for private property rights. Without state protection, the incentive to work would be eroded, and society would suffer (Locke, in Sandel 2007, 83–125). According to Locke, one of the paramount justifications for the very existence of the state is its capacity to protect private property: “The great and chief end . . . of men uniting into commonwealth, and uniting themselves under government, is the preservation of their property; to which in the state of Nature there are many things wanting” (109).

Another great philosopher who strongly supported private landownership was Jeremy Bentham (mid-eighteenth to mid-nineteenth centuries). He developed the utilitarian theory of real-property rights. The state should protect and promote private real-property rights because landowners are more likely to invest in their land and to manage and maintain it much better than public owners. Thus private ownership contributes to the general societal welfare; without it land would be left derelict or misused.

Rousseau held the opposite view. Writing after Locke but before Bentham, this eminent thinker held that private ownership of land is responsible for much of the misery and violent conflicts around the world. In Rousseau’s much-cited words: “You are lost if you forget that the fruits of the earth belong to all and that the earth itself belongs to no one!” (Rousseau [1755] 1994, 54, cited in Bromley 1999).

Traces of these classical philosophers’ positions are visible in current debates about property rights. Scholars and political leaders who sanction unbridled private ownership have their roots in Locke’s and Bentham’s thinking. They criticize government land-use regulation and taxation, arguing that unfettered or only mildly regulated landownership would utilize land more efficiently by means of market forces (Lefcoe 1981; Fischel 1995; Yandle 1995; Ellickson 2000). According to this view, excessive land-use and environmental regulations and financial obligations are partly to blame for the high cost of housing and other built-up products (as empirically shown by Glaeser 2007 and Quigley 2007).

2. This argument is expressed by many writers, including Ratcliffe (1976, 9–27); Lichfield and Darin-Drabkin (1980); Strong (1979); Clawson and Dysart (1989); Bromley (1991, 1999, 2008); Echeverria and Eby (1995); Jacobs (1999).

The collapse of the Soviet bloc and Communist ideology gave the private property ideology a strong boost. The introduction of property rights still occupies a major ideological position in the odyssey of the “transition countries” from socialism to democracy and market economies. Even basic land-use and environmental regulations of real property still encounter suspicion.<sup>3</sup> The ripple effect of the collapse of Communism in Europe is now felt in those (few) developing countries that still maintain national landownership. In China, Vietnam, and Laos state ownership of land is still officially maintained, but a variety of quasi-private tenure systems are fast emerging (Kim 2008, 2011; Qin 2009; Abramson 2011).

Another stream of support for private landownership comes from policy makers and scholars concerned with the large-scale problem of informal tenure rights in less developed countries. Focusing on the lives of individual household rather than on the ideology of freedom, De Soto (2000) and others note that in many of the world’s societies, real property represents the primary part of household assets, and thus public policy should strive to enhance the formal status of these assets. They argue that if the massive informal land tenure prevalent in most developing countries could be formalized, individual households would be able to leverage their property to create economic benefits in a variety of ways. The United Nations, World Bank, and other world organizations have adopted this view, placing increasing emphasis on the special role of real-property ownership and registration in stimulating development (UN-FAO 2002; Ho and Spoor 2006).

The opposite view of land is rooted in the teaching of Rousseau and other philosophers. In the early and mid-twentieth century these views were applied in extreme forms by the Communist regimes that nationalized all or most private real property. Since the collapse of Communism in Europe and its erosion in Asia, such positions no longer occupy center stage. But the debates over the appropriate relationship between private property rights and the public interest have not wilted away.

The challenge to the conservative conception of rights in land is known today as “the social function of property” or “the social-obligations theory” (Dagan 2007; Alexander 2006, 2009). This view does not negate the legitimacy of public property but seeks to place various socially derived obligations on it. There are many variations on this general idea.<sup>4</sup> The basic concept is summarized by Alexander (2009) thus: “An owner is morally obligated to provide to the society of which the individual is

3. There are however, many differences in the details of the ideologies and policies that postsocialist countries in East and Central Europe adopted in their transition to market and property systems. Compare, e.g., Hirt and Stanilov (2007) about Sofia, Bulgaria; Kim (2006) about Warsaw; Stark and Bruszt (1998, 51–79) about Hungary; Strong and Reiner (1995) about the Czech Republic.

4. Compare Strong (1979, 9–42); Bromley (1999); Dagan (2007); and Alexander (2009). The 2009 Nobel laureate Elinor Ostrom (2009) made a seminal contribution to this topic by proposing a different perspective on the advantages of communal land management in human societies.

a member those benefits that the society reasonably regards as necessary for human flourishing . . . that have some reasonable relationship with ownership of the affected land” (774).

Proponents argue that social obligations should hold even where there is explicit constitutional protection of property rights. Most countries today do provide some form of constitutional protection to property, but its legal implications vary considerably (see Alexander 2006; Alterman 2010, 27–35). In some countries, the constitutional protection of property also contains explicit language about social obligations (Alexander 2006; Alterman 2010, 27–35). However, proponents of the social obligations concept argue that the social obligations need not be explicit in the constitution or in statutes. Private landownership intrinsically carries with it social and environmental obligations derived from a society’s overarching ethical norms, and these should guide the courts as well.

One could argue that, to some degree, the social obligations view of property has in fact been adopted by most countries. Today, almost all countries around the globe practice land-use and development regulations or taxation of real property, so they no longer follow a purist Locke position. The mainstream debates about property rights today no longer revolve around the big ideological issues about whether private property should exist. Instead, the debates focus on specific issues such as the appropriate degrees of land-use and environmental regulation, the extent of government powers to take land for public needs, the level of compensation for injurious regulation, and the topic at hand—whether the increment in value due to government decisions should be recouped for the public.

What are the implications of the property rights debate for policies about land-value changes? According to the conservative view, landowners should keep the full windfall as part of the general rules of the economic game. As a second best, if a particular jurisdiction decides to adopt a tax on capital gains, then real property should be viewed as just another type of capital investment and not be singled out for a separate tax. By contrast, under the socially oriented view, the duties that owners of real property owe to society include the obligation to share part of the “unearned increment” by means of special levies or taxes. Increments due directly to the landowners’ efforts would be exempted (such as installation of irrigation or construction of a building).

## THE IDEA OF LAND-VALUE CAPTURE: HISTORY

The idea that the value of land is created by society and should therefore be reaped for the public is by no means new. The brief survey reported here first looks at the evolution of the notion of the “unearned increment” in land in general, and then specifically at the idea of capturing increments created by land-use regulation.



## Henry George and the “Single Tax” Idea

In 1879 the American thinker Henry George famously proposed the “single tax” idea in his book *Progress and Poverty*. He argued that if the rent from land alone (without the buildings and other “improvements”) were to be paid to the government authority on an ongoing basis, it would suffice to finance the entire set of society’s public needs (Andelson 2000, xxii–xxiv). A tax on land would avoid causing the kind of economic turbulence that taxes on labor and financial capital inevitably create. This latter view is supported by many economists (Ingram and Hong 2007; England 2007; Netzer 1998). George (1962) argued that public capturing of land values represents “a taking by the community, for the use of the community, of that value which is the creation of the community” (421). At the time, his proposal did not link value capture with land-use regulation because he wrote the book long before these were established in their modern formats.

The “Georgian movement” still draws dedicated followers around the world (as well as many critics; see Andelson 2004).<sup>5</sup> However, as attractive as the Henry George theory may be, many generations after he published his seminal book, the vote around the world is clear: “no” to the single-tax idea, with a few small local exceptions. The only type of land tax that is internationally widespread is the local property tax—in some jurisdictions imposed only on land, in others also on built structures. However, in most countries property taxes capture only a small percentage of property values and are thus only a small vestige of George’s idea (Ivanier 2010). Yet the underlying rationale of the Georgian argument is still compelling to many. It is often cited in support of the idea that the added value specifically created by land-use regulation decisions should be shared with the public.

## Value Capture and Land-Use Regulation: The “Betterment Capture” Idea

Currently the vast majority of countries across the globe—recently joined by the post-Communist ones—have adopted laws for regulating land use and development (though in many these laws are poorly applied and enforced). Historically, Britain led the way in the world discussion about the nexus between planning regulations and property values. The phrases that the British coined for the issue—“betterment and compensation” or “betterment and worsenment” (or “worsenment”)—date back to the late nineteenth century (Baumann 1894). In 1909 a British prime minister made the following eloquent statement when introducing a national betterment capture levy as part of the world’s first national land-use planning act (“town and country” in British lingo): “It is undoubtedly one of the worst evils of our present system of land that instead of reaping the benefit of the common Endeavour of its citizens a community has always to pay a heavy penalty to its ground landlords for putting up the value of their land (Hansard 1909).”

5. For an example of one of the movement’s organizations, see <http://www.henrygeorgefoundation.org/>. See also <http://www.earthrights.net/wg/wgi.html>.



The British value capture initiative became instantly popular with some U.S. planning proponents, who in 1910 made the following enthusiastic statement (sprinkled with a modicum of jealousy):

The English act cuts the Gordian knot by providing that the local authorities shall be entitled to recover from any person whose property is increased in value by the operation of the scheme one half the amount of that increase. Thus does the municipality reap the benefit without any of the risks attendant on speculation in land values. . . . Prophecy is valueless, but judging from the interest shown by municipal officials and by the orderly way in which those interested are proceeding, the act begins a new era in English town planning.<sup>6</sup>

However, admiration by American planners was not enough to ensure the success of the 1909 British law at home. This was due not to lack of enthusiasm. Unlike the United States, Britain has had a long tradition of legislative responses to both sides of the property value effects. Subsequent legislation tried various other formulas, and these ideas were exported to many of the colonies (McAuslan 2003; Home 1997). However, neither side ever worked satisfactorily (Grant 1999), as discussed later in this chapter.

Since World War II the betterment and compensation sides have been decoupled in Britain. During the height of the war, the British government appointed the Expert Committee on Compensation and Betterment to guide the government in the laws and policies it should adopt for postwar reconstruction. The influential *Uthwatt Report*<sup>7</sup> introduced two important concepts—“shifting value” and “floating value” (Replogle 1978; Tichelar 2003).

“Shifting value” assumes that the demand for any given type of land use in a particular region is finite. Land-use restrictions in one municipality (or in one part of a city) may cause downward value changes, but at the same time may increase the value of land in another locality where the regulations do permit development. “Floating value” refers to the speculative nature of potential land values. Landowners tend to assume that if only planning regulations did not stand in their way, a lucrative type of development would “land” on their own plot of land. However, the notion of shifting value implies that even if land-use regulations were to be abolished, not all landowners would benefit from development (Moore 2005, 3). The assumption that landowners are entitled to compensation for reduction in development rights was thus shaken, while the justification for capturing the added value was reinforced.

Based on this thinking, the UK Town and Country Planning Act of 1947 reformed the entire system. It discarded the idea of “development rights” granted by

6. Proceedings of the Second National Conference on City Planning and the Problems of Congestion, Rochester, New York, May 2–4, 1910, <http://www.library.cornell.edu/Reps/DOCS/shurtlef.htm>.

7. The *British Expert Committee on Compensation and Betterment*, Cmd 6386 (1942). This report is known by the name of its chair, as the *Uthwatt Report*. Its importance in shaping British recovery is recognized not only by planners and lawyers but also by historians of British history. See Tichelar (2003).



plans in advance and substituted a system whereby each development is approved “case by case” through a “planning permission” (Booth 2003). Local government must prepare local plans, but their function is to guide decisions, not to grant development rights. Thus, the very notion of entitlement to compensation was abolished (Purdue 2010), but not the other side of the coin—capturing the betterment value. For several decades hence, the United Kingdom seemed to have “volunteered” to serve as the world’s laboratory for testing the betterment capture idea, as detailed later in this chapter.

### Is There Symmetry between Windfalls and Wipeouts?

The UK story brings to mind an obvious question: If landowners are required to share the windfall derived from land-use decisions, should they also have the right to compensation for decrease in property values due to such decisions? And the converse: If landowners are allowed to keep the windfalls, then symmetry of logic would hold that they should absorb the wipeouts and not be eligible to compensation from the public purse.

However, my recent thirteen-country comparative analysis on compensation rights has produced some counterintuitive findings: In most countries, the two sides of the coin are not symmetric either in law or in practice (Alterman 2010, 3–5). The lack of symmetry is usually not even a public or legal issue, except as a teaser by proponents of one side of the debate who wish to highlight the other side’s ostensibly faulted logic. In all but two among the sample countries (Poland and Israel), the two sides of the land-value coin are currently disassociated. Thus real-life laws and policies do not operate according to the axioms of elegant logic.

The following sections take a closer look at specific instruments for value capture, with a particular focus on those directly targeted to capturing value created by land-use regulatory decisions.

## THE DISTINCTION BETWEEN MACRO, DIRECT, AND INDIRECT VALUE-CAPTURE INSTRUMENTS

Despite considerable scholarly literature, value capture remains an open-ended concept, variously defined and used. Selected terms are featured in figure 33.1. Some use the generic term *value capture* to cover any type of policy or legal instruments whose purpose is to tap any form of “unearned increment,” regardless of the cause of the value rise. Others use the same term to denote only the policy instruments for capturing value arising directly from land-use regulation or public works. The most direct term available to denote the latter type of value increase is *betterment*—a word that originated in British English and still has no American English counterpart.

- **Betterment** – the rise in land values directly caused by a planning or public works decision (contrasts with "compensation", sometimes also called "worsement" or "worsenment") – Term used in Britain and the former colonies.
- **Unearned increment** – any rise in land values – whether due to public decisions or to the general economy; stressing the fact that the rise is not due to the landowners' own initiatives and efforts. Used internationally (World Bank, UN, academic literature)
- **Plus value** – Used in Spanish-speaking countries to denote either betterment or the unearned increment. Also used internationally (World Bank, UN, academic literature)
- **Windfalls** (to contrast with "wipeouts") Not a specific professional or legal term. A somewhat whimsical term coined by Americans to denote "unearned" gains in property values.
- **Givings** (to contrast with "takings") – an esoteric takeoff on the reverse US concept of "takings".
- **Value capture** – a generic term potentially denoting all the above

Figure 33.1 Key Terms and Definitions Regarding Direct Value Capture

There is also considerable vagueness in the literature on whether a policy should be classified as value capture based on its *purpose* or its *outcome*. Some policies not primarily or overtly intended to reap the unearned increment do in fact exact from landowners or developers monetary or money-equivalent contributions. To provide a more level field for research and knowledge exchange, I propose a distinction among three sets of policy instruments that relate to value capture: (1) *macro*, (2) *direct*, and (3) *indirect* instruments.

## Macro Value Capture Embedded in Broader Land Policies

Macro value capture instruments are not freestanding. They are embedded in some overarching land policy regime, motivated by some broader rationale and ideology. These regimes are assumed to provide a better land and development policy than a market regime. Four major types of land policy regimes have value capture embedded in them—at least in theory. Some authors regard these macro land policies as value capture instruments (e.g., Smolka and Amborski 2007). I have listed the major types in declining order by degree of intervention with private property:

1. Nationalization of all land
2. Substitution of private property by long-term public leaseholds
3. Land banking
4. Land readjustment.

In all these land policy regimes, value capture is only one among several motivating rationales and objectives. However, once the new land regime has been in place for a few years, it will likely develop its own economic and political dynamics, and value

capture may be eroded. With time, it may be difficult to determine how much of the plus value in fact reaches the community. The linkage between these macro land policy regimes and value capture could become remote.

The first three types of macro policy are on the decline on the international stage. Nationalization was a trademark of Communist regimes, but today the idea is rejected in most countries. The assumption was that once land becomes public, the unearned increment due to approval of development or to public infrastructure will go to the public purse. The second, somewhat less drastic regime replaces private freehold rights by a system of long-term government leaseholds with a degree of property security (Hall 1976, 54–55; Bourassa and Hong 2003). The leases would contain a clause stating that, since government owns the land and the right to develop, the plus value too must be paid to the government. After the collapse of Communism, such regimes too are decreasing due to full or quasi-privatization policies (discussed above). More recently, public leaseholds are used on a limited scale in special locations or contexts, and their prime purpose is not to capture the unearned increment (Bourassa and Hong 2003).<sup>8</sup>

Land banking, the third type of macro regime, does not negate private property regimes. The government (often local authority) purchases land that may be needed for future urban expansion well in advance. In the “classic” mode of land banking, the government body supplies the infrastructure and leases or sells the land after it is developed (Bourassa and Hong 2003; Laanly and Renard 1990; Atmer 1987; Strong 1979; Hall 1976). The sale or lease price reflects the added value derived from the right to develop the land and from the infrastructure provided. Several central and north European countries have used this instrument extensively. However, since the 1990s, land banking has been receding even in its bastion countries such as the Netherlands (Needham 2007). The reasons reflect the same deep trends that have led governments to reduce their scope of direct action in many other spheres.<sup>9</sup>

The fourth type, land readjustment, is the least interventionist of the four because it does not aim to replace private property. It is a sophisticated and malleable tool that enables government authorities to reshuffle the current division of land plots and to assign landowners new plots and development rights (Doebele 1982; Needham and Hong 2007; Alterman 2007; Davy 2007). But despite its great promise, land readjustment remains rare among advanced economies.

8. Two successful exceptions are Hong Kong and Singapore—two city-state-like regimes—that apparently do succeed in capturing much of the value increments by means of their leaseholds system (Hui, Ho, and Ho 2004). This may be due to the fact that these two jurisdictions are more akin to cities than to nations.

9. The community land trust movement, which has been gaining momentum in the United States, is sometimes viewed as a form of land bank. However, unlike classical land banking, CLTs are often initiated by nongovernmental organizations, and they are usually scattered sites targeted not to general urban development but rather to affordable housing (Bourassa 2007). CLTs do not have a significant linkage to value capture.

So, three of the macro policies resonate as relics from past regimes and are unlikely to be revived today. The fourth one is a “sleeping beauty.” This leaves the direct and indirect value capture instruments as more relevant for value capture today.

## Direct Value Capture

Direct instruments for value capture are policies that seek to capture all or some of the value rise in real property under the explicit rationale that it is a legal or moral obligation for landowners to contribute a share of their community-derived wealth to the public pocket. As a wealth redistribution instrument, direct value capture is often regarded as a tax and requires legislative authority. Direct instruments do not need to seek any additional rationales—for example, they do not need to show that the funds are necessary to mitigate negative impacts of the project, or that the properties that generated the funds will also benefit from the services financed by them. The rationale for direct value capture stands in its own right.

Direct value capture may be divided into two subtypes, and the second subtype is further divided into two subtypes:

- a. **Capture of the unearned increment:** Where the value rise is not linked to a specific government decision but rather to general economic or community trends.
- b. **Capture of betterment:** Where the value rise is directly caused by a specific government decision related to physical development.

The concept of betterment, too, may be further divided into two subtypes of decisions. Confusingly, both are often denoted by the same term: *betterment*.

- b1. **Betterment arising from public infrastructure works:** The value rise is due to positive externalities from a government decision to approve or execute public infrastructure, parks, or other services.
- b2. **Betterment arising from land use regulation:** The value rise is due to a land-use planning or development-control decision.

Capture of the unearned increment may take many forms, including a capital gains tax on land or real property, an unearned increment tax upon transfer of title, sometimes time-adjusted to curb speculation, or an annual property tax that is closely tuned to the rise in property values. Taxation of the unearned increment is found in several countries. Americans know the examples of Vermont and Pennsylvania (Daniels, Daniels, and Lapping 1986; and Gihring 1999). In the Far East reported cases are Taiwan (Lam and Tsui 1998), Hong Kong, and Singapore (Hui, Ho, and Ho, 2004).

This chapter tells the story of the international experience with the capture of betterment arising from government land-use decisions. But first, the concept of indirect value capture should be introduced.



## Indirect Value Capture

The rationale of the indirect instruments differs from the direct ones. The indirect instruments do not seek to capture the added value for its own sake, simply because it is “unearned,” but in order to generate revenues (or in-kind substitutes) for specific public services. Indirect instruments are usually practiced on the local government level. The objectives behind the indirect tools are usually more pragmatic and less ideological than the objectives behind either the macro or the direct capture instruments. To survive legal and political challenge, the indirect instruments usually need the “cover” of some other rationales beyond the desire to capture the unearned increment.

Unlike the direct instruments, indirect value capture is an ever-evolving category of policies that varies greatly among countries and localities. This topic merits its own comparative research. I will return to this topic later in order to contrast it with direct value capture.

## BETTERMENT CAPTURE: THE INTERNATIONAL EXPERIENCE

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How prevalent is direct betterment capture around the world? This section and the following one are based on international comparative research on betterment capture practices among a large sample of advanced-economy countries (plus a comment on South America).

Many types of government land-use or development decisions could serve as grounds for direct value capture.<sup>10</sup> These vary from country to country and possibly also from one municipality to another. Infrastructure-based betterment levies are historically the earliest form of betterment capture. I will discuss this type first and then proceed to focus on land-use-based betterment capture instruments.

### Infrastructure-Based Betterment Capture

The oldest types of the betterment capture instruments are infrastructure-based. They focus on value increase to neighboring properties caused by public infrastructure. Public works are a government function that preceded land-use planning laws by centuries. When the British enacted the first national town planning act in 1909, they embedded in it a 50 percent infrastructure-based betterment levy

10. In theory, other types of government decisions unrelated to land use could also be the cause of land value increases—for example, a new trade treaty that will influence a border town. However, these have not generated a significant body of law or scholarship and are not discussed here.



that predated that act. This instrument migrated to many of the British colonies and protectorates but experienced many failures (Peterson 2009, 36–38; Grant 1999; Alterman 1982). Apparently, linking value rise to the execution of public works is not easy. The reasons may include difficulties of proving the causal relationship to the infrastructure works; difficulties in determining the geographic range of impact; and difficulties in levying the charge at a time frame reasonably close to the execution of the public works (because the windfall is usually not realized at that point in time).

Yet this idea resurfaces from time to time. For example, in 2004 the Scottish government commissioned a report on whether betterment could be captured from value increase directly due to new transport facilities. Peterson (2009), writing for the World Bank, and Medda (2010) for the UN report on similar initiatives in both developing countries and advanced economies. These initiatives usually stand alone, unrelated to capture of betterment based on land use regulation.

## Land-Use-Based Betterment Capture

Betterment capture policies may target a variety of land-use planning and development-control decisions. I do not know of any country or locality that has ever implemented value capture instruments to tap all the possible “stations” along the planning-to-permitting procedures. The international experience shows that only a few of these stations have ever served as grounds for betterment capture.

As part of a large research project on compensation for value decrease (Alterman 2010), I also looked at the value capture side. The sample of countries encompasses fourteen advanced-economy jurisdictions (thirteen nations and an additional U.S. state) constituting about 40 percent of the members of the OECD in 2010. In alphabetical order the sample countries are Australia, Austria, Canada, Finland, France, Germany, Greece, Israel, the Netherlands, Poland, Sweden, the United Kingdom, and the United States (plus Oregon). The sample was selected to represent a variety of legal and geographic contexts: large and small countries located on four continents; federal and unitary jurisdictions;<sup>11</sup> common-law as well as civil-law countries with varying degrees of constitutional protection of private property;<sup>12</sup> countries belonging to the EU and those outside it; different cultural and language backgrounds, and so forth.

11. The United States, Canada, Australia, Germany, and Austria are federal jurisdictions.

12. The United Kingdom, Ireland, Canada, United States, Australia, and Israel have a common-law tradition (Israel is regarded as a mixed system, but in the area of planning and property law it resembles other common-law systems with former British influence). For an analysis of the constitutional protection of property in these countries, see Alterman (2010, 26–35).



A finding that may surprise many is that there are only three countries in this sample with significant experience in direct betterment capture instruments: the United Kingdom in the past, and Israel and Poland currently. These countries have applied a variety of capture policies, so cumulatively their experiences contain a wealth of potential lessons from which other countries may learn.

## Britain: The World's Former Laboratory of Betterment-Capture Instruments

Britain's vicissitudes with various types of betterment capture policies make it the world's most distinctive laboratory. Between 1909 and the early 1980s, Britain exhibited pendulum-like shifts in policies about compensation and betterment as power changed hands between Labor and the Conservatives (Barker, 2004: 78; Tichelar 2003; Cox 2002; Lichfield and Darin-Drabkin 1980, 144–145). These shifts were accompanied by ideological debates and significant public exposure.

The various policies adopted and repealed represent a large range of rates of recoupment: the 1909 Housing, Town Planning, Etc. Act and its successors imposed a 50 percent levy on betterment arising from the approval of a land-use plan (called “scheme” and functioning similarly to zoning). The British exported this instrument too to many of their colonies around the world. It too proved to be almost inoperable due to difficulties in exacting the levy from landowners at the time of approval of the scheme (Peterson 2009, 36–38; Grant 1999; Alterman 1982).

After World War II and the rethinking brought about by the Uthwatt Committee, Labor enacted the 1947 Town and Country Planning Act that imposed a 100 percent “development charge” on the full extent of betterment. The revenue was to go to central government (Grant 1999; Lichfield and Darin-Drabkin 1980, 136–142). The tax was ineffective (Williams and Hallett 1988, 119), but scholars remain divided about whether it might have succeeded with time (Lichfield and Darin-Drabkin 1980, 142–144). In 1953 the Tories abolished the act.

When Labor returned to power, it enacted the 1967 Land Commission Act along with a new far-reaching plan: In the long run the national Land Commission would assemble a large national land bank by compulsorily purchasing all land coming in for development. In the short run, a 40 percent betterment-like levy was imposed on all land transacted on the open market, and the levy's rate was to go up gradually. The revenues were to go to the central government. However, this act too was repealed by the Tories, who came back to power in 1971 (Grant 1999; Lichfield and Darin-Drabkin 1980, 144–145; Tichelar 2003).

Labor's last attempt (so far?) to institute a direct tax on the betterment value was made in the linked acts of 1975 and 1976. The 1975 Community Land Act was to be a local-government-based version of the Land Commission Act. It would have ultimately made it mandatory for local authorities to purchase all development land (Lichfield and Darin-Drabkin 1980, 169–191; Tichelar 2003). In the interim, the



1976 Development Land Tax Act (DLT) instituted an 80 percent charge on the betterment value. This time the municipalities were allowed to keep some of the tax revenues, but most still went to central government. A team of researchers commissioned to evaluate the DLT in real time found that its partial implementation was due to the lack of financial incentives for local governments to administer the tax effectively (Barrett, Boddy, and Stewart 1979; McAuslan 1980, 118–142).

The Tories kept the DLT in the books for a few years, making it the longest-surviving postwar betterment tax in Britain. However, the Tories broadened the exemptions clauses so much that the tax gradually became ineffective and was formally abolished in 1985 (Denyer-Green 1998, 274–275). Since then, Britain's policy has so far said a loud “no” to betterment capture.

However, the issue is by no means dead. In 2004 the Labor government commissioned the Barker Report, which recommended reintroduction of a mandatory national betterment levy to be called the Planning Gain Supplement (Barker 2004: 84–87). It would have captured 20 percent of the increase in land values resulting from the grant of planning permission. This proposal was not adopted, partially because developers feared that the practice of negotiated indirect value capture would continue in addition, and partly because local governments would not have been the direct recipients of the proceeds.<sup>13</sup>

Instead of going dramatically back to the tradition of direct betterment capture, the Labor government preferred a hybrid graft of direct and indirect value capture called the Community Infrastructure Levy (CIL). The levy is based on a formula linked to the additional floor space allowed by a planning permission. The rationale is partly the anticipated impacts of the proposed development (indirect capture), and partly the uplift in economic value gained from development permission (direct betterment capture). The new levy was to commence on April 6, 2010, on the eve of the national elections. The Conservatives who gained power in the May 2010 elections had declared all along that they would abolish the levy. The new cabinet reviewed that policy,<sup>14</sup> but decided not to abolish the CIL. Instead, the Cabinet issued a more developer-friendly version of the operative regulations for the CIL. Local authorities would have discretion on whether to apply the levy, at what rate, for what public uses, and at what geographic range from the development (so long as some portion of the levy is re-directed to the contributing development). However, the new levy specifically excludes affordable housing, to continue to be delivered by means of “planning obligations” negotiated with developers—a well-established type of indirect value capture extensively used in the United Kingdom (Crook et al. 2002). To assuage developer concerns, the regulations try and minimize situations where the authorities might double charge—both the levy and negotiated contributions for additional public goods. Will the CIL survive longer than its short-lived historic predecessors?

13. House of Commons, 2006; UK Department for Communities and Local Government (2008); UK Department for Communities and Local Government (2010).

14. UK Government Report to Cabinet (May 2010).





With this history, no direct betterment recapture policy (meaning, no Labor government) has yet lasted long enough for evaluation research to provide evidence for future policy makers. Since all direct-capture policies were adopted by Labor yet were altered by Labor itself at the next opportunity, it is clear that none were deemed good enough for readoption. Nevertheless, the British experience does provide some tentative lessons about why betterment capture policies may not work, discussed after experiences of Israel and Poland.

## Israel: A Sustainable Betterment Levy

Israel's experience with betterment capture is the longest-lasting policy among the sample countries (or reported in the international literature). The betterment levy dates back to the 1930s during the British Mandate over the region. Like many other former British colonies and protectorates, Israeli law inherited unworkable notions of a betterment tax similar to the old British laws. But in 1981, an extensive revision to the betterment tax was enacted that sets out clear and workable rules for levying the net betterment derived from land-use decisions. The law also authorizes the government minister to allow some socially-based exemptions such as for deprived towns and neighborhoods, urban regeneration areas.

All local planning commissions are required to levy 50 percent of the real increment in land value, to be assessed parcel by parcel. Three types of planning and development-control decisions are the legal grounds for the levy: approval of a local or detailed plan, (similar to a re-zoning) approval of an area or use variance, and commencement of a new use. A bill submitted to the Knesset in 2011 would add approval of a subdivision plat. The law wisely separates out the grounds from the occasion for levying so as to avoid the mistakes of the old British legislation. The levy is paid upon the sale of the property or application for building permission. Importantly for a country where nationally owned land is predominant, the levy applies equally to both private land and public land on long-term leases (which in Israel function almost like freehold tenure; Alterman 2003).

In addition to the compulsory betterment levy, Israel also imposes a 25 percent unearned increment tax upon sale of a property to tap the general value increase not linked to land-use decisions. Sale of a single private residential unit is usually exempt from the unearned increment tax (but not from the betterment levy). When both the betterment levy and the unearned increment tax apply, the two are offset against each other.

The Israeli betterment levy is an important though highly fluctuating source of income for local governments. Its success is partly due to the fact that the municipalities keep the full proceeds and thus have an interest in its survival, but a price is paid in inter-municipal distributive-justice issues. The revenues from the levy are inherently uneven because the opportunities for development are a matter of "luck," depending on a town's location, past development patterns, and vacant land. Furthermore: the betterment levy is inherently regressive because the revenues per unit of land are higher in localities where land values are higher. The revenues are



also intrinsically uneven over time because land reserves deplete fast, whereas urban regeneration is a slow to occur.

The relative success and sustainability of the Israeli betterment levy has several reasons: its rationale is clear; the appraisal is plot-specific and provides for fair procedures; the rate is uniform, nondiscretionary, and high enough to justify administrative costs; there are reasonable socially based exceptions; the revenues may be used for an open-ended set of public services; and, as mentioned, the municipalities are allowed to keep the full revenues. The levy has never become a major issue in national or local elections. In addition to the betterment levy and unearned-increment tax, Israeli planning bodies also practice indirect capture mechanisms (exactions) in varying degrees (Alterman 1990, 2007). The Israeli example thus shows that, where the real estate market is vibrant, land values may be able to tolerate cumulative layers of value capture mechanisms.

### Poland: A Nonoperational Betterment Levy

Poland too currently has a direct betterment capture mechanism. In the 1990s, after the demise of the Communist regime, Poland legislated a new planning law that introduced a levy on the betterment value created by the approval of an area plan. In view of the strong private property ideology that prevails in Poland, the decision to adopt a betterment levy at that junction in history was not trivial. However, the levy as instituted was in fact destined to be barely operational. The legislators should have looked more closely at other countries' experiences in order to avoid repeating mistakes.

Some aspects of the Polish levy are potentially robust. As in Israel, the Polish levy taps only the real value increase by requiring parcel by parcel appraisal, and the local governments in charge of collection are allowed to keep the revenues. But several factors weaken the Polish levy. First, the Polish legislature anchored the levy in the approval of local land-use plans even though such plans did not exist at the time, and still cover only a small portion the country's area. Most development decisions are granted by means of ad hoc development permits to which the betterment levy does not apply. Second, the law provides for a discretionary rate of between 0 and 30 percent, which may vary even within a single plan. Thus a fairness criterion among landowners is not built in. If a rate lower than 30 percent is applied, the administrative costs may be too high. Third, the law leaves gaping escape loops for landowners. The Polish legislators repeated the mistakes of the British Town and Country Planning Act of 1932 by adopting the occasion of sale of the property as the only tax collection point and by stipulating a maximum number of five years beyond which the authority to tax would expire.<sup>15</sup>

Therefore, direct betterment levies in Poland exist largely on paper. When a legal framework is weak, there is room for differential application (not to say

15. Based on personal conversations with Polish government representatives during two visits as a guest of the Polish government in spring and summer 2009. Based also on ongoing conversations with Dr. Miroslaw Gdesz, an administrative court judge in Warsaw.



favoritism and corruption). There is currently some discussion in the Polish government about major revisions to the law (Gdesz, personal conversations).

## The Spanish Tradition and Beyond

Spain is another OECD country that, although not in my sample of countries, merits a quick look at its plus-value capture policy because the Spanish tradition, like the British one, has been influential beyond its borders. The Spanish Constitution of 1978 enshrines the betterment capture principle: “The community shall have a share in the benefits accruing from the town-planning policies of public bodies” (section 47). The rate of the levy is rather low—about 10 to 15. Unlike Israel and Poland, in Spain the betterment levy is not necessarily assessed parcel by parcel and may not reflect the real value increments of specific plots. In addition to direct betterment capture, Spanish law obliges developers to finance a wide range of public services as well as to dedicate land to the municipality (Calavita and Mallach 2009; Calavita et al. 2010; Gielen 2008).

The importance of Spain extends to South American countries, most of which are not OECD members. In these countries, the discussion of the “plus value” as it is called in Spanish, often occupies a high place in both political and scholarly discourse. Legislated instruments of various types have been enacted (Furtado 2000; Smolka and Furtado 2001, 2003; Smolka and Amborski 2007). However, the evidence shows that actual implementation is weak due to the rampant informal development and other administrative and governance weaknesses. Smolka and Amborski’s (2007) comparative assessment of South America and North America leads to the conclusion that the former is very strong in rhetoric about direct value capture, while the latter shuns direct value capture but is strong on indirect value capture mechanisms.

Because the sample of OECD countries studied is large and varied, my guess is that not many other OECD countries practice direct betterment capture. In developing countries, where public administration is often weak, even where such levies are on the books (perhaps as relicts from former colonial status), they are unlikely to be effective in practice.

## DISTILLING LESSONS FROM THE INTERNATIONAL EXPERIENCE

Why have most countries avoided adopting direct betterment capture policies? The experiences gained by Britain, Israel, and Poland should be mined to draw out the relevant lessons. In the absence of any rigorous comparative empirical research on outputs, outcomes, or impacts of betterment capture policies, I shall rely on the observations presented earlier. Here are some tentative thoughts:



- The rationale for plus-value policy is not as easy to “sell” to politicians and voters as may seem from the intrinsic logic of the argument. The British experience is a real-life laboratory of how the absence of political support can lead to the rise and demise of betterment capture policies with shuffles in the ruling parties. To adopt a successful betterment-capture policy, proponents must be able to package a rationale that transcends party ideologies. This is no easy task, but it is a *sine qua non*. In the Israeli and Polish cases, the betterment tax has not (yet?) become a party-political issue and thus has escaped the tug-of-war that its British counterparts have experienced.

- One of the arguments used against direct betterment capture is that it may raise real-property prices because the price of the land component would rise. If that were true, it would erode some of the justification for recapture policies. The British experience has not generated much evidence on this issue despite the experimentation with a broad range of tax rates. All of Britain’s direct value capture policies installed between 1909 and the mid-1980s were too short-lived to enable systematic evaluation. Nor has the Israeli experience delivered reliable empirical evidence because the 50 percent rate has been uniform over time and place (except where exceptions apply). Thus there has never been a “control group” for the analysis. The scholarly literature on related taxes and exactions indicates that their effect on property values depends on a variety of extraneous market and contextual variables (Skaburskis and Qadeer 1992; Evans-Cowley and Lawhon 2003). Empirical research has shown, for example, that the impact may differ between raw land and built-up areas and that these may offset each other (Ihlanfeldt and Shaughnessy 2004). Since the authority to tax must usually be derived from primary legislation and applied equally, policy makers have little flexibility to adjust the levy in order to accommodate market fluctuations. In considering betterment capture it is important to conduct as much prior economic modeling as feasible (see also Vickars 2003).

- The British experience also teaches us that in order to sustain a betterment capture policy, there should probably be a direct link between the government authority charged with collecting the tax and the one that benefits from the revenues. Research evidence conducted in “real time” during the life of the last British recapture policy in the latter 1970s indicates that when local governments had a lesser interest in the revenues, collection was not robust enough. In the Israeli and Polish cases, the levy is administered and kept by the local governments, and they have been its major watchdogs.

- In order to retain public support, the legislation should determine in advance which public services may be financed by the levy and should make this transparent. However, there is built-in tension between this objective and the need to maintain flexibility to accommodate changing needs for public services or changing public perceptions about what services merit public financing. The traditional services such as linear infrastructure and educational facilities may compete with newer items on the list such as environmental conservation, historic



preservation, or affordable housing. There are always many mouths to feed, while the potential income from a betterment levy is finite. It is difficult to “square the circle” and resolve this inherent tension between earmarking and flexibility.

- Developers are likely to argue that the revenues should be reinvested in public services for the benefit of the project that generated the funds. This argument should be resisted because it turns betterment recapture into an indirect value capture instrument with a rationale based on mitigation of negative impacts or on indemnification of burdens on public services. If so, this type of value capture policy should be designed from the start as an indirect value capture instrument with an impacts-based rationale at its forefront.

- To retain its rationale, the betterment levy should be assessed parcel by parcel so as to capture only the real rise in value, as successfully applied in Israel (and potentially in Poland). However, this raises the administrative costs significantly. To allow a reasonable net yield, the rate of the levy must be relatively high. Public agencies might be tempted to simplify the levy by adopting a preset charge based on some easy formula (such as per the size rather than the value of the built-up area approved). This type of quasi-betterment levy was briefly proposed in Israel in 2006 but discarded following protest by the Association of Local Governments. Some scholars have recommended similar formula substitutes (Ihlanfeldt and Shaughnessy 2004; Gdesz 2005 for Poland). Such shortcuts gnaw away the very rationale of direct value capture and, with time, are likely to lose the value capture justification and become just another tax.

- Direct value capture poses a tough distributive justice dilemma. Adoption of a uniform rate for all landowners and locations is fair in some ways but not in others. Although the rate may be ostensibly equal across landowners, the opportunities for revenue are never equal across place and time. Betterment levies also have inherent regressive attributes. Well-off towns where property values are usually high or where land reserves happen to be available will be able to reap higher revenues than less-advantaged or just historically unlucky towns. Thus an equal assessment rate by no means ensures equal revenues.

- Finally, a similar ethical dilemma applies to the distribution of the revenues. On the one hand, the desire for local voter support justifies retention of the full revenues at the local level. But on the other hand, distributive justice considerations justify redistribution. Localities with high revenues do not necessarily need or merit the revenues most. Calibration of funds among municipalities could be done by means of the national or regional governments on the basis of various criteria. Two of the British postwar policies as well as the 2005 rejected proposal did incorporate a national-redistribution policy. However, these policies may have failed partly because they paid a price in lost local public support and in reduced efficiency in tax collection. This dilemma raises issues of both ethics and feasibility, and there is no sure and tested way to resolve it.



The fact that most countries have not adopted a direct form of betterment capture indicates that the shortfalls and dilemmas noted here are not easy to resolve. There are many built-in catch-22s and very little international experience from which to learn. Meantime, the indirect value capture instruments have been flourishing.

## INDIRECT VALUE CAPTURE

Although direct betterment capture is not prevalent, the idea that government should reap the unearned increment on land has not died away; it has simply undergone various mutations. The need for innovative funding sources for public services has in fact increased in recent years. There are three well-known reasons for this increase: growing voter reluctance to pay higher taxes, higher costs of many services, and—at the same time—voters' expectations for amplified services (Alterman 1988b; Altshuler and Gomez-Ibanez 1993, 1–4; Callies and Suarez 2005; Rosenberg 2006; Nelson et al. 2008, iv–xiv; 1–3).

Local governments therefore increasingly need to conjure up financial instruments that are less visible to voters than direct taxes or levies. The alternative is to leverage local governments' authority to regulate land use, and solicit from landowners or developers money, land, or construction services in exchange for additional development rights, fast-track processing, or relaxation of some regulation. But instead of doing so through the front door of direct betterment capture, local governments in many countries are increasingly adopting a variety of instruments for shifting the burden of supplying public amenities on to the developers.

### A Variety of Terms and Instruments of Indirect Capture

Indirect capture instruments vary from country to country and locality to locality. They are known by a smorgasbord of terms (figure 33.2). A general term proposed by Alterman and Kayden (1988) is *developer obligations*. In the United States indirect value capture instruments are generically called *exactions*. In the United Kingdom they are known as *planning gain*, or, more recently, *planning obligations*. In France the term is *participation* (Renard 1988). If based on preset formulas indirect instruments are called *impact fees* in the United States or *development charges* in Canada (Slack 2004). In the Netherlands the term (as translated into English) is *cost retrieval* or *cost allocation*.<sup>16</sup> The term *incentive zoning*—born in the United States but of recent international spread—refers to a pre-specified two-tier instrument whereby the developer may

16. These are the official terms in the English translation of the Dutch Land Development Act that came into effect in July 2008. Available at <http://www.vrom.nl/docs/internationaal/Land%20Development%20Act.pdf>. Dutch scholars tend to use the term “cost recovery”.



**Developer obligations:** proposed as a generic term: Requirements made by planning bodies to provide some public benefit over and above the usual regulations and taxes. (Term proposed by Alterman and Kayden, 1988)

**Exactions** - used in the USA to denote a variety of instruments whereby developers are required to provide some land, public service or financing as a condition for receiving a rezoning, development permit, subdivision approval or the like

**Developer agreements** - an exaction obtained through negotiations with the developer

**Planning obligations** - term used in the UK to denote exactions negotiated with developers according to explicit statutory authority

**Planning gain** - term used in the UK prior to the above.

**Impact fees** - used in the USA. Detailed formula-based fee calculated to represent the precise share of the anticipated impacts of a specific development on specific infrastructure or environmental costs. Called "development charges" in Canada.

**Linkage fees** - a special fee imposed on developers of office and commercial projects to finance affordable housing, arguing that the housing demand is generated by the commercial development's need for workers. Used in the USA

**Incentive zoning** - a two-tier regulation where in order to be granted development rights beyond a certain permitted level, the developer will have to provide a prescribed public good or financing. Used in the USA.

**Participation** - used in France parallel to exactions

**Cost recovery** term used in The Netherlands to denote exactions to indemnify particular infrastructure costs (translated from Dutch)

### Figure 33.2 A Smorgasbord of Terms Related to Indirect Value Capture

choose either to deliver the desired good and benefit from additional development rights or to remain with lower-tier development rights.

## Alternative Rationales for Indirect Value Capture

How do indirect value capture instruments relate to the direct ones? The same generator propels indirect and direct value capture—the increase in land values due to land-use decisions. However, the indirect instruments leave the unearned-increment rationale in the background, often disguised by some alternative rationale. Under some legal regimes, such as the United Kingdom, to survive legal scrutiny, government authorities may have to show that they are *not* motivated by the desire to recoup "betterment by stealth."<sup>17</sup>

17. The official UK government circular on "planning obligations" states in section B7: "Planning obligations should never be used purely as a means of securing for the local community a share in the profits of development, i.e. as a means of securing a 'betterment levy.'" (Office of the Deputy Prime Minister, Circular 05/2005, July 2005).



I propose the following classification of alternative rationales for indirect value capture (compare Healey, Purdue, and Ennis 1993):

- Cost recovery: Indemnification of direct public investments public services made necessary at the particular project. In cases where the law requires that a direct betterment levy be capped at the cost of public services, the instrument becomes a hybrid between direct and indirect value capture (the recent English Community Infrastructure Levy has this rationale).
- Shortage of resources for various public services within or beyond the project area.
- Internalization of negative externalities such as noise, radiation, or pollution caused by the project.
- Mitigation of impacts on the natural environment or on historic buildings.
- Mitigation of perceived social injustices such as social exclusion or higher housing prices.

In practice, a mixture of these rationales may serve as the legal or public-policy ground for indirect value capture. Real-life application of indirect instruments often contains ambiguities about which of the alternative rationales is being applied in a particular case. Indirect instruments also vary in how the contribution is delivered: some are in money, others in kind whereby the developer constructs a public service, delivers mitigating technologies, supplies land, or builds housing.

## An International View of Indirect Value Capture

Among the sample of thirteen OECD countries, all except Sweden and the Netherlands have decades-long experiences with shifting the costs of public services onto developers. Since the 1990s Sweden too has been gradually joining the group. The Netherlands is the last in the set to adopt indirect capture instruments, formally enabled for the first time by the 2008 Land Act. So even the Netherlands—with its uniquely strong tradition of direct government action in land purchase and development—must now rely more and more on private developers as a source of financing for public services (Needham, 2007, 176–177).

Indirect instruments differ from direct ones in the way they emerge. Direct capture instruments are usually adopted “top down,” often for the entire jurisdiction. This is because in well-governed countries, authority for direct value capture usually entails legislation (at times even constitutional amendments). By contrast, indirect instruments often emerge bottom-up through locally grown policies. If the instruments are viewed as successful and survive legal challenges, they are likely to be copied by other localities. The United States has been an especially rich breeding ground





for a wide variety of innovative value capture instruments that are recently being “exported” overseas (Alterman 2005; Spaans, van der Veen, and Janssen-Jansen 2008, 17–22).

Because the indirect instruments are usually locally determined and may not require explicit legislation, they have several advantages over direct betterment capture:

- They can more easily go under the radar of party-political debates and can therefore better survive changes in party ideology and voter resistance to new taxes.
- They can more easily be justified to the project’s consumers and to the general public if they can be linked to the burden that the project places on the public.
- They are more flexible for financing changing public needs because they are usually applied only when development is ripe.
- They can be fine-tuned to be politically more acceptable when sociopolitical positions change in the community
- They may be adjusted to accommodate the changing economics of real estate so as not to drive away development.

Yet, indirect capture instruments are not a panacea. They are often applied case by case, without ensuring equality among landowners. These instruments are therefore open to political and legal challenges regarding bias and favoritism. The value of the financial or in-kind resources delivered by developers is often unpredictable because it depends on uncertainty about the success of negotiations with the developers. The financial gains to the community may vary even among parallel projects. The financial gains to the public represent only a few percent of the unearned increment, such as with the American “linkage fees” (Alterman 1988a).

## Some Preconditions for Adoption of Indirect Value Capture

Despite their shortcomings, indirect value capture policies are likely to expand and intensify around the world. Because of the complexity of these instruments, there is great need to share knowledge among jurisdictions, with the help of further systematic comparative analysis with the help of. At the current state of knowledge, four preconditions for reasonably successful application of indirect modes of value capture may be identified:

- Governments should have well-trained professionals (planners or real estate experts) to negotiate with the developers or to develop preset formulas of impact assessment. The professionals need to be savvy in real estate economics to be able to assess the limits of what may be exacted from the developer without killing the projects.



- Local government should conduct monitoring of fluctuations in land prices in order to be able to challenge developers’ arguments that the exactions in fact raise the cost of housing or other products. This type of argument may generate public opposition even though it may not necessarily hold for all market situations.
- There should be enough transparency in negotiated exactions to help withstand legal challenges (yet full disclosure may clash with the need to protect the legitimate economic interests of the developers).
- Countries or local authorities known for high levels of corruption should refrain from adopting discretion-based indirect value capture instruments. A reasonable good level of trust in government is a precondition for their successful operation.

## THE FUTURE OF DIRECT AND INDIRECT VALUE CAPTURE

An obvious issue is the interrelationship between the two categories of value capture. In those few countries that do practice direct betterment capture, does it replace the need for indirect capture instruments? This is a common assumption at times direct capture instruments are introduced with the hope that they would totally replace the indirect ones. However, there is no systematic evidence on this question, but I have some doubts on its validity in practice. So long as governments lack resources for supplying the evolving needs for public services, indirect capture modes will likely be used to some extent. The indirect capture instruments are often open-ended and flexible, and they possess the capacity to fill in the gaps.

The experiences of the United Kingdom and Israel shed some light on this issue. In Israel, negotiated exactions are often applied over and above the 50 percent betterment levy, and case law has not ruled them illegal. In the United Kingdom, until the 1980s negotiated “planning obligations” likely existed to some extent in parallel to the various direct betterment capture modes exercised until the early 1980s. The inter-party debate that surrounded the 2010 Community Infrastructure Levy discussed earlier illustrates the difficulties of drawing a solid boundary between the two modes of value capture.

The bottom line is that the rationale for direct betterment capture may be convincing on paper, but it has not caught on widely across the world. At the same time, indirect value capture tools have proliferated. As counterintuitive as it may seem to those who have not walked through this chapter, the indirect value-capture instruments—with their “messy” rationales and vulnerability to legal challenges—hold the more realistic potential for funding public services than their elegant direct-capture siblings.

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