

LOCATION VALUE COVENANTS



Using consent and contract law to dismantle our coercive, complex and harmful tax and welfare systems.

By Dr. Adrian Wrigley

A new philosophy

The Location Value Covenant (LVC) is a startling and simple idea for tax and welfare reform. The concept breaks away from forcing tax change simultaneously across a whole nation. In place of compulsion is consent, contract and the market mechanism. In these respects, it is the antithesis of conventional tax or welfare reform. LVCs minimise economic turbulence and financial instability by avoiding windfall gains or losses.

Occam's Razor

An LVC places a legal obligation on the owner of a particular plot of land to pay a specified sum of money regularly to a specific public body. Nothing more, nothing less. It is the simplest and most direct means of transferring the economic rent of land to public purposes. Legally, the LVC is a covenant with these key features:

- runs with the land in perpetuity
- requires payments to a named public body by the owner
- specifies an initial payment amount and date
- specifies subsequent amounts and dates
- amounts are adjusted in line with a specified formula or index

The obligation to make each payment is on the registered owner of the land at the time the payment is due. The payment would normally be to a city, regional or national government responsible for supplying services to the land concerned or to an intermediate body responsible for collecting and distributing the payments. Ideally, the index represents local site location annual values. By fully specifying

the payments, LVCs are relatively immune from political interference, giving a stable, predictable revenue stream to government while reducing payment risk to the owner. LVCs would be published, helping ensure transparency. One way of looking at an LVC is as a kind of Land Value Tax (LVT) specific to the particular plot. Another way is as an interest-only, index-linked perpetual mortgage tied to the site. (See Table 1 below.)

Failure by the owner to pay the specified sum would be a breach of the LVC. The beneficiary would be able to use existing legal procedures for debt recovery, up to and including a forced sale of the land and fixed property. Failure to pay would not be subject to criminal sanctions.

Since land with an LVC is financially burdened, it will fetch a lower market price than land otherwise. Only the legal owner of the land is entitled to create an LVC – and it must be voluntary. The immediate reduction in the asset price must therefore be matched by a corresponding benefit or inducement to the owner. This benefit is governed by a contract with fully negotiable terms.

Consent not confiscation!

Attempts to base reforms on changes to the tax system are by their nature imposed without individual consent and often require compromises and transitional measures. This created the political logjam that has led to the gradual economic failure of tax systems worldwide. The perceived losers in any tax reform work tirelessly to compromise or block any changes. Politicians are funded by selfish interests looking to exploit the system. The LVC however, opens new opportunities for reforms based on contract law and consent.

	<i>LVT</i>	<i>LVCs</i>	<i>Mortgages</i>
<i>Beneficiary</i>	government	government	bankers shareholders
<i>Lifetime</i>	perpetuity	perpetuity	until sale or repayment
<i>Creation</i>	by legal imposition	consent	consent
<i>Uniformity</i>	same everywhere	sites differ	sites differ
<i>What adjusts payments</i>	site valuations politicians	land value index	bankers
<i>Legal basis</i>	new tax laws taxation	existing contract law covenants	existing contract law debts

Table 2 : Replacing rates on a property with an LVC		
The Contract: Upon creation of the covenant below by Mr Smith, the present unencumbered owner of plot #12345678, the City of Melbourne Council or successor will fully discharge all further liability to Council Rates due in relation to property at said plot or subdivisions thereof.		
The Covenant: The owner in due course of Land Registry plot #12345678 will pay to the City of Melbourne Council or successor the sum of \$1400 on July 1st 2010 and on each anniversary thereafter this sum multiplied by the most recent Bureau of Statistics Melbourne Annual Location Value Index published at the time, rebased to 1.0 in 2010.		
	To the home owner	To the council
Benefits	<ul style="list-style-type: none"> • can make property improvements without notification or paying more tax • no risk of revaluations or tax hikes • payments decrease automatically if the economy sours and the index falls 	<ul style="list-style-type: none"> • reliable revenue stream • revenue rises if services are improved • no need for site valuations
Costs	<ul style="list-style-type: none"> • payments under the LVC • payments may rise ahead of rates 	<ul style="list-style-type: none"> • rates payments foregone • inability to increase arbitrarily • inability to “bribe” LVC payers

By using contract law for tax reform, it is possible to overcome the logjam. Rather than trying to force universal changes in tax obligations, people can be offered the opportunity to contract-out of existing taxes using the “currency” of LVCs. A taxpayer simply makes a deal with the taxing authority to leave existing taxes behind. If the person and the government both benefit by the deal, it can go ahead. It is a market-based approach to tax reform and overtly accepts that the current systems are misguided and wasteful for all concerned. Our crumbling tax and welfare systems must now be viewed as obsolescent.

The flexibility and scope of the LVC with suitable contracts is illustrated by a wide variety of applications.

Creating an LVC

A simple deal to create an LVC involves swapping out an existing property tax. For example, a home owner in Melbourne might currently be paying annual rates of \$1500 to a city council. The owner offers to create an LVC payable to the council in exchange for the council ceasing to collect the rates on the property. To proceed, the council and the home owner have to enter a contract beneficial to both sides. This will usually be possible, even though the benefits may be modest. In general, the initial payment under the LVC will be comparable to the tax or rates which it replaces. The deal is effective once the contract is signed by both parties and the owner signs the covenant. (See Table 2 above.)

Eliminating property taxes

Most countries have multiple taxes and welfare connected with property. In Australia, there are state land taxes, state stamp duties, mortgage duty, income tax on rental returns and capital gains tax. Welfare payments vary between states and include Commonwealth Rent Assistance (CRA), the First Home Owner Grant and First Home Bonus. Each of these has its own rules and burdens. By creating a bundle of

benefits in exchange for an LVC, an immediate and dramatic simplification can be achieved for a property’s owners and occupiers. A basic package should aim to settle all these property linked taxes and also eliminate future welfare payments for the property. The basic contract is extended to discharge liability to each payment and the LVC’s initial payment amount is adjusted to a level acceptable to all parties. This tax consolidation results in just one regular payment, independent of changes in circumstances – the marginal rate of tax (with changing circumstances or home improvements, for example) is zero.

Criticisms

While the public may find particular LVC deals simple and appealing, campaigners for monetary reform and for LVT sometimes find the underlying principles alien to their thinking. Of particular concern is that it does not seize land rent from the biggest landowners – although a separate law could do this.

Applying LVCs

The LVC is a flexible instrument to facilitate key reforms to the systems of banking, money, welfare and taxes of all kinds. Although these systems have simple goals they have grown to be extraordinarily complex. The basic LVC can be used as part of a series of deals to phase out or rationalise each in turn.

Settling an existing tax bill

A property owner may settle an existing tax bill by creating an LVC. Liabilities may include business taxes or Capital Gains Tax (CGT). For example, a \$100,000 CGT bill is settled using an LVC of \$650/month on the taxpayer’s existing property. The tax liability may have arisen from selling shares, inherited property or sale of a second home. The taxpayer benefits by improved cash-flow, while the government

benefits from the long-term buoyancy of the land value index. The contract also includes the discharge of liabilities to the rates and property-linked taxes as described above.

Lightening the tax burden

Another application of an LVC is the exchange for a permanent tax exemption, lower tax rate, higher tax threshold or other restructuring. A named person or business would be the beneficiary, while the LVC as always runs with the land. Income tax, company taxes and GST are obvious candidates. If a fair price can be negotiated, a deal is possible. Lower marginal rates stimulate production while tax exemptions can reduce administrative costs.

Repaying a mortgage

A home owner with mortgage debt to the bank of \$100,000 offers to create an LVC of \$650/month to the national government. In return, the government offers to repay the mortgage and discharge the property from all property-linked taxes. By executing this deal, the home owner benefits from a single, regular, stable payment in place of volatile interest payments and the burdens of the various taxes. If the amount of the LVC is correct, the home owner's net equity will be increased slightly. Subsequent buyers of the house benefit from the avoidance of rates and other taxes, the single payment structure and the lower market price, perhaps obviating a mortgage. The government gets the share of the land rent in perpetuity, while the return on the existing and any new buildings is retained by the owner. The government can use existing sources of finance to pay the bank. But is there something smarter?

Monetary reform

"The issue which has swept down the centuries and which will have to be fought sooner or later is the people versus the banks." Lord Acton (1834-1902), First Baron Acton of Aldenham.

The monetary system is profoundly "miswired" and its catastrophic pathologies are now obvious. The settlement of mortgage debts in exchange for LVCs offers a powerful means to rebuild the monetary and tax system.

At present, the power to issue and withdraw money from the economy is in the hands of profit-seeking private banks. Modern money is bookkeeping entries of government-backed privately issued public credit, redeemable only against taxation and private debts. Banks work together to control the scarcity of money, adjusting the prices (interest rates for borrowers and for lenders) to collect an economic rent.

Money has zero unit cost of production but an insatiable demand guaranteed through taxation. The resulting profits to the banking sector and their favoured customers and staff are staggering. The money supply is carefully controlled supporting profligate banking businesses, complete with their plush central offices and sports sponsorships. The consequences beyond the banking sector are largely immaterial

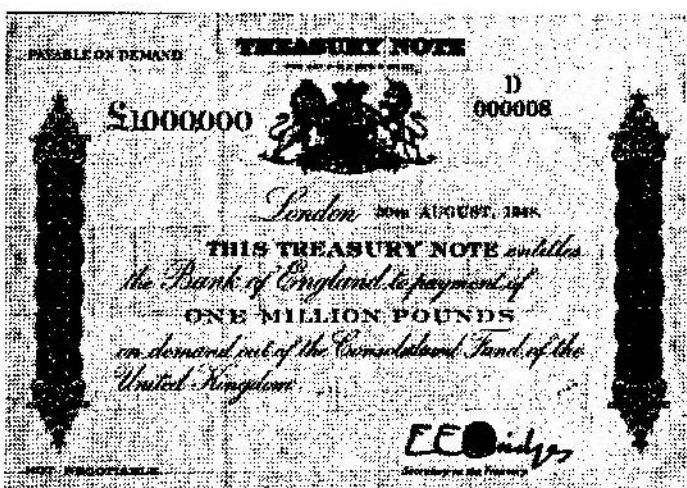
to the banks, even when this means mass insolvencies and public austerity. Profits from the control of the money supply are drawn from the government-granted privilege to sell the public's credit back to itself, backed by the government power to collect taxes. There is no public economic value from the government granted privilege – indeed, there is acute harm. The finance sector becomes parasitic on the land owners and both are parasitic on the general economy. Monetary reform means fundamental change to the system of issuing and withdrawing money to eliminate the damage from this behaviour.

Starving the parasite

Most money is issued by banks in exchange for mortgages on property or government bonds (in effect, "mortgages on taxpayers"). In the past, when money was issued by governments it usually led to over-issue and hyperinflationary collapse. Political leaders always find spending money much easier than collecting taxes! Now, the banks own the printing presses, imposing fiscal discipline on governments and collecting seigniorage (money creation) profits.

The LVC solves the monetary reform problem by allowing the government to issue new money to settle existing mortgages. The demand for money is little changed because the LVC payments are about the same as the mortgage repayments they replace. By removing control of payments both from profit-seeking banks and from vote-seeking politicians, major threats to monetary stability are removed.

The mechanics of monetary reform using LVCs are simple. Home owners would offer to create LVCs benefiting the treasury, which in return would print new money – special high denomination legal tender treasury notes (see image below), using these to repay the home owners' bank mortgages. The notes would be held at the banks as regulatory capital to back depositors' funds. Bank reserve requirements would be increased to prevent them expanding the money supply using fractional reserve lending.



The UK Treasury issued its own legal tender £1 notes until 1928 ("Bradbury" notes) as well as this special 1948 £1 million note.

Government bonds would be retired in a similar manner by repurchase in the open market using treasury notes – a variation of the current quantitative easing programmes.

The ultimate goal of this monetary reform is for the government to issue money by spending it into circulation while withdrawing it via LVC payments and taxes at about the same rate. Any financial surplus should be paid directly to all citizens in the form of a universal welfare payment (Citizens' Dividend). This is a natural dividend resulting from good governance and shares the economic rents.

Hurtling into economic crisis

Much of the world economy is in latent collapse. Solvency of banks, governments and citizens is in grave doubt. A systemic fiscal reform may be the only hope to avert collapse. It is only time before Australia is engulfed. The economic parasitism of the finance and real-estate sectors must swiftly be curtailed without killing the productive

economy through waves of insolvency. The treatment must be accurately targeted. I have shown how the LVC allows the flow of economic rents to be immediately switched from private to public purposes while removing harmful taxation. Protecting the economic parasitism through actions such as lender bailouts, stimulus and austerity measures, and forced negative real interest rates is suicidal.

Paradoxical goals

Jobs must be cut without creating unemployment. Production must be increased while resource consumption is diminished. Tax rates must be reduced while government revenues are boosted. Labour costs must be shrunk without cutting wages. House prices must fall without creating negative equity. Welfare costs must tumble while eliminating poverty. These paradoxical requirements stem from the effects of self-defeating and contradictory government policies in the post-war era. Reform can no longer be delayed.

Table 3: Comparing LVT and LVCs for public rent collection	
LVT	LVCs
Advantages <ul style="list-style-type: none"> principles and theory well established targets the largest landowners existing campaign groups can help improve understanding easily reversed or repealed if unpopular or problems arise 	Advantages <ul style="list-style-type: none"> can avoid creating losers – low political risks needs no site valuation minimises economic turbulence rapid and flexible introduction needs minimal or no primary legislation relative immunity from political interference due to use of contract law, consent promotes a fresh look at economic rent and the structure of tax and banking easily trialled, mistakes easily rectified early adopters can lead the way can rapidly address the current crisis through debt-for-covenant swaps
Disadvantages <ul style="list-style-type: none"> numerous winners and losers requires comprehensive registration and valuation in advance – slow introduction financial and economic turbulence if rapidly expanded or repealed high political risk, many pitfalls acts as a lump-sum tax on home equity implies overhaul of property taxation political pace is hard to control history of political failure, public fears, flawed Acts, repeal and persistent misunderstanding needs widespread prior popular support valuations must be frequent, impartial and skilled to avoid difficulties 	Disadvantages <ul style="list-style-type: none"> currently unfamiliar to economists, politicians, civil servants and campaigners needs suitable indexes hard to change an existing covenant largest landowners may not participate share of economic rent collected will vary over time as index drifts from true site value share of economic rent collected varies from site to site – may be seen as unfair house prices depend on value of covenants

Emergency measures

In place of cuts in wages, welfare and government services, we need rapid debt deleveraging. An austerity programme should be applied to banks, bankers and land speculators.

Key steps include:

- offering to repay each and every household and commercial mortgage and eliminating all associated property taxes in exchange for LVCs of equal value
- repayments are funded by treasury note issue, administered through the existing retail banks
- replacing missing bank capital by legal tender treasury notes while sharply raising reserve requirements
- introducing an upstream carbon duty on importation and abstraction of fossil fuels to fund reforming and cutting of GST to 5% or below
- introducing a Citizens' Dividend, matched by corresponding cuts in pensions and means-tested welfare

Consequences

In the banking sector, the early repayment of so many mortgages will dramatically shrink bank business. Sharply lower prices on covenanted property will mean few new mortgages. Interest paid on deposits will remain at zero, just as on gold or silver deposits (bailments), but real returns on investment and savings will rise. A small storage fee may be levied. Banker pay will tumble as it can only be paid out of profits on services provided, not out of newly created money. Bank mergers and closure of duplicate branches will follow. Jobs will be shed.

In the productive sector, demand for labour will accelerate due to lower effective labour costs and broad-based consumer demand triggered by the Citizens' Dividend. Labour shortages will be met by transfers from the other sectors. Top graduate talent in engineering or mathematics will find ample opportunity in business while jobs in finance will become scarce. Investment funds will be attracted by realistic interest rates. Physical capital will expand.

In the government and bureaucratic sectors, tax and welfare simplification will drive deep cuts in tax and welfare departments while tax accountants, advisers and planners will find many customers no longer need their services. Government will expand services only where these can enhance land values.

Reductions in income tax, company taxes and GST will rapidly feed through to higher land index values and, paradoxically, will automatically result in higher public revenue from LVCs. Historically, such measures would have pumped property prices and credit money inflation. Instead, with these systemic fiscal reforms, increases in Citizen's Dividend and leisure time would result.

Conclusion

Location Value Covenants offer the simplest way of directly collecting land rent for public purposes. They combine the best characteristics of taxation and mortgages in a debt-free, contract-based instrument. They are a basis for rapid and flexible solutions to seemingly intractable problems reforming public finance, banking and monetary systems. They overcome the key challenges which have kept LVT on the fringes of debate. Once you understand the advantages to all concerned, the question posed is "why should anyone stand in the way?" Isn't it time taxpayers asked for a better deal?

These are the only proposals to unify the collection of land and money rents. They are the only ones headed towards liberty through the use of individual incentives and contract, and the only ones to share natural wealth while strengthening free markets in the capitalist system. The alternative roads lead to total collapse and fascism.

Dr. Adrian Wrigley has a degree in physics and engineering and a Ph.D in Computer Science from the University of Cambridge. He saw the technology bubble from the inside, founding a computer company and working in Silicon Valley, predicting the crash in 1999. In 2008, he cofounded the Systemic Fiscal Reform Group think-tank and now trades stocks, commodities, currencies and precious metals.



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