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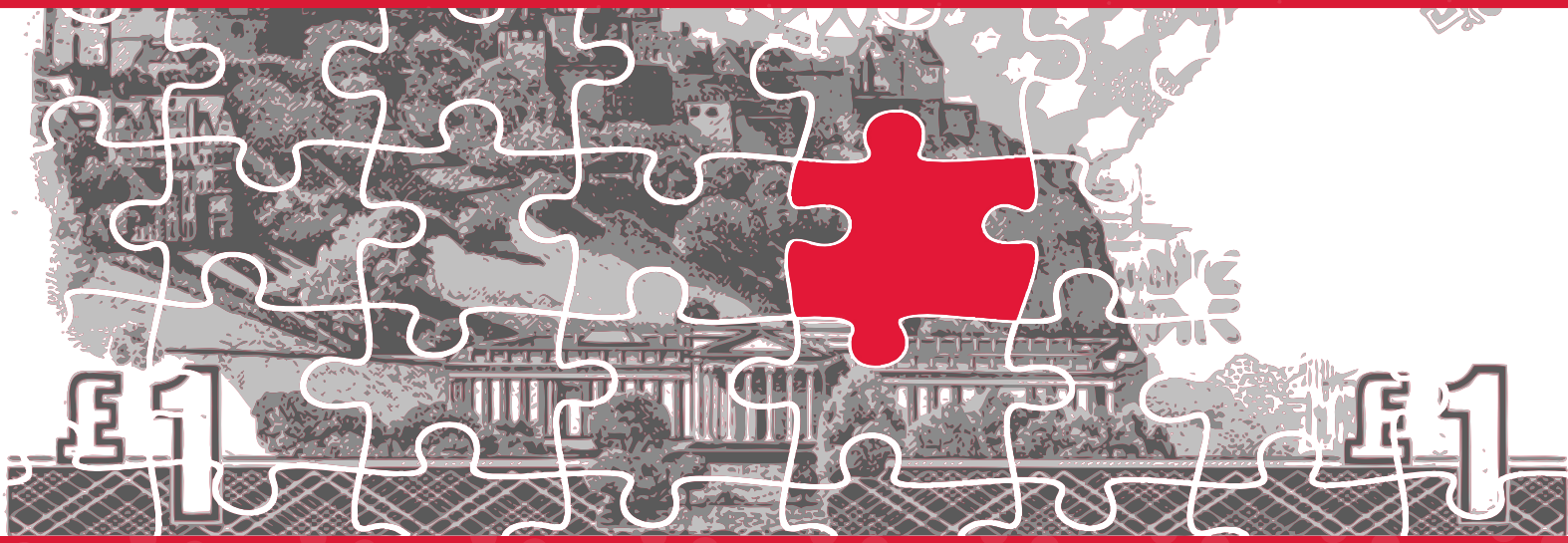
Investing in the Good Society

Five questions on tax and the Common Weal



Mike Danson, Laurie Macfarlane and Willie Sullivan

September 2013

Investing in the Good Society

Five questions on tax and the Common Weal

Mike Danson, Laurie Macfarlane and Willie Sullivan, September 2013

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Foreword

The ability to tax is one of the clearest symbols of nationhood. It implies many things; the right to pass law, the ability to demand allegiance by way of payment from a population and the capacity to defend that right against competing claims from other states. Without the capacity to tax there is no state.

That right to tax has though to be used with care. A nation's tax system can in very many ways be seen as a reflection of its society and what it considers important. To give obvious examples, the UK has favoured the interests of a tiny minority in society in its tax system, and big corporations most of all. Ireland brought its economy to its knees as a consequence of its dedication to attracting speculative financial capital with its 12.5 per cent corporate tax. Many small countries sell their souls and become tax havens. And some states, like those in the Nordic region, use their tax systems to promote social well being, and are amongst the places with the highest wellbeing ratings in the world as a result.

As Compass Scotland and the Reid Foundation note in this new report, Scotland now has to face a choice about the tax system it wants for the first time in centuries. Whether in the UK or outside of it the prospect of real taxing powers being decided in Scotland is now a real one. Those powers will, very obviously, be much more significant if independent, but the message is that the choices on tax policy send will be real in either case. That means the time for a focused debate on the tax policy that Scotland wants to adopt has arrived.

This paper argues that tax decisions are not just about raising money. They also shape an economy. As important, they help determine the distribution of wealth and income in a country. As a consequence they reflect its view of social justice. This in turn impacts on the way that business is expected to operate, and – let's be clear - business is, along with the people of a country, an essential partner of the government in achieving the hopes and aspirations of a nation.

This paper suggests Scotland should aspire to have a strong business sector, paying high wages that will yield the taxes needed to fulfill Scotland's social ambitions. And the paper also makes clear that Scotland needs an honest business sector, that plays by the spirit as well as the letter of the law backed up by the resources Scotland's tax authority will need – both in terms of people employed and appropriate laws – to make sure those who do not play by those rules are identified and stopped.

In combination these policies could deliver the foundation for a vibrant, confident, economically prosperous, sustainable and secure Scotland. That has to be the wish for all in Scotland, and those like me who will in all probability neighbour it. As such I think this an important paper that opens a vital debate for Scotland that requires commitment from all with concern for its future, independent or not, and as importantly right now, north or south of its border with the rest of the UK.

Richard Murphy

Introduction

On one fact politics-watchers agree; left-green politics may have some strong arguments which are popular with the public but when it comes to explaining how more tax is needed, it alienates potential supporters.

There is a kernel of truth in this; many on the left have tended just to shout 'tax the rich' without examining how and why tax creates a better society and what impacts will result. It is not uncommon to hear people say they wish we had a more progressive tax system 'like the Nordic countries', apparently unaware that we already have a more progressive tax system than the Nordic countries. This default cry of 'tax will be your downfall' has also been applied to the Common Weal project.

So this paper seeks to address this. It is not a comprehensive strategy for tax or the economy in Scotland but a description of how tax delivers strong social outcomes, a case for why we need to take a greater proportion of GDP in tax, an argument against ill-informed assumptions about social attitudes and an exploration of how Scotland could generate more tax take without harming the economic well-being of citizens and businesses.

The conclusions are encouraging; there is a clear path towards Scotland creating a strong and efficient tax base without harming competitiveness or economic security - and all the evidence suggests that it would be popular. This is a contribution to the Common Weal project and shows that its aim of making a case for a strong welfare state delivering high-quality public services on a universal basis while investing in infrastructure and developing a competitive domestic economy is realistic.

Aim and purpose of this report

The primary purpose of this report is to open up a debate about taxation in Scotland and how it can contribute to national wellbeing. It aims to move discussion away from a simple dichotomy of 'high tax rates' and 'low tax rates'. Rather it wishes to explore the capacity to increase tax take in ways other than increasing the main rates of tax. It also seeks to alter the debate by addressing the questions of why higher tax appears to be broadly beneficial for society and whether tax generally is a politically toxic subject about which the public will not tolerate an open debate.

At no point is this report intended to imply that it is tax reform which will create a higher wage economy (although it can play a part); rather it seeks to show that a higher wage economy will help significantly to improve tax revenues.

The report is necessarily predicated on Scotland having the capacity to develop a tax system different from the existing UK system. This would clearly be possible in the event of independence but there would also be scope to develop some of these approaches if there is greater devolution

of tax powers to Scotland. However, it does have to be noted that there would be significant constraints in developing a different fiscal system within the UK, even if there was substantial moves towards federalism.

So while the paper sets out a comparative case for why international experience suggests that there is strong social benefit from higher tax take, the main purpose is to explore the opportunity to strengthen public finances based on five questions:

- Could we generate increased tax take on existing income tax rates if we can successfully reform the economy to create a higher wage labour market?
- Is it possible to greatly reduce tax evasion and avoidance in a small country?
- Is there a realistic possibility of generating new tax income from wealth, land and property taxes?
- What potential is there to generate greater national income from Scotland's natural resources?
- Can reform of consumption taxes raise more income in a progressive manner?

It is important to be clear that the report does not intend to imply that these are the only possible approaches, nor that there is only one approach to answering the above questions. It seeks only to show that such approaches, if they can be delivered, can play a major part in stabilising and increasing the public income which funds the public services that boost the economy and generate greater levels of social cohesion (see below for further details).

As the approach of this paper is intentionally limited in its scope, it is also worth outlining some of the issues it does not address. These are areas on which the Foundation would like to explore further work in the future. Among those are:

- **Decentralisation of tax.** There is a strong case for decentralising tax collection. In the Nordic countries much of the tax collection is done not by the central state but by local government. This reflects heavily decentralised decision-making powers and the capacity of lower tiers of government to hold and determine budgets.
- **Tax incentives.** As this report primarily considers the case of tax as a means of creating healthy public finances, the role of tax as a social tool to incentivise positive behaviours and discourage negative ones is only incidentally considered.
- **Tax as economic policy.** The uses of tax as an economic policy are again only incidentally considered. The capacity to support virtuous economic activity through tax breaks or other tax approaches will be considered in a future paper on industrial strategy.
- **Exemptions and incentives.** The existing UK tax system is a complex web of exemptions and incentives. The report summarises criticisms of the existing complexity of the system but does not look in any detail at the potential for simplification and in particular to look at whether exemptions and incentives favour those on higher incomes (particularly related to pensions and investment).
- **Corporation tax.** We have not considered cutting corporation tax as a tax-increasing mechanism since we do not believe it is a credible solution. At a time when the UK's large corporations are sitting on a cash pile estimated to be in excess of £750 billion[1]

this corporation tax cut amounts to nothing more than a cash handout to already cash bloated corporations. It also favours low-pay, low-margin, low-productivity, high-volume enterprises, the very ones we need to rebalance the Scottish economy away from. Furthermore, there is little evidence to suggest that low corporation tax is related to the competitiveness of an economy. The World Economic Forum assesses the competitiveness of various countries economies every year to produce a global competitiveness index. As shown in figure 17, no discernible relationship is observed between corporation tax rate and the level of competitiveness among the ten highest scoring countries[2].

Figure 1

World Economic Forum Global Competitiveness Index 2012/13

Country	Corporation tax (%)	Global Competitiveness Ranking	Global Competitiveness Score
Switzerland	21	1	5.72
Singapore	17	2	5.67
Finland	25	3	5.55
Sweden	26	4	5.53
Netherlands	25	5	5.50
Germany	30	6	5.48
United States	39	7	5.47
United Kingdom	24	8	5.45
Hong Kong	17	9	5.41
Japan	40	10	5.40

Source: WEF

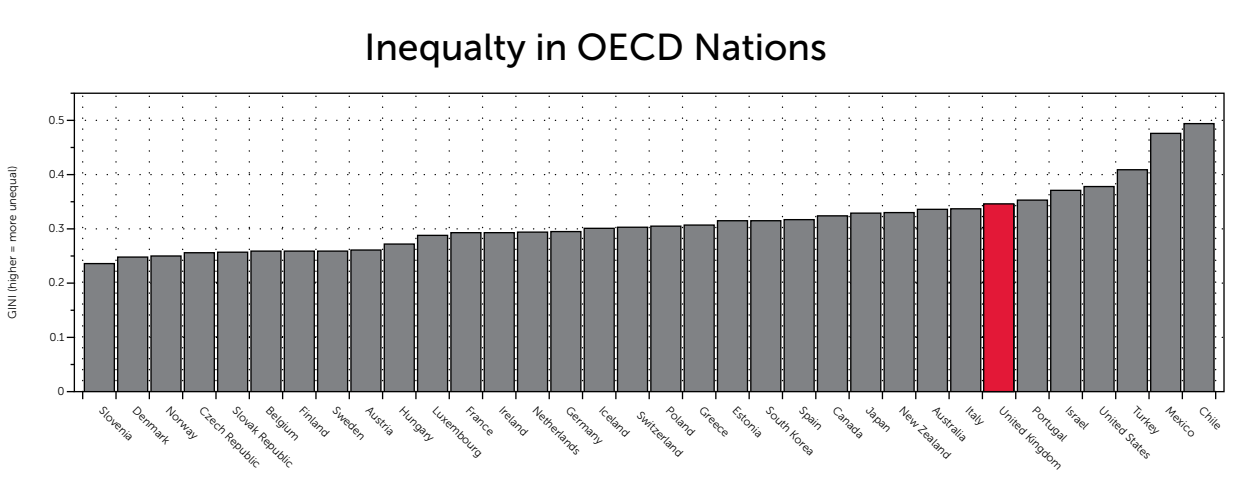
A note on economic transformation

At the heart of this report is an analysis of the potential impact on tax revenue if Scotland was able to move away from a low-pay economy. To understand the problem it will be helpful to take a quick look at the broad income structure of the Scottish economy.

Income distribution of the Scottish in-work population		
	£ per week	Annual Salary £
Median	393.7	20,472
Mean	470.2	24,450
10 Percentile	123.2	6,406
20 Percentile	206.4	10,733
25 Percentile	243.5	12,662
30 Percentile	274.0	14,248
40 Percentile	333.0	17,316
50 Percentile	393.7	20,472
60 Percentile	468.0	24,336
70 Percentile	554.0	28,808
75 Percentile	605.3	31,476
80 Percentile	656.3	34,128
90Percentile	833.5	43,342
		Source: ONS

Figfure 2

This shows that the curve of income distribution is heavily weighted towards the low end of the wage spectrum. The average wage in Scotland is £24,400 but the median wage is significantly lower at £21,000[3]. Given that income inequality in the UK is among the worst in the world, this income distribution imbalance is what we would expect to see[4]:



Source: OECD

Figure 3

This report wishes to make the case for the benefits to all if we can pursue a process of economic transformation which results in a higher wage economy in Scotland. To demonstrate this the authors have developed a basic model of the Scottish tax base by income groups and have then remodelled on the basis of an income distribution closer to that of our more successful competitor countries. No attempt is made here to predict or guess the structure of the Scottish economy which could deliver this higher-wage economy; this model has not been based on a process of shifting people between industry sectors, only of shifts between income groups.

This is not to make light of the very significant effort which will be required to create a rebalancing of the economy which would deliver this shift in income. The authors do not for a second believe that we can move to a higher wage economy simply by increasing pay rates in existing industry sectors or without achieving productivity improvements – Scotland is part of a globalised economy

and overpaying for low-value, low-productivity work would be likely to lead to capital flight. What is needed is a more fundamental restructuring of Scotland's economy; for the purpose of this report we have taken a 15-year time frame (although some may believe that to be optimistic).

What this paper seeks to do is make part of the case for the benefit that would be gained if we can achieve this outcome. It should not be read as making the case that a high-wage economy can be achieved through tax strategies (the relationship examined is the other way round). Nor is it the place for a detailed industrial strategy. However, the Foundation has published work showing some approaches which could begin to achieve this[5] and is developing further work on the principles of an industrial strategy which could generate that transformation.

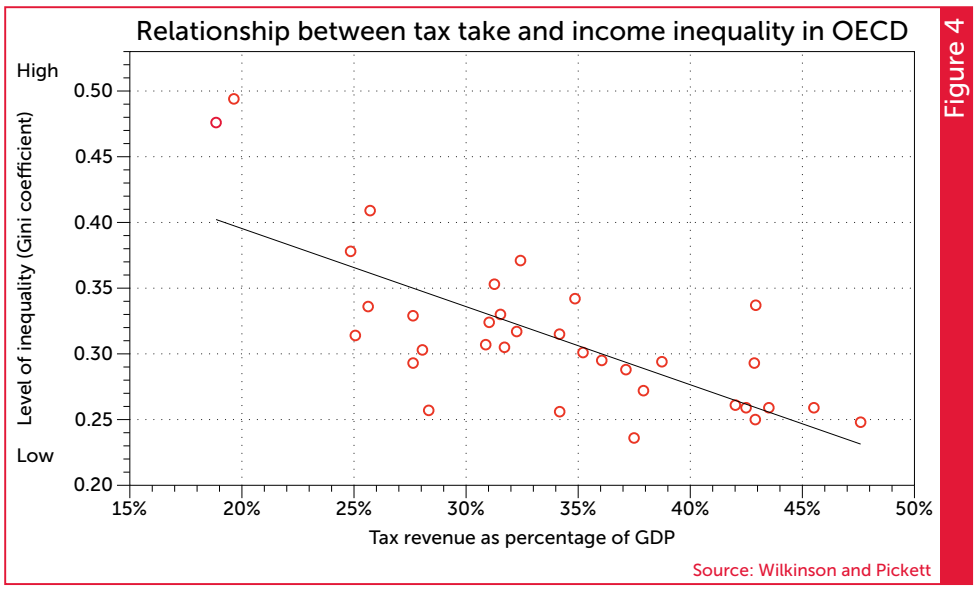
To repeat; economic reform will not be simple nor will it happen overnight. But the authors believe that it is important to begin now to make a strong case for why pursuing a high-wage economy should be a national priority. The impact on tax revenues is one part of that case.

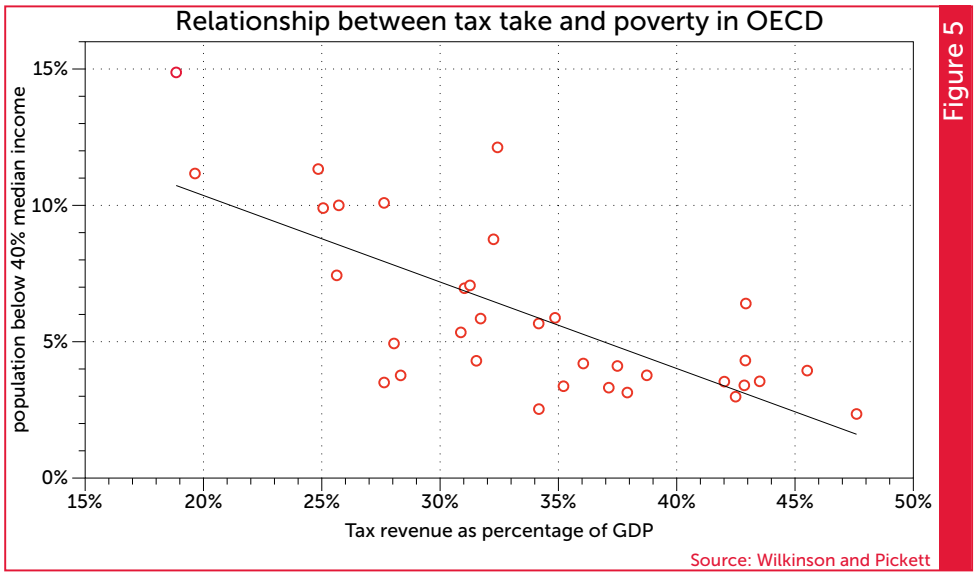
Why tax matters: a fair and efficient tax regime benefits everyone

A tax system can be used for several different purposes, among them:

- It has a primary role of funding collective goods, services and infrastructure provided by the state for its citizens
- It can have a redistributive role
- It can have a role in altering behaviour patterns
- It can have an important role in making a market economy work more effectively by distributing resource efficiently across the economy (mainly by creating jobs in the public sector and creating demand through procurement) and acting as a 'counter-cyclical balance' to the market economy

Its use in these way has been linked to a range of social 'goods' through creating greater levels of equality in society. There is a consistent relationship between higher overall tax revenue and income equality (see figure 4 and 5 below). The available evidence suggests that the most important aspect in determining whether tax has this equalising effect is not how progressive the tax is but how much is taken overall as a proportion of GDP[6]. In fact, the Nordic countries have slightly less progressive tax systems than the UK (mainly because they have much flatter income distribution) but higher overall tax take.





Higher tax revenues, if they are spent effectively, can create this effect because it is able to emphasise expenditure on employment, infrastructure and goods and services over, for example, marketing and advertising – and of course there are no corporate profits extracted[7]. The efficient distribution of resource achieved by collective provision can be seen (for example) in the comparative costs of healthcare in Europe and the US. In the UK healthcare absorbs only nine per cent of GDP, the vast majority all of which goes directly into healthcare by creating jobs, buying goods and building infrastructure. In comparison healthcare in the US absorbs 18 per cent of GDP. In a 2012 analysis entitled "Why an MRI costs $1,080 in America and $280 in France"[8] the conclusion is drawn that the difference in cost can be almost wholly attributed to profiteering; "... unlike in other countries, sellers of health-care services in America have considerable power to set prices, and so they set them quite high. Two of the five most profitable industries in the United States — the pharmaceuticals industry and the medical device industry — sell health care. With margins of almost 20 percent, they beat out even the financial sector for sheer profitability." If public expenditure can create more jobs and infrastructure per pound spent and deliver better outcomes while dedicating a significantly lower proportion of national wealth, it is highly economically efficient. And crucially it is a expenditure profile which creates a virtuous circle as more good-quality jobs create greater economic multipliers, stimulate demand in the economy and improve public finances through greater tax take.

In turn, more egalitarian societies rank better in measures of life satisfaction and happiness. It is perhaps unsurprising that Norway, Denmark, Sweden and Finland are among the highest scoring countries on the OECD Life Satisfaction measure contained within the OECD Better Life Index – all rank within the top ten[9].

Figure 6

OECD Life Satisfaction score - 2012

Country	OECD Life Satisfaction rank	OECD Life Satisfaction score
Denmark	1	7.8
Norway	2	7.6
Finland	8	7.4
Sweden	10	7.3
UK	20	6.9

Source: OECD

Then there is considerable evidence to show that income inequality is significantly related to many factors of health and social malaise. Wilkinson and Pickett (2009) examine the relationship between income inequality and many different factors of wellbeing, health and social problems among 23 of the world's richest countries[10]. Their findings suggest that high levels of inequality undermine trust and community cohesion, exacerbate mental health problems and drug abuse, damage physical wellbeing, stifle education and cause higher rates of violence and law-breaking.

So there is a clear and well-established link between income inequality and various 'social bads' which harm society and require remedial solutions funded through tax.

Figure 7

Relationship between income inequality and health/social problems

Source: Wilkinson and Pickett

This evidence suggests that collective provision paid for by progressively-collected tax is important because it creates jobs, evens out inefficient income distribution and builds infrastructure which further improves economic performance. By using taxation as part of a strategy to reduce income inequality and poverty, virtually everyone would stand to gain from higher public revenues, lower rates of crime, lower incidents of health and social malaise and increased overall wellbeing. Furthermore, with complementary strategies to rebalance the labour market it would build social cohesion and trust, essentials for successful economies and societies[11]. A fair and efficient tax regime therefore stands to benefit all in society – not just the poor.

The place from which we start: the Mirrlees Report and the UK labour market

In September 2011 the Institute of Fiscal Studies published The Mirrlees Review[12]. The Mirrlees Review brought together a high-profile group of international experts chaired by the Nobel Laureate and founder of the modern theory of optimal taxation, Professor Sir James Mirrlees, to identify the characteristics of a good tax system for any open, developed economy in the 21st century. It concluded that the UK tax system was in dire need of reform from an economics perspective and went on to recommend detailed changes and set out arguments for these changes. In the press release that the IFS put out at that time they stated:

> "In the deepest and most far reaching analysis of the UK tax system in more than 30 years, the Mirrlees Review puts the case for radical tax reform. It shows how the current system is inefficient, overly complex and frequently unfair. And it sets out a range of proposals designed to increase output and welfare."

Government, through the tax system, takes around £4 in every £10 earned in the economy. It is not surprising that getting tax design wrong can be hugely costly. Yet the level and quality of debate on tax policy is inadequate; there has rarely been any clear sense of direction from governments and expensive and damaging mistakes have been all too common. In the UK, poor tax design contributes to an inefficient housing market, distorting taxation of financial services, excessive reliance on debt finance, employment levels lower than they need be and distorted and inefficient savings and investment decisions. The review sets out a long-term strategy for reform, and in doing so speaks to immediate policy priorities.

The Mirrlees review sets out many principles of tax reform which the authors of this report can support and many of the recommendations are also consistent with a model for the Common Weal.

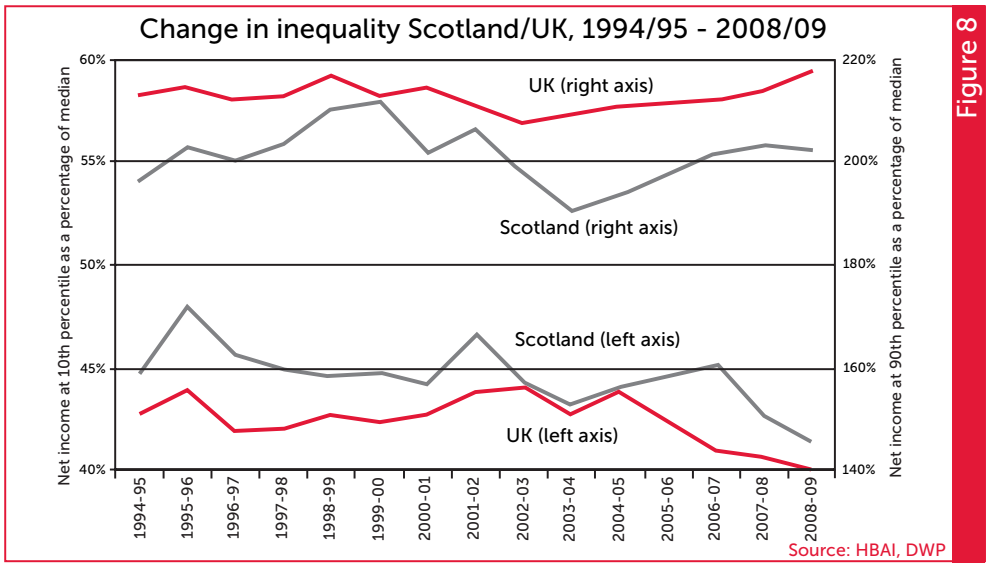
Firstly, Mirrlees argues that tax redesign has to be incremental. Changes to a tax system impact immediately on the wider economy and vice versa so reforms to either need to be harmonised or there might need to be changes in the economy before desired changes to the tax system can be made. Secondly, the general results of reform must be a system that is sufficiently flexible to respond effectively to significant changes in circumstances - economic recession, for instance, or marked changes in population. The resultant system needs to be progressive, neutral and open in the sense that tax liability increases as the amount subject to tax increases. It should only distinguish between different types of income or expenditure where absolutely necessary and has a rational relationship to policy needs. It must be internally consistent and understandable by ordinary tax payers and be regular monitored as a system to ensure that it keeps pace with its purposes. All of this is very different from the current short-term tweaking to which the UK tax system has been subjected for decades.

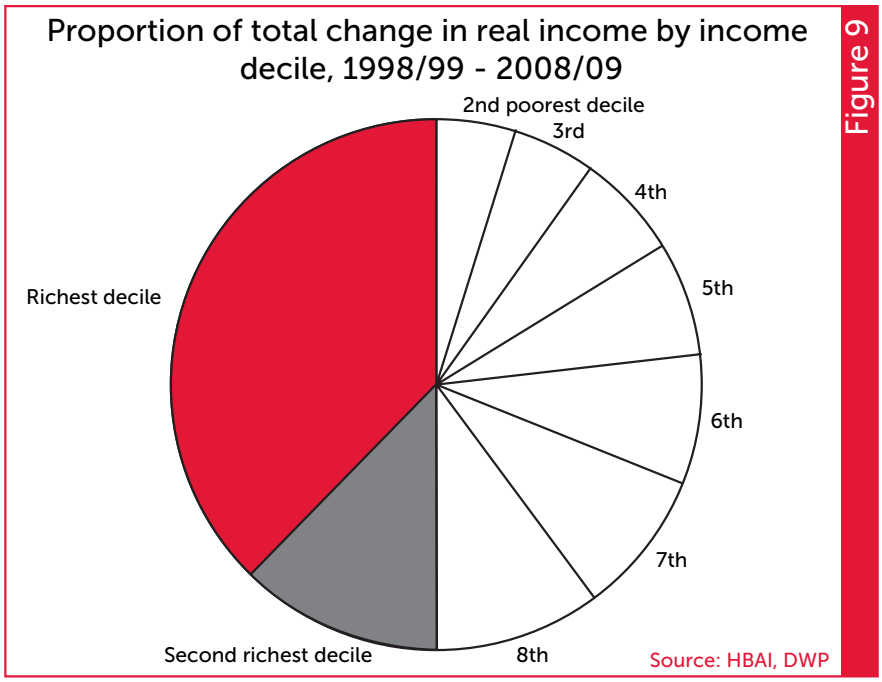
Some very specific recommendations from the Mirrlees Review are equally consistent with the goals of the Common Weal. For example, benefits, tax credits and personal taxation should be integrated, the present parallel systems being the clumsy and unnecessarily confusing result of short-term tactics and fixes. We also believe that in a fair and functional tax system income should be taxed the same way at the same rates however it is earned - there can be no justification for taxing employment income differently from capital gain, for example, and specific allowances can be used to cover the different types and levels of cost involved in earning different types of income.

But it is also important to recognise the problems of the UK labour market and their impact on tax. Only 12 pence of every pound of UK GDP now goes to wages in the bottom half of the

income spectrum, down 25 per cent in the last three decades. One in five workers in Britain is paid below two-thirds of the median wage (below £7.49 an hour or £13,600 a year for full-time work) compared with fewer than one in 10 in some other European countries[13]. Data on the Scottish situation was set out in Figure 2 above. It showed that three in five people in employment in Scotland earn less than £24,400 a year and half earn less than £21,000.

The following two figures illustrate the problem of increasing income inequality and how it weakens the tax base.





This preponderance of low-paid 'flexible' jobs in the British Economy has two immediate impacts. Firstly, it means that very many people in the UK economy are simply not paid enough for them to be able to make a positive contribution through tax to the UK public finances. But secondly, a low-wage, high unemployment, high under-employment and low productivity economy also means a higher tax spend on transfer payments – direct cash transfers like for example working

tax credits and unemployment benefit, as opposed to expenditure on capital or workers like public services and public service workers wages. The amount spent on transfer payments rose from an average of 30 per cent of total government spending in the 1970s to 43 per cent by 1998. As a result state expenditure in other areas plummeted; research and development spending (as a share of GDP) fell by more than half from 1979 to 1997, from 1.3 to 0.6 per cent[14]. The common mythology of the Thatcher years was that she oversaw a shift from a high tax, high spend state to a low tax, slimmed down state. In reality, state spending averaged 45 per cent of GDP during the 1970s and 44 per cent under the Tory governments of Thatcher and Major[15]. What changed was the functions of tax-spend, from productive investment on industries and services that created jobs and wealth to managing the fallout from deindustrialisation, high unemployment and a low-wage economy centred on the financial sector. That this was funded in part by squandering the tax revenues from the North Sea that accrued over this period is particularly disappointing.

Opportunity for Reform: tax and the Common Weal

Fiscal autonomy, either in an independent Scotland or one with significantly greater devolved tax powers, presents an opportunity to fundamentally rethink the role of taxation in shaping Scotland's economic and social landscape. It is often assumed that a devolved or independent Scotland would operate a tax regime broadly similar to that which currently operates in the UK, albeit with the ability to adjust the individual taxation rates. However, as stated above, the most comprehensive review of that tax system has found it unfit for purpose .

The amount of taxation revenue raised, as well as the way in which it is raised, matters enormously for economic efficiency and for fairness. Compared with our successful Northern European neighbours, UK tax revenue is relatively low as a proportion of overall economic output. Given the unmistakeable relationship between overall tax take and income inequality, it is little surprise that the UK has one of the highest levels of income inequality in Europe and in the entire developed world.

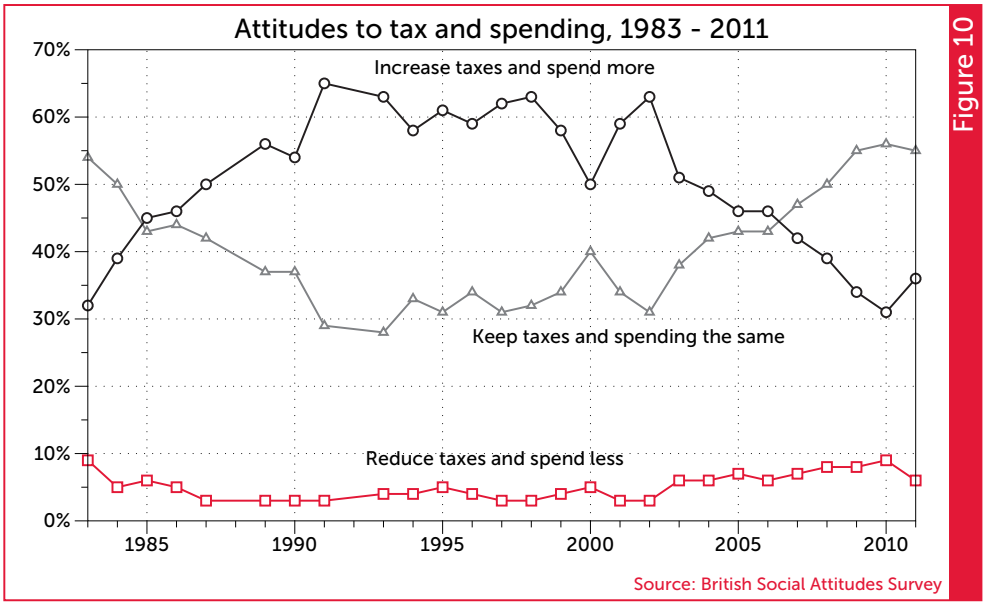
Common Weal is partly about discovering what has worked well elsewhere and suggesting ways of making that transition for Scotland, with a particular focus on the Nordic states. While there are different forms of tax across the Nordic nations with different balances between income, business, property, land and consumption taxes, the consistent pattern is that they take a larger proportion of their GDP in tax. This both enables stronger public services and (through the redistributive effect of taxes) much greater social and economic equality. However, this is combined with higher pay and much less prevalence of low-skill, low-pay work, which means that even with higher taxes, people have higher take home pay as well as higher standards of wellbeing and living standards.

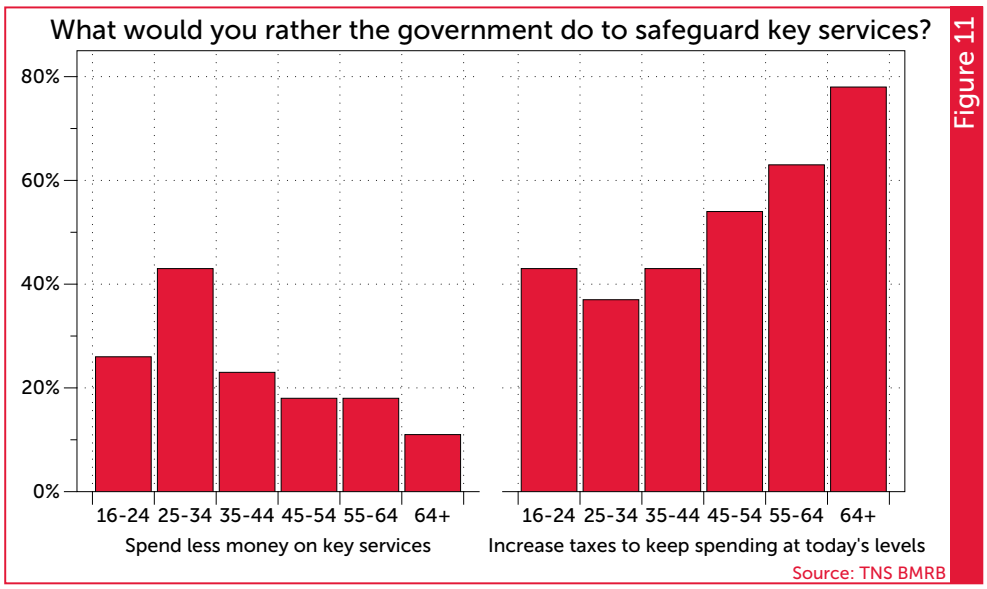
Scotland has much higher levels of inequality than the Nordic countries. To make progress there needs to be a process of increasing overall tax take – the alternative is major and permanent cuts to public services and the welfare state. This can be done gradually, targeting wealth inequality as a starting point. However, in tandem with this it is important to pursue strategies to increase pay and to structurally reform the economy so it is much less dominated by low-skill, low-pay work. In addition, it should be remembered that in the Nordic nations taxation is not the only source of income for government – profit from nationalised industries also contributes (the Norwegian Oil Fund sustained by a publicly-owned oil company is the best known example). Government at different levels in Scotland should pursue similar strategie[16] – it already does this through revenue from Scottish Water.

Common Weal is in summary a different type of economy that leads to a better type of society. A society that is more self sustaining and which shares its assets and the wealth that is created from them. We believe that the way our economy is structured has a huge effect on the type of society we live in. The last thirty years of neoliberal finiacialised capital have driven and sustained inequality and it is our assertion that inequality is the key factor in the alienation of large parts of the population. An alternative is not only possible, it would be popular.

The Politics of tax - Dispelling the myth that tax is unpopular

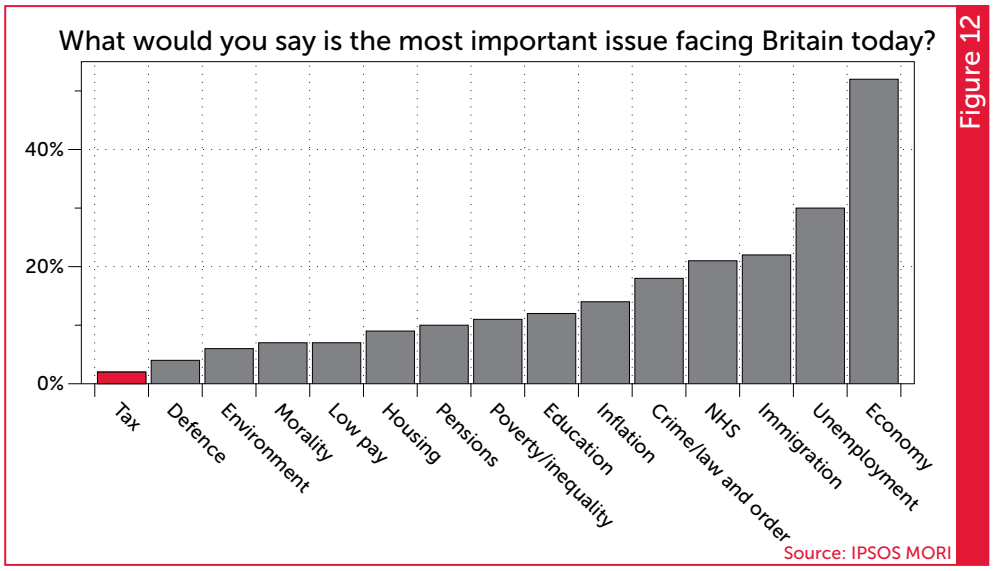
It is a fixed aspect of the post-Thatcher British political scene that tax is highly unpopular. In fact, so pervasive is this belief that tax is unpopular that it is repeated routinely as a statement of fact in the reporting of politics, not only in the commentary around politics. The evidence for this belief, however, relies on ignoring the available data and claiming that it is wrong. The following two graphs demonstrate what people say they feel about the relation between tax and public expenditure[17, 18].





As another example, in September 2011, a ComRes survey a short BBC Radio 4 series on tax showed that lowering tax is not the public priority[19]. What the majority supported was a simpler, easier to understand and harder to avoid tax system. If this could be achieved, 74 per cent of respondents said they would be prepared to pay a bit more in tax.

In all of these cases (one including 30 years of data) it is absolutely clear that a tax-cutting agenda is not a popular one. Perhaps more surprisingly, a tax-raising agenda is not only accepted but appears to be comparatively popular. We see the same thing happening when people are asked to rank their own political priorities; people do not raise tax as a priority issue (we are regularly told that the environment is not a politically important issue, but here it is ranked above tax in importance)[20].



The standard response to this is to claim that people say things in opinion polls which they believe they 'should' say rather than saying what they really believe. Apart from the fact that there is no evidence to support this claim, it is methodologically problematic. Firstly, it appears to stem from the assumption that the polling data 'must' be 'wrong' because the political classes do not believe it. Secondly, it becomes impossible to say anything about tax if all the available data is summarily dismissed without any compelling evidence.

The narrative version of this argument is that when tax becomes an election issue, it has a harmful effect on the political party proposing it. The case study example of this is the received wisdom about the outcome of the 1992 UK General Election. Labour was narrowly leading the polls throughout the campaign but lost. It is argued that this happened in the face of a relentless Conservative campaign highlighting tax. However, the main authoritative study of the election (Centre for Research into Elections and Social Trends) concludes that there is no evidence for this. In fact, the evidence strongly suggests that there was little change in voting intentions during or after the period where the Conservative tax campaign was being run. In fact, its conclusion dismissed the tax myth and instead identified polling failures as the source of the disparity between what people thought would happen and what actually happened:

> "But our surveys find little evidence to back this argument [that Labour's tax stance cost it the election]. It arose because the polls showed a small Labour lead throughout a campaign in which taxation was one of the dominant issues and yet the Tories won. Our research, however, confirms that the pollsters had it wrong all along: they consistently underestimated the Tory vote. The Conservatives were ahead throughout the campaign. There was a late swing, but far too small to account for Labour's defeat. And the people who deserted Labour were not particularly averse to high taxation; rather, they seemed to have relatively little faith in Labour's ability to improve services such as health and education."[21]

There is a parallel accepted orthodoxy in Scotland - that the SNP lost the 1999 election because of its policy of raising income tax by a penny in the pound to fund public services. The evidence for this is only that the SNP lost (and appeared to lose votes during the campaign - according to one opinion poll). The SNP subsequently dropped the policy in 2003. If the argument holds, it would therefore be assumed to be the case that the SNP vote in 1999 would be low by historical standards and that its vote would rise again in 2003 after the policy was reversed. It would also be assumed that its lost votes would go to low (or steady) tax parties. In fact, in 1999 the SNP got its second biggest proportion of votes cast in its history. The following shows what actually happened:

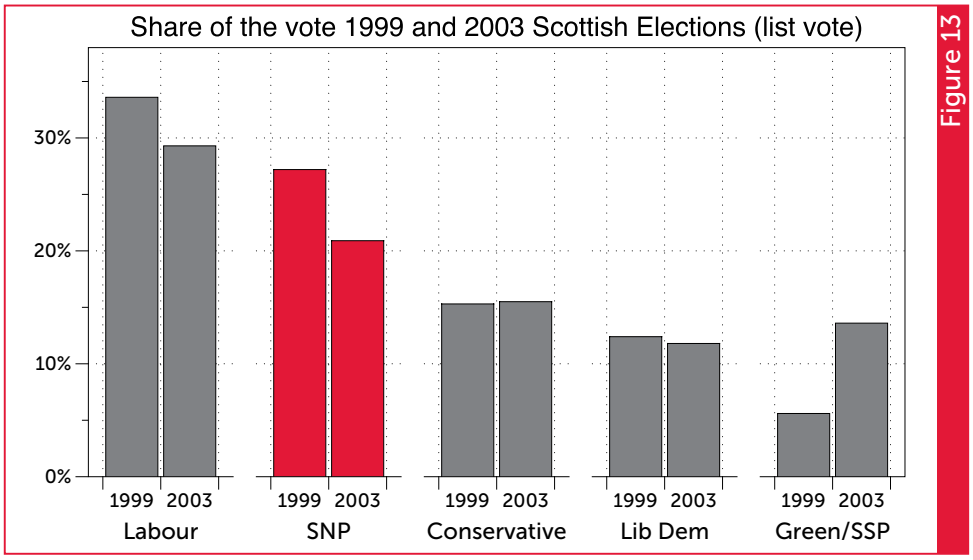


Figure 13

So what we actually see here is that the SNP significantly lost votes after it dropped its Penny for Scotland policy and these votes did not go to low-tax parties but to parties that proposed raising income tax.

Since the economic crash in 2008, the debate has shifted towards the inadequacies of the tax system as UK Uncut and other high-profile tax campaigns have shed light on the corporate tax avoidance and evasion of major UK companies. Hard and fast statements like 'higher tax is

unpopular' are not backed up by the evidence. Neither does it do justice to the nuances of the public's thinking on tax; its quite clear that if higher taxes were introduced subsequent to higher wages and therefore more prosperity it is popular. Additionally, higher taxes on those who are most able to afford it – the wealthiest percentile – are not condemned by most in the same way that they are condemned by our complacent political elite.

Five Questions

The preceding has been an attempt to set a context for the five questions we explore in this report. It has aimed to set four principle factors as a starting point:

- The UK tax system is almost universally seen as being "not fit for purpose" and "absurd" (both from the Mirrlees report) and is considered excessively complex and filled with unnecessary loopholes.
- One of the major strains on the UK tax system is endemic low pay in the economy which reduces tax revenue while requiring remedial public spending
- Internationally, there is a strong correlation between higher tax take and positive social outcomes, but there is not corresponding correlation between low tax and better economic performance
- There is little evidence to support the assumption that the public is inherently hostile to tax

We shall now explore each question.

Question One: Could we generate increased tax take on existing tax rates if we can successfully reform the economy to create a higher wage labour market?

The concept of moving to a higher-wage economy to increase the capacity to generate tax has sometimes been known as 'predistribution'. This is a term that, despite its lack of poetry, has become politically 'on trend' with certain elements of UK politics, including for a short time Ed Milliband. Coined by the Harvard political scientist Jakob Hacker, in fact it describes what many Nordic states have achieved for decades. The basic premise is that instead of allowing markets to be distorted and manipulated in favour of the rich and powerful - leaving the state to try and deal with the consequences of huge inequality - the state should shape the economy to avoid inequality in the first place[22].

Here we do not aim to set out a strategy for reforming the economy but rather to model the benefits that will accrue if we can achieve it (see 'a note on economic transformation' above). Economic transformation will not be achieved overnight nor without very significant efforts, involving a wide range of actions including labour market and training policies, industrial strategy, effective use of public resources, reform of finance and tax redesign among other things.

The modelling that has been carried out here is not a prediction of what will happen but a projection of what benefits can be gained if we succeed. We know empirically that the introduction of the

minimum wage here and elsewhere may well have been beneficial to growth and employment; very recent theory backs this up[23]. Modelling published by the Centre for Economic Performance at London School of Economics[24] showed that assuming an unequal distribution of labour income, wealth, and share of profits and general equilibrium, an increase in wages will stimulate aggregate demand. This is because a wage increase always redistributes income from firm owners to wage earners, and wage earners have a higher marginal propensity to consume than firm owners[25]. This increase in aggregate demand in turn stimulates labour demand, thus reducing unemployment.

The methodology here does not seek to remodel the Scottish economy based on imagined shifts in industry sectors. It simply adjusts income distribution across the economy to bring it more in line with the nations that perform better than Scotland and re-runs the model to identify what tax revenue increases can be achieved. The main data used in the model is for the year 2010-11 which is the most recent year for which comprehensive data on incomes and income tax is available for Scotland. The data is sourced from the HMRC publication 'Personal Incomes Statistics 2010-11'2. The base data is shown in figure 14.

Figure 14

Income and tax in Scotland 2010-11

Range of total income (lower limit)	No. of individuals	Total income	Average income	Total income tax	Average income tax
£	Thousands	£million	£	£million	£
6475	344	2860	8314	107	311
10000	592	7340	12399	567	958
15000	498	8680	17430	1,000	2008
20000	620	15200	24516	2,100	3387
30000	477	18000	37736	2,790	5849
50000	109	6280	57615	1,270	11651
70000	48	3980	82917	987	20563
100000	22	2680	121818	778	35364
150000	7	1150	164286	368	52571
200000	6	2560	426667	1,010	168333

Source: HMRC

Using this data it is possible to model the additional tax revenue generated from shifting individuals between the income brackets as well as increasing overall levels of employment over time. The model assumes no population growth. All monetary figures stated are in 2010-11 prices.

Two scenarios have been modelled. Scenario 2 models the effects of Scotland achieving the IPPR definition of full employment by 2025-26 accompanied by a significant shift of low paid workers up the income brackets. Scenario 1 represents the half way point of this transition in 2017-18.

Scenario 1 is based on the following assumptions:

- A gradual increase in employment levels from 69.5 per cent in 2010-11 to 76.2 per cent in 2017-18. The rate of increase is greatest in the first five years to reflect the upturn post-recession, and then slows in the last two years.
- A gradual shift in the income distribution whereby low paid workers gradually move up the income brackets, establishing a healthier income distribution by 2017-18 whereby more workers are comfortably in the middle income brackets.

The above scenario results in a 18 per cent increase in income tax receipts by 2017-18 in real terms (2010-11 prices) – increasing from £10.7 billion in 2010-11 to £12.9 billion in 2017-18. The model assumes no population growth – the increase in income tax receipts derives solely from increased employment levels and an improved income distribution.

	2010-11	2017-18
Employment level	69.5%	76.2%
Income tax receipts (2010-11 prices)	£10.7 billion	£12.9 billion

Figure 15

Scenario 2 is based on the following assumptions:

- A gradual increase in employment levels from 69.5 per cent in 2010-11 to the highest levels seen in the OECD today – 80 per cent – by 2025-26. This is seen as a reasonable and obtainable level for full employment in the UK today[26]. The employment trend is the same as Scenario 1 up until 2017-18 after which the rate of growth slows down towards 2025-26.

- A gradual shift in the income distribution whereby low paid workers gradually move up the income brackets, establishing a healthier income distribution by 2025-26 whereby most workers are comfortably in the middle income brackets.

The above scenario results in a 35 per cent increase in income tax receipts by 2025-26 in real terms (2010-11 prices) – increasing from £10.7 billion in 2010-11 to £14.8 billion in 2025-26. The model assumes no population growth – the increase in income tax receipts derives solely from increased employment levels and an improved income distribution.

	2010-11	2025-26
Employment level	69.5%	80%
Income tax receipts (2010-11 prices)	£10.7 billion	£14.8 billion

Figure 16

Conclusion: This exercise tells us nothing of the difficulties in achieving economic reform but it does demonstrate that success comes with significant rewards. If Scotland could move substantially towards the top end of the spectrum of equitable income distribution it could generate a 35 per cent increase in income tax revenue without raising tax rates.

Question Two: Is it possible to greatly reduce tax evasion and avoidance in a small country?

Corporation tax in the UK has attracted significant attention in recent months. One reason for this has been the revelation that many high profile multinational corporations have been paying little or no corporation tax despite recording significant profits. HMRC acknowledges that there is a significant corporation tax avoidance problem in the UK, and estimates the corporation tax gap (the difference between tax collected and that which should be collected) to be £4.1 billion in 2010-11[27]. There is, however, substantial evidence to suggest that HMRC consistently underestimates the scale of the problem, and that the actual corporation tax gap is considerably larger. Richard Murphy of Tax Research UK estimates that the true corporation tax gap in the UK is in excess of £12 billion[28].

Corporation tax avoidance takes many forms including improper submission of claims for special tax reliefs and transfer pricing strategies. Without the public transport, infrastructure and educated

workforce provided by the community at large companies would not be able to operate and make profits; therefore it is essential that companies pay a fair contribution to the community.

Although corporation tax avoidance would likely be on a slightly smaller scale in an independent Scotland than it currently is in the UK (due to the effects of corporate clustering in the South East of England), an independent Scotland could operate a far more stable, transparent and straightforward corporation tax regime that contained far fewer opportunities for avoidance. Similarly, the Scottish fiscal authority could house sufficient resources to effectively challenge those corporations who take the benefits of operating in Scotland but do not pay their fair share.

Tax avoidance and 'tax planning' around personal taxation also results in significant loss of tax revenue and, since this only applies to the very wealthy, it also increase inequality. In a fairer and more equitable Scotland, tax avoidance by individuals would not be encouraged with a simpler system with fewer loopholes and allowances for professional advisors to exploit.

There are many approaches which can close opportunities for tax avoidance, and while the international nature of some corporations means that aspects of avoidance are best tackled internationally, it is untrue to say an individual nation state can do nothing about it or about people with different residency situations. The following are simply three examples[29]:

- Have a precise definition of who is and is not a Scottish resident. This should include all people who are citizens of the country, whether they are physically present or not (they would receive credits for any taxes paid in a country of residence). It should also include all people who spend more than 183 days in any country in a tax year whether they are citizens or not. Then tax all its residents on all their world-wide income and gains, without exception, minus credits for tax paid elsewhere.

- Companies with international income that operate within Scottish territory can be taxed on a fair part of their world-wide income. This means that most issues arising from transfer pricing, thin capitalisation and licensing abuses cease to be a concern.

- A presumption can be made that where any transaction undertaken primarily to secure a tax advantage, or where any step in a transaction is added for that purpose, then the financial benefit that transaction can be ignored, and tax can be charged as if it had not taken place.

Conclusion: It is simply incorrect to claim that greatly reducing tax evasion would not be possible in Scotland. Taxing on a basis of global income removes the avoidance technique of transfer pricing and assumptions against 'tax planning' methods, along with simplification of tax rules, can make very significant steps to reduce evasion and increase revenue. However, there is insufficient data at the Scottish level to model the scale of this.

Question Three: Is there a realistic possibility of generating new tax income from wealth, land and property taxes?

In the IPPR report 'Property and Wealth Taxes in the UK'[30] strong arguments for some forms of wealth taxation on grounds of both economic efficiency and social justice are made and show why the current regime of wealth taxes is not working well in the UK. Focusing on empirical evidence using the IPPR and Landman Economics wealth tax model we look here at the potential impact of different reforms and the practical and political challenges to progress. We outline options for reforming or replacing existing taxes and also discuss the case for additional taxes on property and wealth that are not currently part of the tax regime. For a number of reform options, we demonstrate the potential impact on households and the public finances using the

IPPR wealth tax model. We also draw on analysis of the tax systems and experiences of other OECD countries in order to identify the reform strategies likely to be most effective for Scotland. It is important to note that these are a range of options - different proposed taxes may involve taxing the same asset so should be seen as a menu rather than a package.

The current system of taxation of land and property is inefficient and inequitable. There is a tax on business property — a produced input — but not on land, which is a source of rents. Taxation of housing involves both a transactions tax and a tax based on 20-year-old valuations[31].

Property and Wealth Taxes

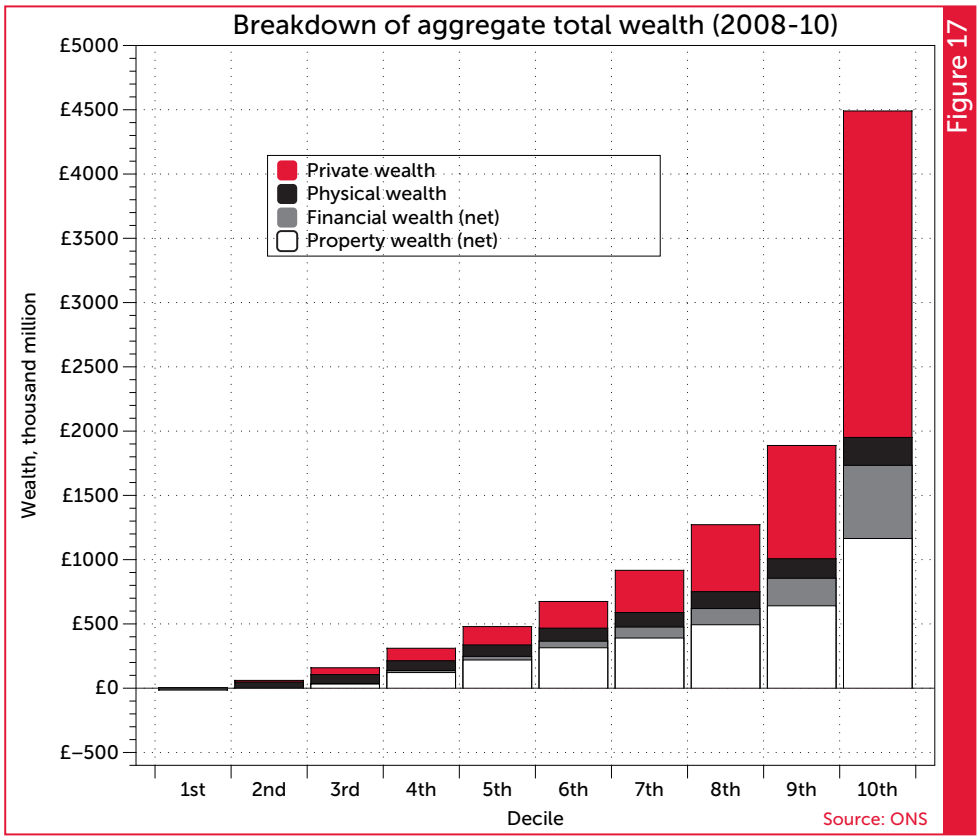
A strong case can be made for the tax burden to be spread more broadly over assets and income. Assets can be depositories of unearned value rather than income earned through work. Land is unique among the factors of production given that, in its unimproved state, it is a gift of nature and, unlike other capital and labour, it has no cost of production and is fixed in supply. The value of a plot of land is therefore derived purely from location and not from any form of individual work or effort. Fluctuations in the value of a plot of land are often due to changes in the demand for the location, which predominantly arise as a result of external public and private investment.

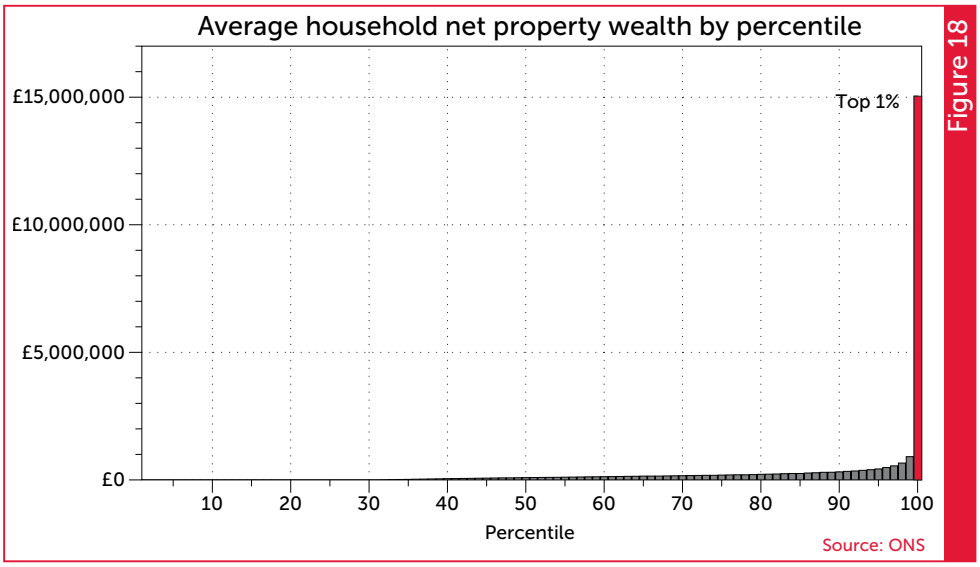
For example, a landlord that owns a plot of land may experience significant increases in the value of their land due to new local public infrastructure, such as a new railway line, or due to new private investment such as housing development nearby. In this instance the landlord benefits significantly through the increase in the value of their land despite no increased effort on their part; the increase in value enjoyed by the landlord has been created by the community at large. The result is that wealth appropriates to landlords through increasing land prices, as landlords capture value created by others simply because they have an exclusive right to land. Consequently, wealth is distributed away from those that create it towards a rent-seeking landlord class which grows wealthy by being idle and economically unproductive. As well as being economically perverse, this also creates a damaging incentive for capital to flow into unproductive speculative activity, therefore causing destabilising asset booms and busts and periodically plunging economies into recession.

According to the Office for Budget Responsibility's 2012-13 forecast, Income Tax and National Insurance are projected to make up 43.4 per cent of total tax take. By comparison the projections are that Capital Gains Tax will raise 0.6 per cent, Inheritance Tax 0.5 per cent, Land Stamp Duty 1.1 per cent, Share Stamp Duty 0.4 per cent and Council Tax 4.4 per cent. This means that the total for income taxes will be 43.4 per cent of tax while taxes on wealth and property will make up seven per cent of the total[32]. It seems important that a rebalancing between income and property/ wealth taxes should be attempted. The current situation produces disincentives for work, equity investment and job creation and incentivises debt and capital accumulation[33]. Using data from OECD countries between 1970 and 2005, Johansson et al (2008)[34] estimate that a shift of one per cent of tax revenues from income taxes to consumption or property taxes would result in a long-term increase in GDP per capita of between 0.25 and one per cent. The precise impact depends on a number of country-specific factors. The effect was also found to be larger for property taxes than for consumption taxes, and in particular for recurrent taxes on stocks of property wealth. Johansson et al[35] also argue that achieving such a shift in the tax base by increasing property taxes would have better distributional outcomes than if achieved by raising consumption taxes.

Wealth is very unequally distributed in most countries, much more so than income[36]. Total personal wealth in the UK is over £10 trillion – a sum that is considerably larger than the national debt. This figure includes financial wealth, property wealth, physical wealth and private pension wealth. Wealth in the UK, however, is distributed extremely unevenly and is mostly concentrated at the top – the wealthiest 10 per cent own £4.5 trillion, roughly £4.5m per household. The bottom half

of our society own less than 10 per cent of the total wealth[37] while the poorest 10 per cent are net debtors on average. The top 10 per cent own almost five times as much wealth as the bottom half put together. The concentration of wealth has increased in recent years, following a longer period of gradual equalization[38].





A short run or windfall wealth tax

We have explored the possibility of an annual wealth tax or a one-off windfall tax on wealth in Scotland as a means to 'reset' the massive wealth inequality and to provide funding for investment in other changes to the economy that would provide long-term benefits. The economic case for an annual net wealth tax is not particularly strong[39]. Taxing wealth holdings rather than returns means that assets producing very different rates of return are taxed at the same rate, so that investments generating a 'normal' rate of return are taxed at the same rate as those producing

'above-normal' returns. Economists argue that it is more appropriate to leave 'normal' returns untaxed but to tax 'above-normal' returns because they are effectively economic rents so taxation will create fewer distortion[40, 41]. Therefore taxing the returns associated with assets, with an exemption for 'normal' returns, is more efficient than taxing stocks of wealth.

However, there are signs that the financial crash, deficit reduction plans and sluggish recovery have reinvigorated the appeal of taxes levied on the wealthy in many European countries. Iceland and Spain have both temporarily reinstated an annual net wealth tax, while in France, President Hollande has reversed cuts in the wealth tax imposed by President Sarkozy in 2011[42]. In the last year, social democratic parties in countries including Austria and Germany have put forward concrete proposals for reintroducing a net wealth tax in response to current economic and fiscal challenges[43].

Using the IPPR/Landman Wealth Tax Model we have modelled the impact of an annual wealth tax on revenue generation and distribution in Scotland based on the data from the Wealth and Assets Survey (WAS)[44]. The analysis detailed here uses data collected by the WAS between July 2006 and June 2008, referred to as 'wave one'. Prices are uprated to 2012 values The dataset was large enough for us to examine the distributive effects on the Scottish population by wealth by quintile. So this model shows that one per cent annual tax on net wealth (all non-pension assets) above £500,000 would raise gross revenue of £562 million

Figure 19

Annual Wealth Tax – Distributional Impact by Wealth Quintiles

Wealth quintile	Annual gain (£)	Average wealth (£)	Gain as % of total wealth	Average income (£)	Gain as % of average income
1	0	4,525	0.00	20,521	0.00
2	0	76,661	0.00	27.753	0.00
3	0	160,623	0.00	26,899	0.00
4	0	275,801	0.00	28.351	0.00
5	-2,091	793,021	-0.26	41,799	-5.00

The Problem with Council Tax

Council tax is an unpopular tax. There are a number of possible reasons for this. It is highly visible: 88 per cent of tax is remitted by firms so for the vast majority of people Council Tax is one of the only taxes they are asked to pay personally[45]. Council Tax is regressive in relation to property values. The lowest-value properties, those towards the bottom of band A, have very high effective tax rates, which fall sharply until property values reach band B. Effective tax rates then fall more gently, with some small jumps when property values cross bands. After properties move over into the highest band, effective tax rates gradually comes down as property values rise. The result is that Council Tax is charged at 2.4 per cent on average for a property worth £40,000 in 1991, at 1.8 per cent for a property valued at £100,000 in 1991, and at just 0.3 per cent for a property worth £1 million in 1991[46]. In general, younger, poorer people living in less expensive houses are overtaxed and older, richer people living in high value properties are under-taxed. The banding system has not been updated since 1993 and it was far from perfect then. The failure to reassess has led to the system failing to properly differentiate between homes of widely varying and changing values[47]. The system of discounts in council tax also encourages the inefficient use of properties. Discounts of 25 per cent are available for households containing only one adult or 50 per cent for those with no qualifying adult. Councils are also able to give discounts of between 10 and 50 per cent for second homes, while homes that are empty for up to six months attract no Council Tax. Councils may offer a discount of up to 50 per cent for homes that are empty for longer[48].

Mansion tax

At a UK level both the Labour Party and the Liberal Democrats have shown interest in a mansion tax primarily as a means to raise revenue. Such a tax would partially address the regressive nature of the council tax detailed above and would have some distributional effect away from the wealthiest fifth. We have modelled a one per cent annual tax on property values above £1 million in Scotland. This would raise gross revenue of £250 million.

Figure 20

Mansion Tax – Distributional Impact by Wealth Quintiles					
Wealth quintile	Annual gain (£)	Average wealth (£)	Gain as % of total wealth	Average income (£)	Gain as % of average income
1	0	4,525	0.00	20,521	0.00
2	0	76,661	0.00	27.753	0.00
3	0	160,623	0.00	26,899	0.00
4	0	275,801	0.00	28.351	0.00
5	-401	793,021	-0.05	41,799	-0.96

Direct Property Tax

Council Tax could be replaced by a genuine property value tax levied only on property owners. The purpose of a property tax, unlike a consumption tax, is partly to raise more money as real house prices rise, so the tax rate stays the same regardless of fluctuations in property values. Households that see their property value rise faster than others end up paying more tax in absolute terms[49]. One goal of a property tax is to dampen house price volatility; the total tax burden on a property rises with the value of the property, pushing up the overall purchase price and therefore making the property less attractive as an investment. A property tax linked to market values has been widely recommended for the UK[50, 51, 52]. The OECD has argued for the introduction of a property tax in the UK (as well as in a number of other countries) to lessen the attractiveness of housing as an investment and discourage people from leaving properties empty. The OECD estimates that a property tax would have lowered house prices by around 20 per cent at the peak of the housing market in 2007[53]. However, fluctuating revenues would make it a less appropriate source of funding for local services. The distributional impacts would also vary over time since it is likely that some households would see their properties rise in value faster than others[54].

We have modelled a flat 0.5 per cent annual tax on residential property values which would raise gross revenue of £304 million. This is substantially below the current amount raised by council tax at £1.9 billion per annum and so a higher rate of tax would be required to match current income.

Figure 21

Property Tax – Distributional Impact by Wealth Quintiles					
Wealth quintile	Annual gain (£)	Average wealth (£)	Gain as % of total wealth	Average income (£)	Gain as % of average income
1	0	4,525	0.00	20,521	0.00
2	0	76,661	0.00	27.753	0.00
3	0	160,623	0.00	26,899	0.00
4	-8	275,801	0.00	28.351	-0.03
5	-637	793,021	-0.08	41,799	-1.52

Land Value Tax

A land value tax is a tax on the underlying value of land regardless of the value of any property or development on the land, and is favoured by most economists as one of the most efficient ways for the state to raise revenue. A Land Value Tax is a fair and efficient way of redistributing socially-created wealth resulting from increases in land values away from landlords, who unfairly appropriate value created by others, to society as a whole. A Land Value Tax is a levy on the annual rental value of land alone, excluding any capital improvements such as buildings and other structures. This is because landlords may increase the value of the property on their land through construction and improvements; however they do not contribute to the base value of the land occupied by their buildings. As stated, this comes from 'locational' factors created from the endeavours of the community through infrastructure, utilities and other external public and private developments. Although described as a tax, a Land Value Tax is more accurately described as the recovery of economic rent; a payment for benefits received resulting from the effort of others.

Despite the strong economic (and social justice) case for land value tax, it is applied in relatively few countries. Austria charges a one per cent tax on land without buildings, and Denmark operates a land value tax of between 1.6 and 3.4 per cent. Some states in Australia, Canada and the US also levy a land value tax, as do some Caribbean countries and a number of African countries including South Africa and Kenya. New Zealand used a land value tax until 1991 when it was abandoned following a sharp increase in commercial land values in 1989. The likely explanations for the relatively low take-up of land value tax are partly practical and partly political[55]. Landowners are typically powerful voices capable of lobbying against a new tax that imposes a windfall loss on them. Numerous attempts to introduce various forms of taxation on land in the past have failed in the UK, although this may have been in part because they were taxes on land transactions rather than on capital values[56].

As with property taxes, the practical challenge is how to value land and ensure values are updated regularly. A comprehensive valuation of all land in Scotland would be required. According to Andy Wightman[57] this is technically straightforward even taking into account the relative unfamiliarity of valuing land separately from improvements. Valuers in Scotland have no difficulty general in valuing land and property for a range of purposes. The only difference between current valuations carried out for capital gains tax, business rates or compensation appeals is that they are normally of the whole property (i.e. land and buildings together). All that needs done to value land alone is to adopt the familiar Residual method[58].

A Land Value Tax has the potential to be a significant source of public revenue and hosts a number of other benefits that make it a more efficient source of revenue than the current range of property and land taxes in the UK. A land value tax would dampen speculation, disincentivise hoarding of land and control property prices so that homes where more affordable and more of peoples income was disposable into the productive economy instead of being sucked up through mortgage payments into large financial institutions for investment in probably less productive activity.

To give an order of magnitude, a Land Value Tax of 3.16p in the pound could replace the regressive Council Tax and Uniform Business rate (£3.8 billion) in Scotland[59].

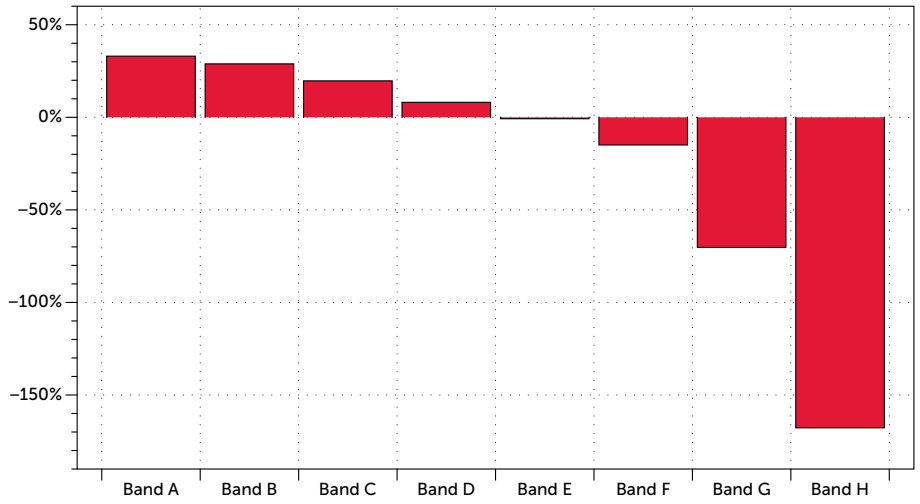
The transfer from council tax to a more progressive and socially and economically beneficial Land Value Tax would of course be a political challenge . However there has been modelling that shows that a Land Value Tax set at 4.392p in the £ levy on the land value of Scotland would collect the £3.8 billion currently achieved by the council tax and uniform business rate and allow for a 3p in the pound cut in the basic rate of income tax raising in total £5.28 billion[60].

Effect of LVT at rate of 4.392p/£				
Band	LVT @ 4.392p	Council Tax	+/-	LVT yield
A	£713	£766	-6.7%	£372,583,843
B	£884	£894	-1.1%	£498,660,150
C	£1,140	£1,021	+11.2%	£422,740,110
D	£1,468	£1,149	+27.7%	£438,036,214
E	£1,967	£1,404	+40.2%	£601,892,707
F	£2,651	£1,660	+59.8%	£446,136,135
G	£4,533	£1,915	+135.9%	£489,228,104
H	£8,552	£2,298	+269%	£97,916,418

Wightman (2009)

Figure 22

Beneficial gain as proportion of income of moving from Council Tax to Land Value Tax (by Council Tax band)



Source: Wightman (2009)

Figure 23

Conclusion: While the aim of Common Weal is not to 'tax inequality' but to reduce inequality through economic means, there is clear scope to use wealth, land and property taxes to stabalise public finances during the transition period. There is also a strong case, in the longer term, for a shift from property taxes to land value taxes and where possible from taxes on income to taxes on wealth.

Solution Four: What potential is there to generate greater national income from Scotland's natural resources?

Scotland's natural resources predominantly benefit the corporations which have bought them with very little value returning to the Scottish people. Approaches to challenge that position should be developed.

Scotland has a wealth of natural resources; plentiful water, oil and gas and numerous sources of renewable energy. As part of the UK the benefits from these natural resources have either been squandered or usurped by multinational corporations – the people of Scotland have benefited little.

A good example of this is one of our most famous products: whisky. Whisky is Scotland's second largest export and is regularly lauded as an invaluable contributor to the Scottish economy.

However, an overwhelming majority of distilleries in Scotland are now owned by multinational corporations, and these distilleries along with the associated intellectual assets are domiciled in foreign tax jurisdictions. The Scotch Whisky Association estimates that the industry contributes around £4 billion gross value added to the Scottish economy; however as much of the whisky industry is owned and controlled from abroad little of this is retained in Scotland. Professor John Kay, visiting professor of economics at the London School of Economics and fellow of St John's College Oxford, estimates that only £400 million of the £25 billion global retail sales value of Scotch whisky (around two per cent) remains in Scotland[61]. This is mainly wages for low paid jobs in production facilities and local purchases. The whisky industry makes a profit margin of two thirds of the retails price, an enormously high margin of profit.

As the success of the whisky industry relies on Scotland's plentiful natural resources, such as high quality water and fertile land for grain, imposing a production tax on bottles of whisky would allow the people of Scotland to share some of the economic benefit arising from the use of these collective goods, and reduce the amount being appropriated by multinational corporations. A recent report by Graeme Blackett of BiGGAR Economics found that a £1 production tax on each bottle of whisky could generate over £1 billion in tax revenue, even when accounting for a corresponding fall in demand[62].

Similarly, Scotland's vast energy resources could be utilised to benefit the people of an independent Scotland. Here lessons can be learned from our Nordic neighbours. The Norwegian government is the majority shareholder in the country's oil and gas company, Statoil, and taxation revenues from profits are invested in a sovereign wealth fund which is now the second largest in the world worth £450 billion[63]. This fund is used to smoothen out fluctuations in oil prices and ensure that future generations share the economic value of the nation's natural resources. An independent Scotland could utilise oil revenues to create a reserve fund that could be built up over time and used to finance projects in Scotland. This would create a buffer to minimise the impact of future fluctuations in oil prices and ensure that the economic value of our most lucrative natural resource is collectively shared among the people of Scotland.

In Denmark state owned energy producers and local wind co-operatives account for 80 per cent of the energy sector[64]. Such models of public participation and engagement in economic decision- making ensure that natural resources are utilised for the benefit of the people and that the economic value generated from the resources is retained within the country. This also encourages active participation and enterprising activity more broadly. Scotland has a considerable natural resource base for generating renewable energy, the most prominent potential sources being wind, wave and tidal energy. An independent Scotland could maximise its renewable energy potential and implement an ownership and taxation regime that ensures that the economic benefit from renewable energy is retained within the Scottish economy.

Conclusion: Scotland has many valuable natural assets, but it is not clear that these are being used for the benefit of society as a whole. There is clear scope for using tax and alternative means of exploiting resources[65] (notably collective ownership) to generate additional income for the collective good, and while it is beyond the scope of this report to measure the potential revenue from all of them, it is clear that this can be a significant income stream.

Question Five: Can reform of consumption taxes raise more income in a progressive manner?

The 2011 Merrillees review of the UK tax system stated[66]:

> "There is a strong case for a move to a broader-based and more uniform system of indirect taxation. There are a few clear-cut situations where there should be deviations from uniformity — taxes on environmental harms, and taxes on goods such as alcohol and tobacco that can have damaging effects on the consumer and on other people, are the obvious examples. But the case for the widespread differentiation in indirect tax rates that we see in the UK at present is not strong. In particular, if we are concerned about equity, then it is much better to use the direct tax and benefit system to achieve the distributional outcomes that we favour than it is to use differential indirect tax rates."

The case is strongly made in the report of their review for a uniform rate of VAT on over all goods and services consumed. The distributive arguments for not having VAT on food and other essential goods only hold up if wages policy, direct tax (income) and the benefits system are not being efficiently utilised for redistribution. Mirrlees makes it clear that VAT is not an efficient means to fairly distribute and that tax and benefit could, if done properly, be the best option.

It should be stated here that it is clear that in Nordic states while the income tax system is generally less progressive, the higher overall tax take out of the economy, flatter, higher salaries and an effective welfare system means that consumption taxes are flat without impacting negatively on overall equality and welfare. The Mirrlees review explains in detail how the transformation from consumption tax distribution to one based on direct tax and benefits can be made. They outline a set of compensating changes to the direct tax and benefit system so that the overall reform package would avoid worsening work incentives and would be broadly distributionally neutral. This distributional neutrality is achieved by ensuring that gains and losses for households with different levels of incomes and spending would, on average, be relatively modest.

However, there are also arguments against large changes in consumption taxes. For one, unless there really is a very robust system of compensation through transfers for higher prices, it could well have a negative impact on fuel and food poverty. Another is that a strong assumption towards flat-rate consumption taxes greatly restrains the capacity for using consumption taxes to incentivise positive behaviours.

When the Mirrlees review was published in 2011 it suggested that the UK simply accompany the VAT-base broadening with a 15 per cent increase in all the main means-tested benefits and tax credits. This costs only about £13 billion, whereas the base-broadening raises £24 billion, so the reform package in total raises net revenue of £10 billion (after rounding), or just under £400 per household per year. If the extra revenue was then dedicated to labour market and other predestibutive polices the welfare costs could be reduced overtime and increase in direct revenue as described above would be realised.

Conclusion: Much more work needs to be done on the impact of consumption taxes in Scotland and until it has been done it is difficult to make any firm recommendations. There is certainly a case for rationalising consumption taxes; there may be a strong case for a more radical approach which might generate greater income.

Conclusions

The conclusions from this work are fairly straightforward. First of all it is possible to identify the aims of a reformed tax system in Scotland:

- To increase the overall tax take in a way that equalises and raises income
- To build a robust tax base which can support strong public services without running deficits
- To make more equitable and effective the overall tax system to end evasion and remove glaring inconsistencies, especially where those favour groups at the top of the income spectrum
- To end perverse tax incentives which discourage positive actions and discourage negative actions
- To simplify tax and increase understanding of the benefits of tax

But it is also important to state what a tax system should not seek to do:

- To reduce the economic security of anyone in society
- To act in a punative manner
- To be developed in the belief that tax changes themselves will be sufficient to reform the economy or the labour market

There are also underlying principles that it will be useful to keep in mind:

- Changes to the tax system must be incremental
- Reform of the tax system and reform of the the economy must be harmonised
- A reformed tax system must be designed to offer maximum flexibility as circumstances change
- It should be progressive, neutral and open
- It should only distinguish between different types of income or expenditure where absolutely necessary
- It should have a rational relationship to policy needs
- It should be internally consistent and understandable by ordinary tax payers
- It should be regularly monitored as a system to ensure that it keeps pace with its purposes

This initial work suggests that there is a credible path which can stabilise and then improve public finances over a comparatively short period of time:

- Firstly, make the central aim of government to reform the economy to make it more productive and to make major labour market reform a priority, pursuing a high-pay strategy for Scots. This could, in a comparatively short period of time, increase tax take significantly as a result of making Scots richer. This does not require income tax rates to be altered. However, once people are wealthier there is a strong case for an incremental increase in tax rates.
- Secondly, to bridge the public finance gap in the period while economic and labour market reforms are taking place by using a combination of wealth, land and resource

taxes, particularly targeting unproductive wealth accumulated during a period of lax tax collection and industries which take high value out of the Scottish economy based on Scottish natural resources

- Thirdly, to move to a more consistent system of taxation which also increases tax take in an equitable way, for example by treating all income in the same way and over the longer term by exploring the scope for rationalising consumption taxes and introducing land value taxes

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