Press Release

Independent Scotland could face conflict between pressure to lower tax rates and need to fix its public finances

There would be plenty of scope for an independent Scotland to improve its tax system, though to do so would require a Scottish government to make the sorts of bold decisions over tax reform that successive UK governments have failed to make. But an “optimal” tax system for an independent Scotland might also be different to that for the UK as a whole. For example:

- The Scottish income distribution is more equal, so the scope and need to redistribute through high rates of income tax would be less;
- There is less congestion on Scottish roads so optimal motoring taxation would be lower;
- Independence could lead to increased tax competition and cross border shopping and create pressures to reduce taxes such as corporation tax and excise duties;
- There would be a strong case to focus taxes more on immobile tax bases such as property. This would involve a reversal of long-standing policy which has seen council tax rates in Scotland fall well below English levels.

On the other hand an independent Scotland would face fiscal pressures at least as strong as those faced by the UK as a whole and might want to consider tax increases as a possible response. These are among the main conclusions of new IFS research, funded by the Economic and Social Research Council (ESRC), that looks at taxation in the context of the 2014 Scottish independence referendum and at options for increasing tax revenues.

The current situation

- Scottish tax revenues per person are very similar to those in the UK as a whole if North Sea oil revenues are allocated in proportion to population but significantly higher if oil revenues are allocated geographically. But oil revenues are very volatile and there is great uncertainty over their future path. While Office for Budget Responsibility forecasts suggest they will have declined dramatically by 2017-18, the Scottish government is more optimistic. This will matter for the Scottish public finances.

- Whilst average income in Scotland is little different from that in the UK as a whole, there are fewer very rich individuals in Scotland than in the rest of the UK. As a result Scotland raises less per person from income tax than does the UK as a whole: £2,120 versus £2,411 per person in 2011-12, expressed in today’s (2013–14) prices.

- Wealth and property taxes also account for a lower fraction of Scottish revenues, partly because there are fewer expensive properties and very wealthy individuals, but also because, as a result of deliberate policy choices, council tax rates are about a fifth lower in Scotland than in England.
Tax design post independence

- If Scotland opts for independence it will gain almost complete autonomy in the design of its tax system. This autonomy would provide an opportunity to improve upon the current UK tax system, for example along the lines proposed in the recent IFS-led Mirrlees Review of the tax system.

- An independent Scotland might place more value on redistribution or on higher taxes to fund public services. But differences between Scotland and the UK as a whole mostly point towards lower optimal tax rates in Scotland. A less unequal income distribution means there is less need for redistribution via heavy income taxation; less congested roads means less rationale for heavy motoring taxation.

- An independent Scotland would be a much smaller and more internationally open economy than the UK is – particularly because of what would become cross-border movements of goods and services, people and capital between Scotland and the rest of the UK (rUK). Tax competition between Scotland and rUK could leave their combined tax revenues lower than what would be best for them collectively.

- If Scotland sets a corporation tax rate 3 percentage points lower than in rUK, as the Scottish National Party proposes, preventing companies from artificially shifting profits north of the border would be a real challenge for the rUK government.

- Greater international openness would point towards relying more on relatively immobile tax bases, especially property. But in recent years Scotland has been moving in the opposite direction, raising less of its revenue from property taxes by freezing council tax rates in cash terms.

- Property taxation is in any case ripe for reform, and is an area where Scotland will have autonomy even if it votes against independence. But while Scotland’s intended replacement for stamp duty land tax is an improvement, the failure of successive Scottish governments to date to undertake even the most obviously desirable reform to council tax – a revaluation to base it on up-to-date property values – does not bode well for making politically difficult improvements under independence.

Using taxes to strengthen the public finances

- An independent Scotland would probably need to undertake some fiscal tightening. How much would be for the Scottish government to determine. But to give a sense of possible scale, previous IFS research has found that £2.5 billion of tax rises or spending cuts (in today’s terms) would be needed during 2016–17 and 2017–18 to match the UK government’s plans. If a Scottish government also wanted to offset the decline in oil revenues by 2017–18 forecast by the OBR, another £3.4 billion would be needed.

- We estimate that a one percentage point increase in all rates of income tax, or in the main rate of VAT, would raise around £430 million in Scotland. Making a substantial contribution to a possible fiscal tightening would require significant tax increases.

Continues...
Stuart Adam, a senior research economist at the IFS and an author of the report, said: “Independence would give Scotland an opportunity to design a much more efficient tax system than the one we live within the UK. But to do so would require tough political decisions. And independence does not give any government a completely free hand. On the one hand tax competition will create pressure to reduce tax rates. On the other an independent Scotland will need to look to fill a substantial fiscal gap.”

ENDS

Notes to Editors:

1. For embargoed copies of the report or other queries, contact: IFS press office: 020 7291 4800 / 07730 667013, bonnie_b@ifs.org.uk.

2. This is the fourth major publication from a new IFS research programme which aims to clarify some of the fiscal choices that might face Scotland were it to become independent. Outputs associated with this project are being produced under the auspices of the Centre for Microeconomic Analysis of Public Policy, an ESRC research centre hosted by the IFS.

   This project forms part of a wider ESRC programme of work addressing issues around the future of the UK and Scotland. A further paper examining long-term public finance projections for Scotland will be published by IFS (November 2013)


3. ESRC programme of work “The future of the UK and Scotland”: The ESRC is supporting a programme of work addressing issues around the future of Scotland. The work will provide robust independent research based evidence. It will aim to both inform the debate in the run-up to the referendum and assist in planning across a wide range of areas which will be affected by the outcome of the vote, whether for independence or the Union. These include voting, culture and identity, business intelligence, fiscal and monetary policy, policy development, building of new constitutional arrangements, and defence and administrative practice - particularly in public service delivery. http://www.futureukandscotland.ac.uk/.

4. A conference to present this and other work from the programme is taking place on 18 November in Edinburgh (a press release will be sent out in advance but you are welcome to attend – please register at events@ifs.org.uk). More details at: http://www.futureukandscotland.ac.uk/events/fiscal-implications-independent-scotland.