What if the Welsh Government raises or cuts taxes? Implications for revenues and behaviour

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Background

• Tax devolution is not just about power to change rates and rules
  – Also provides Welsh Government with a more direct financial stake in performance of Welsh economy

• But government may want to change rates
  – To raise more revenue to spend on public services
  – To reduce taxes in an effort to boost competitiveness
  – To shift the burden of taxation between taxes and between people

• When developing strategy and specific policies understanding effects of policy changes will be key
  – Will a tax increase be offset by people leaving Wales or reducing taxable incomes?
  – Will a tax cut pay for itself by boosting economic activity?
(Almost) hot off the press...

• Unlikely to be the case

• This report looked at all revenues raised in Wales

• Doing this gives a misleading picture of cost/benefit of tax rate changes to Welsh Govt
  – Not all taxes devolved to Welsh Government
  – UK Government plans to keep most income tax, NICs, VAT, corporation tax, excise duties, etc.
Remember plans are to devolve

- Stamp duty land tax (land transactions tax)
- Landfill tax (land disposals tax)
- (Potentially) part of income tax
  - 10 percentage points of the basic rate (UK rate = 20 – 10 = 10%)
  - 10 ppt of the higher rate (UK rate = 40 – 10 = 30%)
  - 10 ppt of the additional rate (UK rate = 45 – 10 = 35%)
- And Wales already has council tax and business rates
Imagine an income tax cut (I)

- Welsh Govt bears the full “mechanical” effect of the lower tax rate
  - e.g. 1 ppt cut in all income tax rates cost ~ £200 million

- If this leads to more people to move to Wales, or people in Wales to earn and declare more income, or spend more...
  - Welsh Govt gets any tax from its (now) 11% income tax rate
  - Stamp Duty, business rates, council tax

- Remaining revenues from this extra income accrue to UK Govt
  - Rest of income tax revenues
  - NICs, VAT, Duties, CGT, Corporation tax, etc..
Imagine an income tax cut (II)

• So from a Welsh perspective a tax cut is less likely to pay for itself
  – Some of the extra revenues in Wales go to Westminster

• New “Fiscal Framework” may give scope for Welsh Govt to negotiate with UK Govt to get some of this money
  – But difficult to calculate what any transfer ‘should’ be
  – And default likely to be no transfer

• Is it ‘unfair’ Welsh Govt does not reap all these behavioural rewards?
  – If a large part of response is a result of people or businesses moving to Wales then these rewards come at cost elsewhere in UK
  – Might reduce potential for tax competition to drive down tax rates and revenues across the UK
Imagine an income tax increase

• Welsh Govt gains full “mechanical” effect of a higher tax rate
  – e.g. 1 ppt increase in all income tax rates raises ~ £200 million

• Welsh government only bears part of any behavioural cost of this
  – Its income tax, council tax, business rates, etc.
  – UK Govt picks up tab of lower NICs, VAT, etc.

• A tax rise is less likely to be counterproductive from a revenue perspective than if Welsh Govt bore full effects
  – Might this skew Welsh Govt decisions towards tax rises?
  – Need to consider wider economic impacts of policies
A few thoughts on behavioural response

• Unlike Scottish/English border, Welsh/English border is quite densely populated
  – Does that mean more scope for movement in response to tax differences?

• Welsh income tax will not apply to savings and dividends
  – Owner-managers dividends most responsive to tax policy, and employment income less responsive
  – Ability to swap corporate forms and income between sources in response to tax differences

• More of Wales’ high earners are in the public sector
  – A less responsive group?
Summary

• Welsh Govt will not have control of all Welsh Revenues

• So any economic boost less likely to “pay for” tax cuts

• And any economic hit less likely to “undermine” tax increases

• Benefit is less potential for tax competition that reduces revenues everywhere

• Potential cost is skew towards tax increases

• Important tax strategy keeps in mind wider economic and social objectives and interests of Wales