

NEW POWERS, NEW SCOTLAND?

How the Scottish parliament could use its new tax and benefit responsibilities

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60-SECOND SUMMARY

Scotland is increasingly taking on more powers and responsibilities over devolved income tax and benefits. Following the successful passage of the Scotland bill, it is estimated that these powers will mean that Scotland will have control over revenue totalling almost half of devolved expenditure by the Scottish government and Scottish local authorities, and 15 per cent of Scottish benefit spending.

This development prompts two core questions. First, what will be the likely impact of the Scottish government using its new powers to offset short-term challenges that are expected to reduce Scottish household incomes and lead to a deterioration in the Scottish fiscal position? And second, over the medium and long term what is the likelihood of the Scottish government developing its own distinctive tax and benefit system?

On tax, the Scottish government's new powers over income tax offer significant flexibility to reduce or increase tax paid on earnings by Scottish households, particularly those further up the distribution.

On benefits, while coverage of devolved disability benefits is low, changes to the level of these benefits can have a significant impact on a claimant's living standards.

EFFECT OF TAX-BENEFIT CHANGES IN SCOTLAND

Scotland faces a series of short and medium-term challenges.

- Welfare cuts planned at a UK level will see benefit spending in Scotland fall by £600 million a year by 2020/21.
- These cuts will vastly outweigh the benefit from the new national living wage for the poorest households in Scotland. Among the 700,000 Scottish households who will be negatively affected by the changes, losses will average £730 per year.
- Planned UK government income tax cuts will reduce tax revenues in Scotland by £600 million a year by 2020/21 if matched in Scotland, comprising £300 million lost due to an increase in the personal allowance, over which the Scottish government will have no control, and a further £300 million lost if Scotland matches UK government increases in the higher rate threshold. If operating as intended, the fiscal framework should insulate the Scottish budget from reductions in tax revenue from reserved decisions (such as increased personal allowance).
- If implemented in full in Scotland, these tax cuts would benefit Scottish households, but the biggest winners will be those at the top of the earnings distribution, who will on average gain £590 a year.
- Devolved spending will be reduced further over the coming years as a result of UK-wide spending decisions. The Scottish block grant, under current arrangements, is expected to see reductions in total departmental spending of 4.2 per cent, or £1.2 billion, in real terms between 2015/16 and 2019/20.
- The projected reduction in Scotland's working-age population could see a £300 million decrease in Scottish tax revenues when compared to projected working-age population growth across the UK as a whole. The fiscal framework, agreed through to 2022, should insulate the Scottish budget from changes in population, if it operates as intended.

OPTIONS FOR THE SCOTTISH PARLIAMENT

Given these pressures on Scotland's public finances and households, how could the Scottish parliament's new powers (and some existing powers) over taxes and benefits be used to:

- reduce or eliminate the impact of cuts to the Scottish parliament's block grant?
- mitigate or reverse cuts to benefits in Scotland?
- reshape Scotland's tax system?

The fiscal effects of using the Scottish parliament's powers are as follows.

- **Varying the basic rate alone** (a 1p change) would see revenue grow/fall by £400 million by 2020/21. **Varying the higher rate alone** would see revenue grow/fall by £100 million (an increase of 1p in the higher rate) per year in 2020/21. **Varying the basic, higher and additional rates of tax** by 1p in the pound would see revenue grow/fall by £500 million annually by 2020/21.
- **Freezing the higher rate threshold** in cash terms would raise revenue by £300 million per year by 2020/21. **Increasing the higher rate threshold** by CPI inflation would raise £100 million by 2020/21, relative to a business-as-usual case of inflation-indexation of the basic rate limit.
- **Increasing taxes on the highest earners** by reducing the additional rate threshold in Scotland from £150,000 per year, would raise around £8.5 million per year for a £10,000 reduction.
- **Increasing the current rates of council tax** could increase revenues to Scottish local government by £100 million (if increased in line with inflation – a real-terms freeze) or £200 million (if increased in line with average earnings) per year in 2020/21, relative to continuing the Scotland council tax cash-terms freeze.

- **Reversing the planned UK government cuts to universal credit work allowances** would cost the Scottish government £200 million by 2020/21, increasing the incomes of 200,000 claimant households by an average of £990 a year.
- **Reversing the planned UK government freeze to working-age benefits** would cost the Scottish government £200 million by 2020/21, increasing the incomes of 900,000 claimant families by an average of £230 a year.
- **Increasing disability benefits in line with earnings** would increase the disposable income of households claiming these benefits by an average of £490 per year at a cost of £100 million per year by 2020/21.

KEY CHALLENGES

After the parliamentary elections in May, the next Scottish parliament will face six key challenges:

- **Challenge 1:** What, if anything, should the Scottish parliament do to reverse UK-wide benefit cuts in Scotland?
- **Challenge 2:** Given UK government plans to increase the higher rate income tax threshold to £50,000, at what level should the higher- and additional-rate thresholds be set for higher earning Scottish taxpayers?
- **Challenge 3:** What should the Scottish parliament do to boost earnings in Scotland, at least in line with UK-wide earnings increases?
- **Challenge 4:** What should the Scottish parliament do to grow the working-age population in Scotland, at least in line with growth in the rest of the UK?
- **Challenge 5:** What, if anything, should the Scottish parliament do to reverse public spending cuts affecting Scotland over the coming years?
- **Challenge 6:** How, if at all, should the Scottish parliament radically reform the income tax system in Scotland over the coming years?

For the full report, including all references, data sources and notes on methodology, see: www.ippr.org/publications/new-powers-new-scotland

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