

Options for increasing taxes in Scotland to fund investment in public services

A report by Howard Reed, Landman Economics, commissioned by the STUC

December 2022

Acknowledgements

I would like to thank participants in a virtual seminar in October 2022 for comments on feedback on the initial research and recommendations from this research, and in particular to David Byrne, David Eiser, Mike Danson, Francis Stuart and Linda Somerville for detailed comments on an earlier draft version of this report.

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1. Introduction and Background

Landman Economics has been commissioned by the Scottish Trades Union Congress (STUC) to produce a report exploring the options for increasing taxes in Scotland to fund investment in public services and public sector pay.

At the time of writing (November 2022), the most recent statistic for the annual increase in inflation is 11.1% (Consumer Prices Index) and 14.2% (Retail Prices Index)¹. However, nominal wages in Scotland are rising by far less than this. The overall rate of pay growth in Scotland in September 2022 was just under 6 per cent². The situation for public sector workers in Scotland is even worse than this, with annual wage growth being less than 4 per cent in the year to September 2022³. Thus, wages in the Scottish economy – and particularly the public sector – are falling at an unprecedented rate, and this is occurring after more than a decade of pay restraint due to austerity.

Unsurprisingly, workers across Scotland are agitating for pay rises to at least keep pace with inflation. Nowhere is this more evident than in the public sector, where disputes have arisen in local government, education, the NHS and elsewhere⁴.

The 2023/24 Scottish Budget, which is due to be delivered in December 2022, and subsequent tax and spending policies, provide an opportunity to deliver real-terms public sector pay rises, which would not only inflation-proof incomes for a significant section of Scotland's workforce, but could have knock-on benefits for pay in the private sector as well as stimulating bottom-up economic growth among a low-paid, predominantly female workforce who spend money and pay taxes locally.

However, public sector pay rises – and investment in public services more generally – will need to be funded by additional revenue, raised through the Scottish Government's tax-raising powers.

Given that many corporations and individuals are benefiting from price rises, increased profits and asset and rent inflation, these tax powers could also help address economic inequality in Scotland.

The structure of this report is as follows. Chapter 2 presents estimates for the size of the total public sector wage bill in Scotland and the cost of increasing public sector

¹ Source: ONS Consumer Price Inflation statistics, October 2022
<https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/october2022>

² Source: Earnings and employment from Pay As You Earn Real Time Information, UK: August 2022.
<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/dataset/s/realtimeinformationstatisticsreferencetableseasonallyadjusted>

³ Source: Earnings and employment from Pay As You Earn Real Time Information, UK: August 2022 (annual growth of around 1.7 per cent for education and 3.7 per cent for health).

⁴ For example: "Scottish ambulance staff set date for industrial action", BBC News Scotland, 12 November 2022 <https://www.bbc.co.uk/news/uk-scotland-63601912>; "Scottish Government 'trying to shift blame' on public sector pay amid strike threat", *The Scotsman*, 1 August 2022.
<https://www.scotsman.com/news/politics/scottish-government-trying-to-shift-blame-on-public-sector-pay-amid-strike-threat-3788503>

pay – both in gross terms and in net terms after taking into account increased income tax and National Insurance contributions from public sector workers, and reduced payments of in-work benefits. Chapters 3, 4 and 5 discuss the options for tax increases in detail, looking at income tax (Chapter 3), property and wealth taxes (Chapter 4) and other parts of the tax system (Chapter 5) respectively. Chapter 6 presents recommendations for a package of tax increases that would fund a real-terms pay increase for public sector workers in Scotland, featuring a mix of short-term recommendations, which could be implemented at the next Scottish Budget, and medium to longer-term recommendations. Chapter 7 discusses the economic impacts of a package across a range of metrics including distributional effects, potential macroeconomic spillovers, implications for the environment and impacts on the performance of public services in Scotland. Chapter 8 offers conclusions.

2. The cost of increasing public sector pay in Scotland

2.1 The public sector wage bill in Scotland

The Scottish Government's statistical publication *Public Sector Employment in Scotland*⁵ suggests that in June 2022 (the most recent month for which published statistics are available at the time of writing) there were 594,700 public sector workers in Scotland. The Annual Survey of Hours and Earnings (ASHE) – a large-scale survey of earnings across all countries and regions of the UK – is the best source for data on earnings broken down by public and private sector in Scotland. Data for ASHE Table 25⁶ (which provides a breakdown of number of employees and pay levels by country and sector) shows an average (mean) annual salary of £30,933 in the public sector in Scotland. Multiplying these two estimates and uprating the resulting figure by 3 per cent to take account of public sector pay growth during 2022 gives an estimate for the total public sector pay bill in Scotland in 2022 of approximately **£18.95 billion**. In addition to this, I estimate that the Scottish government pays £1.91bn in employer National Insurance contributions (NICs) and £3.41 billion in employer pension contributions for public sector workers, summing to a total gross cost of employment of **£24.27 billion**.

2.2 The cost of increasing public sector pay

Table 2.1 uses the estimates from ASHE to present estimates for four scenarios for the cost of increases in public sector pay in Scotland, ranging from a 5 per cent increase to a 20 per cent increase.

Table 2.1. Estimated cost of increasing public sector pay in Scotland: four scenarios, from a 5 per cent to a 20 per cent increase

Pay increase	Costs (£m)			
	5%	10%	15%	20%
Gross cost to Scottish Government (including employer NICs and employer pension contributions)	1,214	2,427	3,641	4,854
<i>Increased revenues accruing to Scottish Government:</i>				
Increased income tax receipts	286	582	888	1,203
Net cost to Scottish Government	927	1,845	2,753	3,652

⁵ <https://www.gov.scot/publications/public-sector-employment-scotland-statistics-2nd-quarter-2022/pages/2/#:~:text=In%20June%202022%2C%20there%20were,more%20than%20in%20June%202021>

⁶ <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/dataset/s/earningsandhoursworkedallemployeesashtable25>

Net cost to SG as percentage of gross cost	76.4%	76.0%	75.6%	75.2%
<i>Increased revenues accruing to UK Government:</i>				
Increased NICs receipts	213	422	626	826
Reduced Universal Credit expenditure	13	26	39	50
Overall net cost to public finances	701	1,3970	2,088	2,776
Overall net cost as percentage of gross cost	57.8%	57.6%	57.3%	57.2%

Source: Landman Economics calculations using Tax-Transfer Model running on combined 2019/20 and 2020/21 Scotland Family Resources Survey data

The gross cost to the Scottish Government of increasing public sector pay is the overall public sector wage bill (plus employer NICs and employer pension contributions) multiplied by the relevant level of pay increase. However, increases in the gross earnings of public sector workers will result in additional payments of income tax and National Insurance contributions, as well as reduced payments of Universal Credit (and other means-tested legacy benefits and tax credits). The increased income tax payments accrue to the Scottish Government, meaning that the net cost of increasing public sector pay is only approximately three-quarters of the gross cost. For example, for a 10% increase in public sector pay, the gross cost to the Scottish Government is just over £2.4 billion, but the net cost is around £1.85 billion.

The increased payments in National Insurance Contributions⁷ and the reduction in Universal Credit payments accrue to the UK (Westminster) Government, as shown in the bottom four rows on Table 2.1. To calculate the net cost of increasing public sector pay, the Landman Economics tax-transfer model (running on data from the Scottish component of the UK Family Resources Survey) was used to estimate the increase in income tax and National Insurance Contributions payments, and the reduction in Universal Credit (and other legacy benefit or tax credit) receipts, for public sector workers at each level of pay increase.

Overall, the net cost of a pay increase to the Scottish Government ranges from just over £900 million in the case of a 5 per cent pay increase, to £3.65 bn in the case of a 20 per cent increase. These additional costs should be seen in the context of total Scottish Government resource spending of £39.2 billion in the 2022/23 tax year (Scottish Government, 2021). However, just over 40 per cent of this increase is returned to the public finances through increased income tax receipts which accrue to the Scottish Government, and through NICs receipts and reduced Universal Credit expenditure, which accrue to the UK Government.

⁷ Note that employer NICs are a cost to the Scottish Government, but are paid to the UK Government (via HMRC).

3 Options for tax increases: Income Tax

This chapter discusses the distributional effects of potential increases in income tax. This project models a range of reforms to income tax rates and thresholds, including reductions in the higher rate and top rate thresholds, a nominal freeze in the intermediate rate threshold, and the introduction of a new tax band in between the current higher rate and top rate bands, as well as increasing the higher and top rates. Section 3.1 presents estimates of the revenue yield from these income tax increases, while Section 3.2 shows the distributional effects by household net income decile.

3.1 Estimated yield of the package of income tax reforms

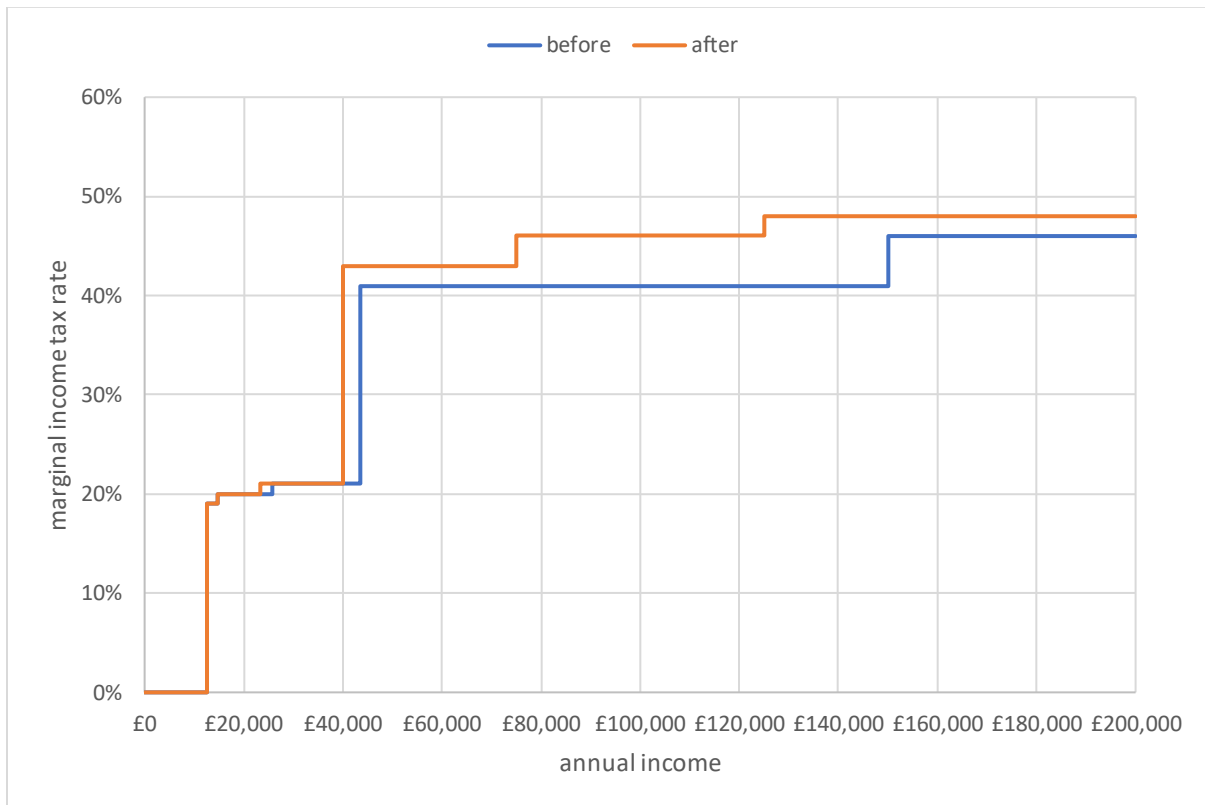
The proposed package of reforms to the income tax system has five components:

- a) Reducing the higher rate threshold (HRT) for income tax from its current value of £43,662 to £40,000.
- b) Reducing the top rate threshold (TRT) for income tax from its current value of £150,000 to £125,140. (This is in line with the reform to the additional income tax threshold in England announced by the UK Chancellor of the Exchequer in the November 2022 Autumn Statement).
- c) Introducing a new income tax band of 44% between the current higher rate and top rate thresholds (between £75,000 and £125,140 of taxable income).
- d) Freezing the intermediate rate threshold of £25,689 in nominal terms.
- e) Increasing the higher rate of income tax (and all rates above the higher rate) by 2 pence. This means that the higher rate becomes 43%, the new rate for income between £75,000 and the top rate threshold becomes 46% and the top rate becomes 48%.

Note that these tax rates only apply to earned income and other income which is not from savings and dividends. Savings income in Scotland is taxed at rates that are set at the UK level.

Figure 3.1 below shows the proposed marginal rate schedule for income tax after these reforms, compared to the existing (2022/23) Scottish income tax marginal schedule. For easy comparison, the reforms are modelled as if they had been introduced at the start of the current tax year (i.e. April 2022). The proposed reforms do not affect any Scottish taxpayer with income below £23,350, and most of the increase in marginal rates affects only taxpayers with incomes (excluding savings and dividend income) of above £40,000.

Figure 3.1. Marginal rate schedule before and after proposed reforms, using 2022/23 baseline



Source: author's calculations

Table 3.1 shows the estimated additional revenue arising from the proposed package of reforms to income tax, broken down by component. The estimates are produced using the Landman Economics tax-transfer model, with revenue yield forecasts from the Scottish government for changes to higher and top rate income tax (Scottish Government, 2022b) used to calibrate the model results to make them consistent with official estimates.

Table 3.1. Estimated additional annual revenue from increases to income tax

Reform	Additional revenue (£m)
Reduce higher rate threshold to £40,000	387
Reduce top rate threshold to £125,140	15
Introduce 44% band for incomes between £75,000 and £125,140	200
Freeze intermediate rate threshold in nominal terms	35
2p increase in higher rate and all rates above higher rate (i.e. all income above £40,000)	230
Total	867

Source: estimates from modelling using Landman Economics tax-transfer model, calibrated to estimates from Scottish Government (2022b).

Table 3.1 shows that the combined package of reforms raises just under £900 million annually. The largest revenue-raising measures are the reduction in the higher rate threshold, the 2p increase for all incomes above £40,000 and the introduction of a 44% income tax band for incomes between £75,000 and £125,140.

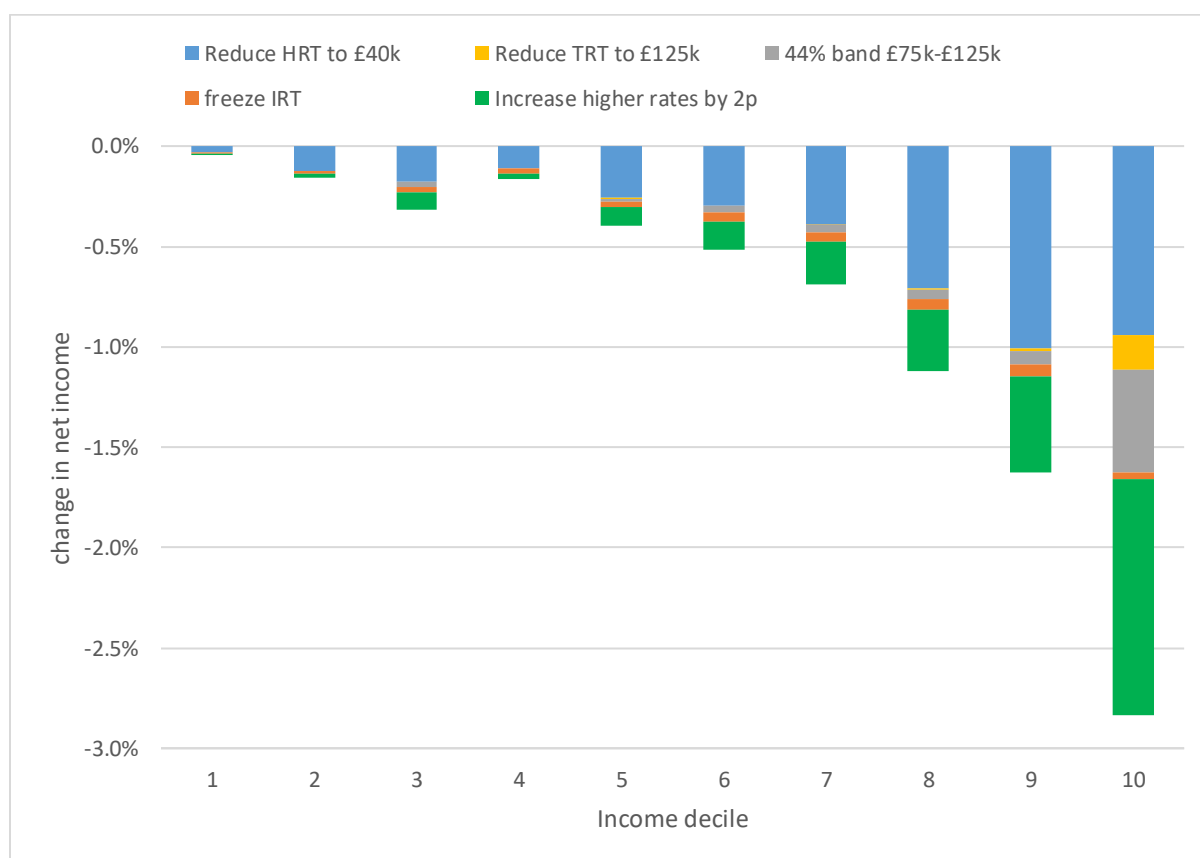
It should be noted that the revenue yield from reducing the top rate threshold to £125,140 is relatively low, at £15 million. This is two reasons: first, the number of Scottish taxpayers with incomes above £125,140 is relatively low, and second, the assumptions that the Scottish Government uses on “taxable income elasticity (TIE)” – the extent to which taxable income adjusts in response to an increase in tax rates – are that top incomes are relatively sensitive to increases in tax rates, and hence increases in rates on top incomes will raise relatively little. To some extent, these pessimistic assumptions reflect the limits on the devolved Scottish Government’s powers to legislate on income tax within the UK. There are obvious loopholes in the existing system which reduce the yield on increases in top tax rates due to avoidance – for example, the fact that the top rate of capital gains tax (CGT) is much lower than income tax means that taxpayers who can relatively easily reclassify income as capital gains pay lower rates of tax. However, the Scottish Government does not have powers to set the rates of CGT paid in Scotland – this is done at a UK-wide level by the UK Government. Devolution of CGT, and alignment of CGT rates with income tax rates (as well as making savings and dividend income subject to Scottish tax rates) would tend to reduce taxable income elasticity and increase the yields from increases in marginal rates at the top end of the income distribution.

3.2 Distributional impacts of increases in income tax rates

Figure 3.2 shows the distributional impact of the package of reforms to income tax presented in Table 3.1. The Figure is a “stacked bar chart”; that is, the overall distributional impact of the tax package is shown by the stacked sum of all the bars. The horizontal axis of the Figure shows deciles of equivalised household income (from the poorest households in decile 1 to the richest households in decile 10). Changes in annual net income are shown in percentage terms on the vertical axis.

The package is very progressive overall across most of the income distribution, with the richest decile of households paying an average of just under 3 per cent of net income in increased income tax and the 9th decile paying just over 1.5%, while households in the middle of the distribution pay an average of around 0.4 to 0.5 per cent of net income and the poorest decile pay almost nothing extra. The distributional effects are slightly “lumpy” in decile 3 (which has a higher average tax payment than decile 4) but this is due to volatility in the results caused by the relatively small sample size of the pooled Scotland FRS sample. The most progressive components of the tax package are the reduction in the top rate threshold to £125,140 and the new 44% income tax band for incomes between £75,000 and the top rate threshold.

Figure 3.2. Distributional impacts of package of income tax reforms



Source: Landman Economics modelling using Tax-Transfer Model running on Scotland subsample of 2019/20 and 2020/21 Family Resources Survey data

3.3 Using income taxes to fund an increase in public sector pay and investment in public services

As a source of tax revenues to fund an increase in public sector pay and investment in public services, the income tax system has the advantages that increases in tax rates above the higher rate threshold are distributionally progressive and administratively easy to implement, with the necessary tax infrastructure already in place and the Scottish Government having clearly defined powers to implement these increases. The package of reforms shown in Table 3.1 and Figure 3.2, which includes reductions in thresholds and a new tax band between £75,000 and the top rate threshold, as well as increases in rates, results in almost £900 million per year which the Scottish Government can allocate towards investment in public sector pay and services.

4 Options for tax increases: Property and wealth taxes

This chapter looks at the scope for raising larger amounts of revenue using taxes based on assets rather than income – in particular taxes on property, wealth and land values.

4.1 Reforms to Council Tax

4.1.1 Progressive changes to the current Council Tax system

The Scottish Government's tax-setting powers include control over the organisation and parameters of the local tax system. Currently, the main domestic tax system at the local level in Scotland (as in England and Wales) is Council Tax, which has serious flaws. In particular, the system is regressive with households living in high-value houses paying far less as a proportion of their property wealth than households living in lower-value houses. Also, the bandings used for the Council Tax system in Scotland are still mainly based on house valuations from 1991, which are now over three decades out of date.

There are a number of changes to the Council Tax system that could be made immediately to make Council Tax more progressive without undertaking a fundamental reform of local taxation. These include:

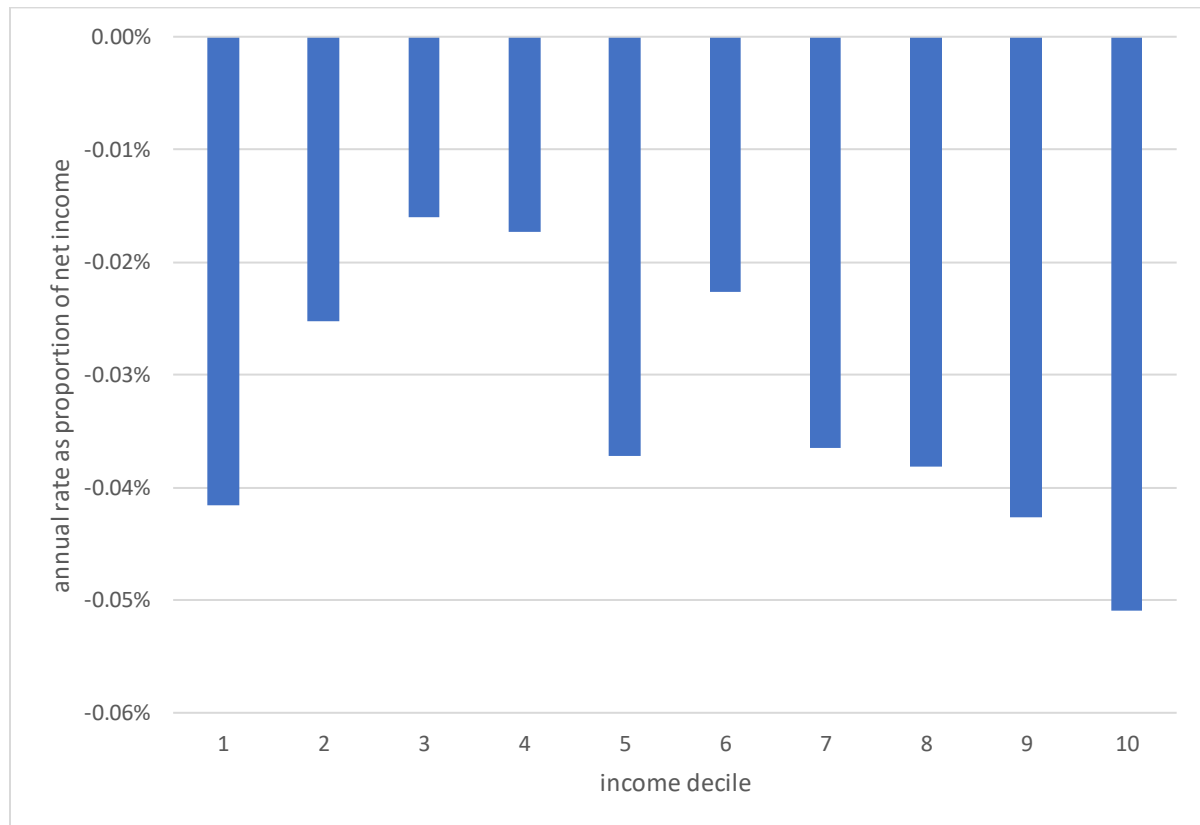
- Lowering the Council Tax reduction for purpose-built holiday homes from 50% to 25%.
- Lowering the Council Tax reduction range for second homes from between 10% and 50% to between zero and 15%.
- Adding further discretion to the empty homes surcharge – an additional 50% after two years of the property being empty and a further 50% after three years. This would allow for a maximum of 300% Council Tax on long-term empty properties.
- Increasing Council Tax for bands F, G and H. Calculations from IPPR Scotland (2021) suggest that an increase of just £100 per property for the most valuable 25% of properties in Scotland would net £69m. More could be raised from the 144,000 properties in Scotland with a median price of more than half a million.

Figure 4.1 below shows the projected distributional effect of increasing Council Tax payments for properties in bands F, G and H by household net income decile⁸. The impact is progressive across the top half of the income distribution but uneven across the bottom half, with (for example) the poorest decile and the 5th decile

⁸ The other reforms mentioned in this chapter are difficult to model using the available survey datasets as they affect relatively few households in Scotland.

paying more on average than the 2nd, 3rd or 4th deciles. An improved and better funded Council Tax Reduction scheme could also be used to make this increase more progressive.

Figure 4.1. Distributional impact of £100 per year increase in Council Tax for houses in bands F, G and H in Scotland, by household income decile



Source: Landman Economics calculations using Scotland component of Understanding Society Wave 11 dataset

4.1.2 Replacing Council Tax with a Proportional Property Tax

In response to the problems with the current Council Tax system, the campaigning group Fairer Share has proposed a more fundamental reform: replacing Council Tax with a Proportional Property Tax (PPT) where households pay a percentage of the value of the property each year (Fairer Share, 2020). The PPT reform was originally proposed for England, where Fairer Share estimated that a tax rate of 0.48% of house value per year for properties in England would raise the same amount as current Council Tax levels (with a double rate of 0.96% for second homes). As the structure of the Council Tax systems in England and Scotland is similar⁹, it is

⁹ There are some minor differences; for example, the band multipliers used in Scotland for Bands E, F, G and H are more progressive than the equivalent bands in England.

relatively straightforward to apply a similar distribution to England. For this project the replacement of Council Tax by a PPT in Scotland has been modelled.

4.1.3 Revenue yield of a PPT

Table 4.1 shows the revenues from the introduction of a PPT at various rates for the annual payment on a primary residence, ranging from 0.5% per year to 0.8% per year. The analysis makes the following additional assumptions¹⁰:

- Two-thirds of the PPT is passed through to tenants in the private rented sector and one-quarter is passed through to social tenants¹¹.
- In the private sector, buy-to-let landlords pay the remaining proportion of the PPT liability for private sector tenancies (one-third).
- Second homes pay a double rate of PPT.
- Households who are currently claiming Council Tax Reduction in the Understanding Society data do not lose out from the introduction of a PPT.

Table 4.1. Revenues from the replacement of Council Tax with a Proportional Property Tax

Annual percentage charge on property value	Average annual household bill (if introduced in 2022/23)	Yield (£m)	Additional revenue compared to Council Tax (£m)
0.5%	£1,084	2,787	-27
0.6%	£1,285	3,303	489
0.7%	£1,482	3,810	996
0.8%	£1,677	4,310	1,496

Source: Landman Economics analysis of Understanding Society Wave 11 and Wealth and Assets Survey Round 7 data.

4.1.2 Distributional impacts

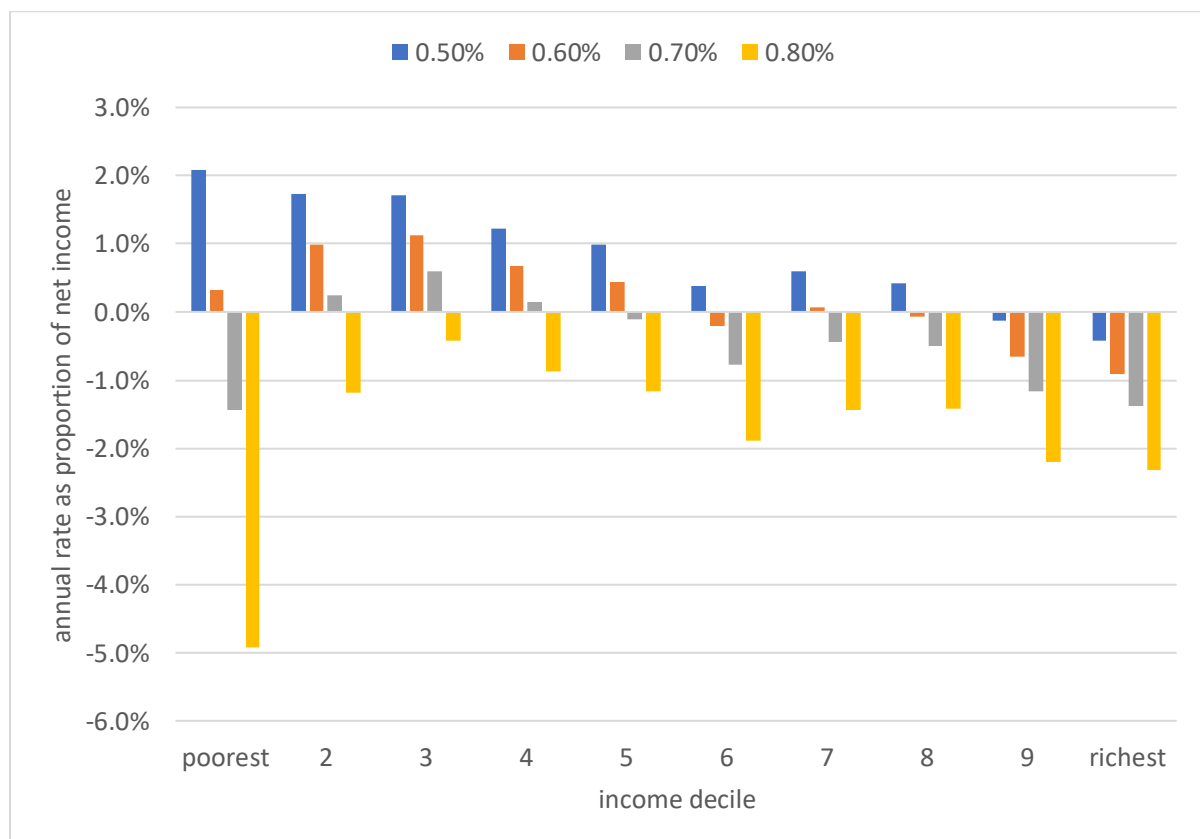
Figure 4.2 below shows the distributional effects of the Proportional Property Tax by income decile at the four rates shown in Table 4.1 above. When the PPT is set at 0.5%, the distributional effects are progressive across the household income

¹⁰ These assumptions are the same as those used by WPI Economics in its analysis of the revenue yield from a PPT (WPI Economics, 2021).

¹¹ Note that the Scottish Government recently committed to a rent freeze and are considering introducing rent controls by the end of the current parliament. A rent freeze would prevent PPT costs being passed to tenants and would tend to make the distributional results of a PPT more progressive than those shown in Figure 4.2 (because tenants have lower incomes on average than owner-occupiers).

distribution, with average gains in deciles 1 through 8, and average losses in deciles 9 and 10. Thus, a PPT set at 0.5% is an (approximately) revenue-neutral with progressive distributional impacts. If the PPT is set at 0.6% the results are still progressive across most of the distribution although the percentage gain in the bottom decile is lower than deciles 2 and 3. At rates of 0.7% per year the impacts in the bottom decile and deciles 6 through 10 are negative on average, while at 0.8% per year, the average impacts are negative across the whole distribution. These results suggest that while a PPT set at 0.6% can produce progressive distributional effects while raising revenue, setting a rate above this level point would require a more extensive replacement for the Council Tax Reduction scheme to compensate low-income households who lose out from the replacement of Council Tax by PPT.

Figure 4.2. Distributional effects of a Proportional Property Tax at four different rates, by household income decile



Source: Landman Economics calculations using Understanding Society Wave 11 and Wealth and Assets Survey Round 7 data.

4.1.3 Pros and cons of a Proportional Property Tax

Overall, replacing Council Tax with a Proportional Property Tax could raise just under £500 million to fund part of a pay rise for public sector workers in Scotland and additional investment in Scottish public services. In addition, the PPT would fix many of the most glaring drawbacks and inequities of the current Council Tax system, and has progressive impacts across most of the household income distribution. The main barrier to the immediate introduction of the PPT is that it requires updates to property valuations before being introduced (although there is a strong argument for updating the 1991 valuations anyway, even if Council Tax were to be retained). Based on the original timescale for Council Tax, which was introduced for the 1993/94 tax year following a valuation exercise in 1991, it seems reasonable that a PPT could be introduced in Scotland for the 2025/26 tax year using property valuations undertaken in 2023.

4.2 A wealth tax

In addition to replacing Council Tax with a more progressive local tax system (such as the Proportional Property Tax modelled above), the Scottish Government has the power to introduce a tax on wealth, provided this is implemented as part of the local tax system rather than a national tax.

4.2.1 Methodology

This report models the introduction of a tax on wealth in Scotland using data from the Scottish component of the UK Wealth and Assets Survey, which is a survey dataset collected on a biannual basis with high levels of detail on the assets owned by households in the survey. The definition of property wealth here includes:

- Net property wealth (including primary residences plus other domestic properties such as second homes or buy-to-let, but excluding commercial properties);
- Pension wealth;
- Net financial wealth (assets minus debts);
- Physical wealth (the value of household contents, possessions and valuables owned, such as antiques, artworks, collections and any vehicles owned by individuals).

The modelling assumes that wealth is taxed on a household, rather than an individual basis¹². In line with other recent research on wealth tax, we assume that a proportion of revenues from the wealth tax is avoided. Because property is immobile, the avoidance rate on property wealth tax is assumed to be low – we assume 10% avoidance. (Some of this may be due to a decline in property values after the introduction of the tax). We assume a higher rate of avoidance of 35% for pension, financial and physical wealth based on these assets being more mobile. This is consistent with recent modelling of the revenues from an annual wealth tax by Tippet *et al* (2021) who assume that avoidance reduces revenues by between 15% and 50%¹³.

The wealth tax modelled here would operate on an annual basis, rather than being a one-off tax as recommended by Advani *et al* (2020). This is because a key objective of the tax measures outlined in this report is to provide stable funding for public sector pay and additional investment in public services on an ongoing basis, and it

¹² This is the approach taken by Tippet *et al* (2021) in recent modelling work. The LSE Wealth Tax Commission (Advani *et al*, 2020) decided on an individual assessment basis for wealth in its recommendations but said that a household assessment unit was a credible alternative.

¹³ The 35% avoidance figure is chosen to take account of the risk that avoidance of the wealth tax might be higher if it were introduced for Scotland only, rather than on a UK-wide basis, because high-wealth individuals might move across the border into England to avoid the tax.

makes more sense to use a recurring annual tax than a one-off tax to achieve this objective.

4.2.2 Revenue yield

Table 4.2 presents estimates for the revenue yield from an annual wealth tax of 1% charged on total household wealth above four different threshold points, ranging from £1 million to £10 million. The results show that, once avoidance is taken into account, 12 per cent of households in Scotland have taxable wealth in excess of £1 million. At higher thresholds, far fewer households are affected; only just over 2 per cent of households have taxable wealth above £2 million, and only 0.1 per cent – one in a thousand – households have taxable wealth over £20 million. However, the yield from a 1% annual wealth tax does not fall off anywhere near as rapidly as the decrease in the number of households affected at higher thresholds. For example, the yield from a 1% tax above a £10m threshold is more than one-fifth of the yield from a 1% tax above a £2m threshold, despite the fact that less than one-twentieth of the number of households are affected at a £10m threshold compared to a £2m threshold. This result is driven by the existence of a small number of very high-wealth households in Scotland. In fact, the revenue yield results presented here probably understate the revenue available from very high wealth households because response rates for the WAS are low for these households and so they are under-represented in the data¹⁴.

Table 4.2. Estimated yields from a 1% tax on wealth in Scotland above various threshold points

Wealth Threshold	Percentage of households affected	Total value of taxable wealth above threshold (£bn)	Illustrative yield of 1% annual wealth tax above threshold, £m	Average annual payment per affected household (£)
£1m	12.0%	128.3	1,283	7,925
£2m	2.2%	55.0	550	18,456
£5m	0.4%	23.4	234	40,999
£10m	0.1%	11.5	115	74,176

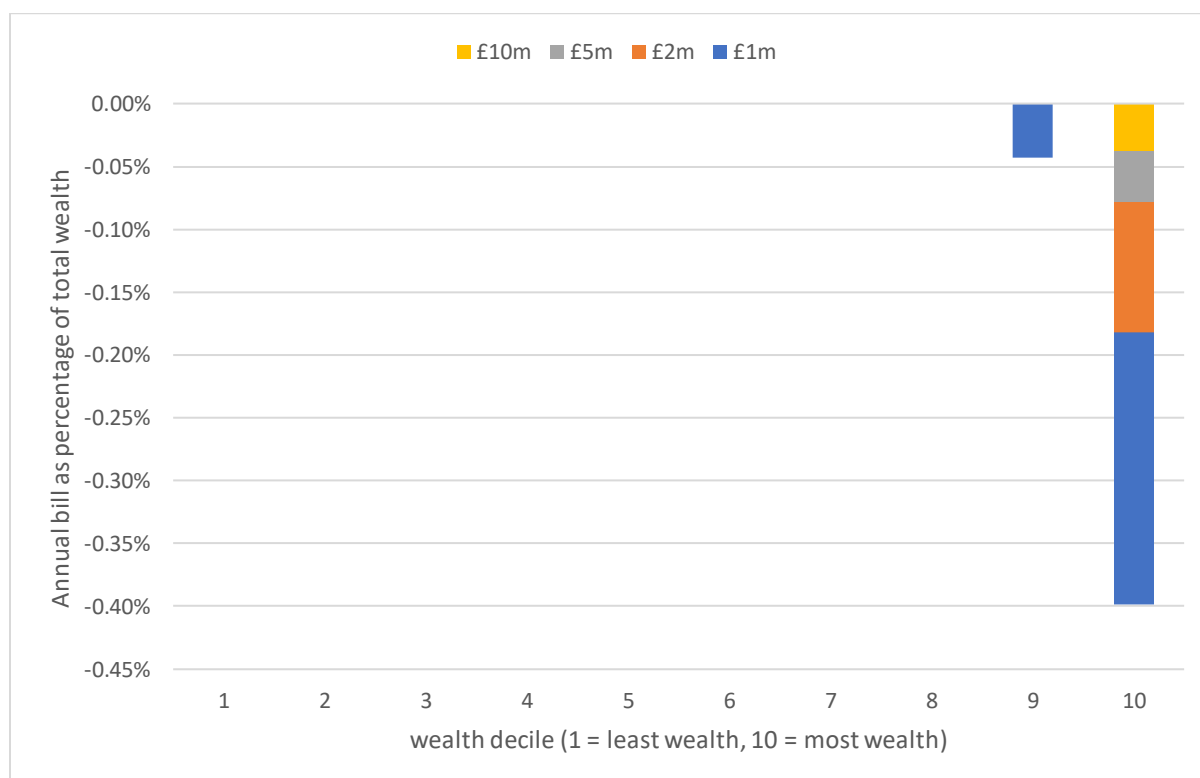
Source: Landman Economics estimates using Scotland subsample of Wealth and Assets Survey Round 7 data. Avoidance rate assumed to be 10% for property wealth, 35% for other forms of wealth.

¹⁴ This under-representation is despite the fact that the ONS uses data from HMRC to identify households with extremely high wealth and they are over-sampled in the survey data. The survey weights in the Wealth and Assets Survey are designed to correct for the under-representation of very wealthy households, as far as is technically possible. See ONS (2022) for more details.

4.2.3 Distributional impacts

The distributional impacts of a wealth tax at a rate of 1% above each of the four threshold points by household net wealth decile are shown in Figure 4.2 below. The wealth tax impacts in Figure 4.2 are stacked bars showing cumulative impact above each threshold value – so the impact of a £1m threshold is equal to the sum of all the bars, whereas the impact of a £2m threshold is all the bars except blue, the £5m threshold is the grey bar plus the yellow bar and the £10m threshold is just the yellow bar. By definition, the impact of the wealth tax by wealth decile is strongly progressive (because the household deciles are defined in terms of wealth). A 1% wealth tax levied above a threshold of £1 million has the vast majority of its impact on households in the top wealth decile, and above the £2 million, £5 million and £10 million thresholds the entire impact is in the top decile.

Figure 4.2. Distributional impact of 1% wealth tax above four different threshold points, by household wealth decile

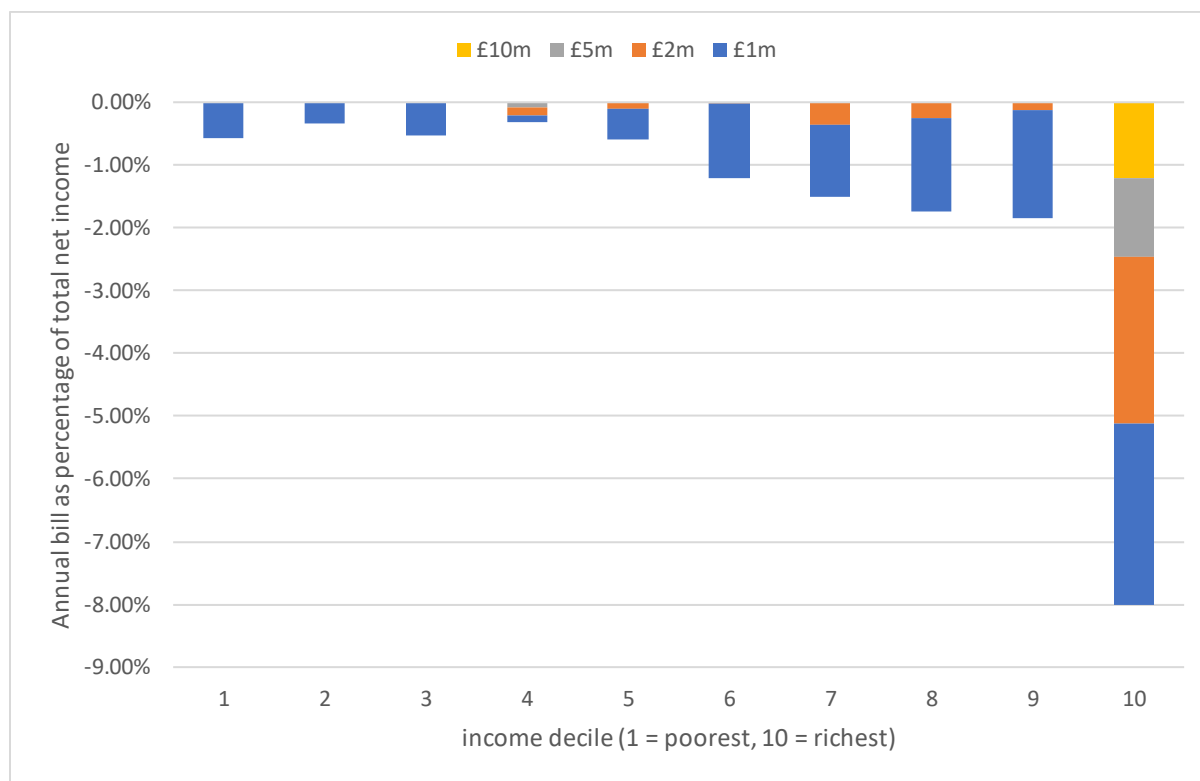


Source: Landman Economics calculations using Wealth and Assets Survey Round 7 data.

Figure 4.3 shows the impact of the 1% wealth tax above each threshold by *income* decile rather than wealth decile, as a percentage of income rather than wealth. This chart shows that the wealth tax is progressive when measured according to income as well as wealth, at least when the average payment by the top decile (as a percentage of net income) is compared to the average payment by lower deciles).

Below the top decile the distributional effects are somewhat volatile, above the £2 million threshold in particular.

Figure 4.3. Distributional impact of wealth tax by household income decile



Source: Landman Economics calculations using Wealth and Assets Survey Round 7 data.

4.2.4 Pros and cons of a wealth tax

The wealth tax has the advantage of good revenue raising potential and being progressive with respect to both wealth and incomes. The main drawback is that it requires updated valuations of property and also valuations of other forms of wealth (including pension funds and physical wealth). The LSE Wealth Tax Commission (2020) estimated that the administration costs of a wealth tax would be equal to a maximum of 1 per cent of the total revenue raised by the tax, and this report uses that assumption in Chapter 6 where the recommended package of tax measures includes a wealth tax. There is also the technical difficulty of estimating the yield for a wealth tax given the uncertainties regarding the level of avoidance and the low response rate for super-wealthy households in the Wealth and Assets Survey.

The requirement for a new administrative system for valuing wealth means that there would be an inevitable delay before a wealth tax could be introduced in Scotland. A timeline from initial proposals in early 2023 to introduction in the 2026/27 tax year seems reasonable.

4.3 Land Value Tax

A land value tax (LVT) is a type of asset-based taxation that has received a lot of attention in Scotland recently¹⁵. Rather than a tax on property values, a LVT taxes the value of land (excluding buildings or other improvements to the land. Land values vary according to location and permitted use of the land (e.g. residential, commercial, agricultural).

The precise yield and distributional effects of a LVT in Scotland cannot be estimated without more research to impute land values for residential (and indeed commercial) land. Therefore, this report does not present revenue yield estimates or distributional results for an LVT. However, the distributional effects of replacing the current Council Tax system with a tax on residential land values are likely to look fairly similar to the distributional effects of the Proportional Property Tax modelled in Section 4.1, if the LVT is levied as an annual percentage of land values. If the LVT is levied as a percentage of land values *above a threshold* (i.e. with an exemption for households below a certain value of land), then the effects are likely to look more similar to the progressive wealth tax shown in Section 4.2 above.

LVT has the advantage of being a relatively efficient tax in economic terms because it taxes the locational rents arising from the location of land (and its designated purpose under the current planning system) rather than taxing improvements to land. It has good revenue-raising potential, and is likely to look progressive with respect to incomes and wealth (if the impacts look anything like the property and wealth taxes modelled earlier in this chapter. It could supplement (or replace) current domestic property taxation, and could also apply to land used for business purposes (thus supplementing or replacing current business taxation).

A pre-requisite for the introduction of a LVT is that it requires valuation of all land in Scotland (or at least all land used for domestic purposes, if the tax were for domestic land only), as well as a complete register of all land in Scotland (the current Scottish land registry is not a fully complete record of all land ownership in Scotland, although considerable progress has been made towards completion in recent years)¹⁶. As with the wealth tax discussed above, LVT presents technical implementation challenges which mean that the earliest it could be introduced in Scotland would probably be the 2026/27 tax year.

¹⁵ See for example Scottish Land Commission (2018, 2022); Wightman (2009)

¹⁶ See Registers of Scotland, "Delivering the benefits of a complete land register", October 2022. <https://www.ros.gov.uk/performance/land-register-completion>

5 Other potential revenue sources

This chapter looks at other potential sources for raising revenues to fund an increase in public sector pay and investment in public services more widely.

Section 5.1 assesses the potential for increases paid by businesses and the non-domestic sector, while Section 5.2 looks at property and land taxes (in addition to those already considered in Chapter 4) and Section 5.3 looks at consumption-based taxes. Section 5.4 assesses the potential to use existing local government reserves to fund increased expenditure, particularly in the short run to allow time for the introduction of longer-term tax raising measures.

5.1 Increased tax revenue from businesses and the non-domestic sector

5.1.1 Reducing or getting rid of current exemptions for Non-Domestic Rates

Non Domestic Rates (NDRs) are the main form of local business taxation in Scotland. Current NDR statistics (Scottish Government 2022c) show that total discretionary reliefs for NDRs for 2022-23 were £713m. A breakdown of NDR reliefs for 2019-20 (the most recent year before the onset of the Covid-19 pandemic, which temporarily expanded the amount and types of relief available)¹⁷ shows that the largest single component of NDR reliefs was the Small Business Bonus Scheme (SBBS). This scheme offers businesses 100% relief from non-domestic rates if the cumulative rateable value of all properties in their business is at most £15,000. If their cumulative rateable value is between £15,001 and £35,000, the business receives 25% relief on any property with a rateable value of £18,000 or less.

Earlier this year the Scottish Government published the results from an evaluation of the SBBS by the Fraser of Allander Institute (which the Government had commissioned in response to a recommendation from the Barclay Review of the non domestic rates system in 2017). The evaluation (Scottish Government, 2022d) used an econometric analysis to determine the impact of the SBSS on business outcomes. The main finding was that there is “no empirical evidence that identifies the SBBS as supporting enhanced business outcomes... in terms of turnover, employment, or gross value added” (Scottish Government, 2022d). This does not necessarily mean that the scheme is a failure, rather that its impact is inconclusive given the available data on Scottish small business performance. Given that expenditure on the SBBS (in real terms at 2020 prices) grew from £93 million in 2008 to £279 million in 2020, it seems reasonable to suggest that replacing or reforming the SBBS to target a smaller number of businesses most likely to support positive economic development might deliver better outcomes. For example, reducing the

¹⁷ See Scottish Government (2019).

cost of the scheme by 25% would save around £70 million. However, research by academics at Heriot-Watt University (Galloway and Danson, 2016) shows that there is a high incidence of poverty among small business owners in Scotland, with self-employment used as an alternative to unemployment, and to mitigate or avoid sanctions in the Universal Credit system. Reducing the scope of the SBBS could lead to increases in poverty and hardship among small business owners. To safeguard against this, any reform should preserve eligibility to SBBS for businesses with taxable income below a certain threshold (for example, the equivalent 35 hours per week at National Living Wage rates – currently £332.50 per week) to avoid exacerbating poverty and deprivation¹⁸.

Specific savings that could be made to the current NDRs system include:

- Reducing various NDR reliefs such as the Enterprise Area or Business Growth Accelerator reliefs.
- Introducing new reliefs based on Fair Work and Net Zero conditions.
- Revisiting the Public Health Supplement which was in force from 2012 to 2015 – a levy on large retailers selling alcohol and tobacco.
- Incrementally reducing reliefs for empty industrial ground.

5.1.2 Landfill Tax

Scottish Landfill Tax currently raises around £125m and is devolved to the Scottish Parliament. The rate it is levied at has remained at the UK level but it could be raised by the Scottish Government – for example, a 30% increase would raise approximately £35m.

5.1.3 Scottish Aggregates Levy

The Scotland Act 2016 provides the Scottish Parliament with the power to introduce a devolved tax on the commercial exploitation of aggregates in Scotland, to replace the UK Aggregates Levy. The Scottish share of the UK aggregates levy is £60 million and a new Scottish Aggregates Levy, at higher rates compared to the UK, could be applied to raise more revenue.

¹⁸ It should be noted that many of the low-income self-employed in Scotland are not eligible for SBBS as things stand, because they do not operate their businesses from commercial properties (but rather, from domestic residences, which do not pay NDRs in most cases).

5.2 Property and land taxes

5.2.1 Land and Buildings Transaction Tax (LBBT)

The current combined revenue from both residential and non-residential LBBT is around £800m (Revenue Scotland, 2022). This is a relatively small tax take given that the value of the residential sales market alone was £22.2 billion in 2021-22 (Registers of Scotland, 2022). Options to raise more money from LBBT include:

- Splitting the £750,000+ residential property band into two, covering £750,000-£1 million and £1 million+
- Increasing the £325,000-£750,000 residential rate from 10% to 12%
- Splitting the £250,000+ non-residential band into two, covering £250,000-£500,000 at 5% and £500,000+ at 10%
- Introducing a 15% surcharge for overseas entities/non-UK residents buying property, similar to what is applied to Stamp Duty in England (currently at 5%).

5.2.2 Additional Dwelling Supplement (ADS)

ADS is LBBT charged on second or third buy-to-let homes. It is currently levied at a rate of 4%. The Scottish Government is currently looking at the future of ADS but it was not increased in the 2021 Budget. UNISON Scotland estimate that increasing ADS by 2% would raise an extra £56 million (UNISON Scotland, 2022). Further increases above this rate – for example doubling the rate to 8% – could also be considered.

5.2.3 A Land Value Tax for commercial land

A Land Value Tax for domestic properties has already been discussed as a policy option in Section 4.3 of this report. By extending LVT to commercial land, it would be possible to supplement or replace the current Non Domestic Rates system with LVT. The current total forecast yield of NDRs for the 2022/23 tax year is £2.83bn (Scottish Government, 2022c). By replacing this with a LVT with a slight extra yield (say, between 3 and 5 per cent of the total yield) it would be possible to deliver additional funding for public sector pay, *and* enhance the efficiency of the business tax system.

5.2.4 Carbon Emissions Land Tax

The John Muir trust has published initial proposals to introduce a local carbon emissions land tax on landholdings exceeding 1,000 hectares in the upcoming Land Reform Bill (John Muir Trust, 2022). They estimate that a notional average tax of £3 per hectare could raise up to £15m per year.

5.3 Consumption taxes

5.3.1 Tourist Tax/ Local Visitor Levy

The Scottish Government has a commitment to introduce a tourist tax or local visitor levy in its 2022-23 programme for government. While this is aimed at enabling Local Authorities to levy the tax, it could be expanded to include National Parks. While the Scotland-wide revenue yield from a local visitor levy would depend on how many local authorities implement the scheme, there have been some estimates of revenue raising potential at the local level. For example, the City of Edinburgh Council has estimated that a tourist tax in Edinburgh could raise £15 million per year (City of Edinburgh Council, 2022).

5.3.2 A Frequent Flyer Levy

Air Departure Tax was devolved to the Scottish Government in 2016 but is not yet in operation because the Scottish Government cannot reach an agreement with the UK Government how to stop Highlands and Islands airports being impacted.

There were 28.9 million air terminal passengers in Scotland in 2019 and only 5% of these travelled to or from other Scottish airports. The vast bulk of passengers go from Glasgow (GLA) or Edinburgh (EDI).

With an exemptive or no detriment policy for the Highlands and Islands, a progressive extension of this tax, such as a frequent flyer levy or fixed penalties for airlines that fail to adopt time-sensitive plans for transition to green fuel sources, could increase revenue while helping meet net zero targets.

5.4 Using local government reserves to fund pay increases

Analysis of Scottish Local Government Finance Statistics (SLGFS) for 2020-21 shows as of March 2021, local government in Scotland held around £3.2 billion of total revenue reserves¹⁹. While it would not be sustainable to use accumulated reserves to fund increases in public sector pay on an ongoing and permanent basis, it would be possible to use the reserve as a stopgap measure to fund an immediate increase in pay for public sector workers while giving time to put administrative and legislative measures in place to introduce new taxes (such as wealth taxes and LVT).

¹⁹ See Scottish Government (2022e). Local Government also held just under £700 million of capital reserves in March 2021 but it is assumed that capital reserves cannot be used to fund public sector pay (which is current spending).

6 Designing a package of tax increases

This chapter outlines a proposed package of tax increases to fund an increase in public sector pay, and investment in public services, in Scotland. The reforms are divided into short-term reforms (which involve changes to rates and thresholds of existing taxes and could be implemented at the next Budget with the increases taking effect in April 2023) and longer term reforms (which require more substantial changes to the tax system such as revaluation of properties, or the setting up of new tax collecting apparatus). The full longer-term package of tax reforms could be in place by April 2026 if implementation of the reforms started in 2023.

6.1 Short term reforms

The short term reforms comprise the following:

- i) **Changes to income tax:** the package of reforms outlined in Chapter 3.
- ii) **Increasing Council Tax for properties in bands F, G and H** by £100 per year, as discussed in Section 4.1.1
- iii) **Increases to Land and Buildings Transactions Tax** along the lines specified in Section 5.2.1. The target for increased LBTT revenue suggested here is £240 million, which would be a 30% increase in revenue yields from current levels.
- iv) **An increase in Additional Dwelling Supplement** from its current level of 4% to 8%.
- v) **Increasing Scottish Landfill Tax** by 30 per cent.

Table 6.1 shows estimates of the revenue yield from the short-run reforms (at 2022/23 prices). The overall amount raised by the short term package is just over £1.3 billion. If the whole of the additional revenues were used to fund an increase in public sector pay, this would fund an increase of around 7 per cent for public sector employees.

Table 6.1. Estimated revenue raised from short-term package of reforms

Reform	Revenue
Income tax reforms	867
Council Tax: increase band F,G,H by £100	69
LBBT increases	240
ADS: increase by 4%	112
Scottish Landfill Tax: increase by 30%	35
Total revenue raised per year (£m)	1,323

Source: income tax reforms – as in Chapter 3. Council tax increase: as in Section 4.1. Other taxes: author’s calculations based on Chapter 5

6.2 Longer term reforms

The longer-term package of reforms comprises the following:

- i) A progressive **annual wealth tax** on household assets above £1 million at the following rates:
 - £1 million - £2 million: 0.5%
 - £2 million - £5 million: 1%
 - £5 million and above: 2%

This tax would operate through the local tax system²⁰.

- ii) **Replacing Council Tax with a Proportional Property Tax at a rate of 0.6% for primary residences and 1.2% for second homes.** 10% of the revenues from the tax (approximately £50m in 2022/23) should be used to fund an enhanced rebate/reduction scheme for low-income households, to ensure that no low-income households lose out from the switch to PPT.
- iii) **Reducing expenditure on the Small Business Bonus Scheme by 25%,** from its current level of £280m to £210m to produce a better-targeted, more efficient scheme while ensuring that the poorest small business owners do not lose out.
- iv) **Replacing or supplement Non Domestic Rates in Scotland with a Land Value Tax on commercial land** which raises a small amount of extra revenue (£100m, or around 3 per cent) compared to current revenue yields.
- v) **Increasing the Scottish Aggregates Levy** by 30 per cent.
- vi) introduce a **local carbon emissions land tax** on landholdings exceeding 1,000 hectares, at £3 per hectare (as outlined in Section 5.2.4. above).

²⁰ Calculations for revenue yield assume that the administrative cost of collecting the tax is equal to 1% of total revenues.

Table 6.2 shows estimates of the revenue yield from the longer term reforms (at 2022/23 prices). The overall amount raised by the longer-term tax reforms is just over £2.0 billion. When combined with the short-term measures discussed in Section 6.1 above (except for the increase in Council Tax, which is superseded by the PPT) the full package of short-term and long-term reforms raises just over £3.3 billion in 2022/23 prices. Based on the net cost to the Scottish Government of different levels of public sector pay increases in Table 2.1, this would fund a pay increase of around 18% for Scottish public sector workers. Alternatively, the package could fund a smaller increase in pay combined with additional investment in Scotland’s public services.

Table 6.2. Estimated revenue raised from longer-term package of reforms

Reform	Revenue
Wealth tax: 0.5% per year on assets £1-£2m, 1% on assets £2-£5m, 2% on £5m plus	1,426
PPT at 0.6% of property values	450
SBBS reform	70
LVT on commercial property	100
Carbon emissions land tax	15
Increase Aggregates Levy by 30%	18
Total revenue raised per year (£m)	2,079
Total revenue raised per year: short-term and long-term packages combined	3,333

Note: Revenue estimate from short-term and long-term packages combined excludes Council Tax increase in short-term package (as Council Tax is superseded by PPT in the long-term), but includes all other short-term measures.

Sources: Wealth Tax: as in Section 4.2. PPT: as in Section 4.1. Other taxes as specified in Chapter 5.

7 Impacts of the increase in public sector pay and associated tax package

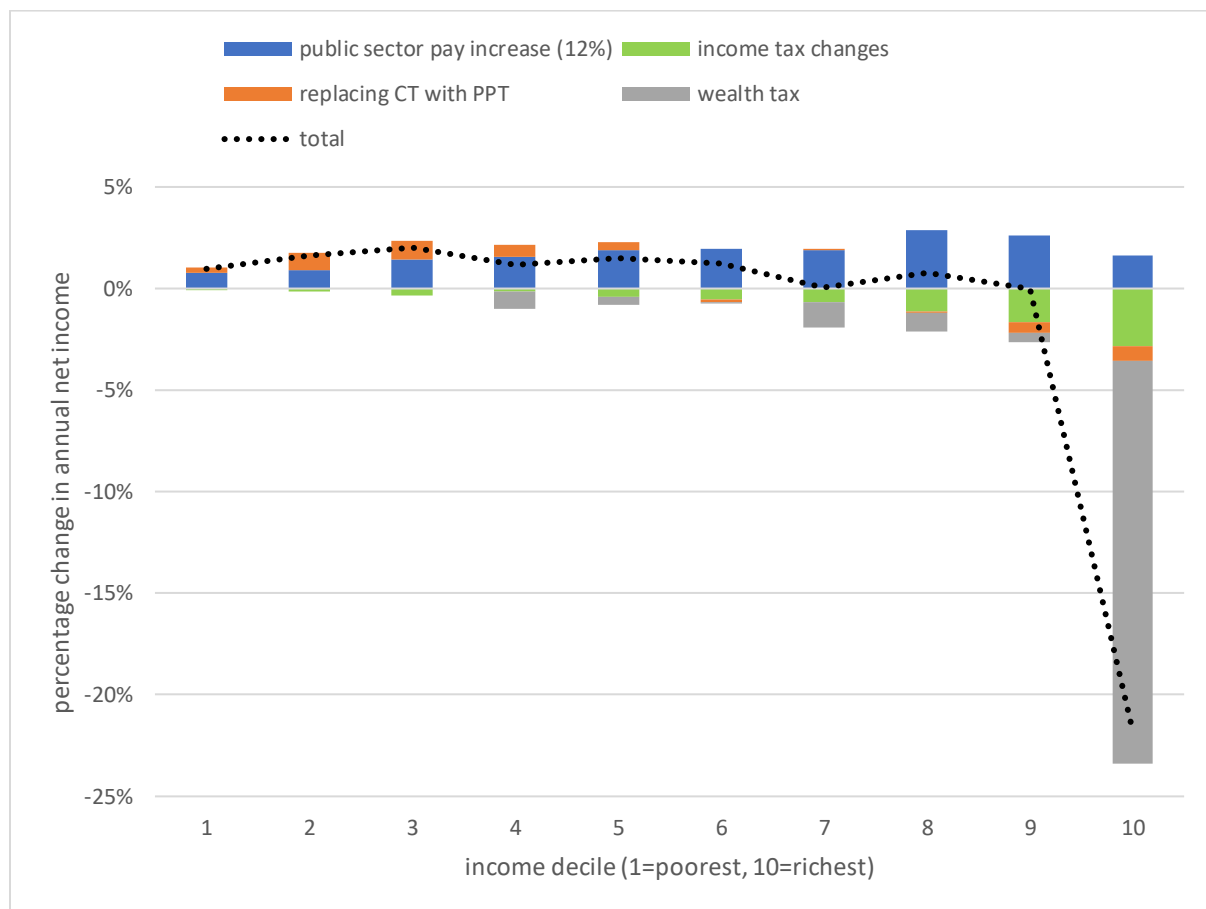
This chapter looks at several aspects of the economic impact of a substantial increase in public sector pay (alongside the tax rises implemented to fund the increase). The modelled scenario is a 12 per cent public sector pay increase, as this represents a (small) real terms increase relative to CPI and can be funded by the combination of short-term and longer-term tax increases in Chapter 6 (with some revenue still to spare, which could be used for additional investment in public services).

7.1 Distributional impacts by income and wealth

Figure 7.1 shows the combined impact of a 12% increase in public sector pay (net of increased income tax and National Insurance contributions, and reduced Universal Credit payments), the package of increases in income tax, and the Proportional Property Tax and wealth taxes introduced to fund the increase. The distributional effects for PPT show the change in net household incomes arising from the replacement of Council Tax by the PPT. The distributional impact of changes to business taxation (such as the reduction in expenditure on the Small Business Bonus Scheme, the replacement of Non Domestic Rates with a Land Value Tax on commercial land, and the increases in landfill tax and the Scottish Aggregates Levy) are not shown as it is not possible to show the impacts of changes to business taxation on household incomes using any existing robust methodology. Similarly, increases in property transactions taxes (the LBBT and ADS) are not shown as the sample of Scottish households buying property in datasets such as the FRS or Understanding Society is not large enough to derive robust distributional results.

The distributional effects in Figure 7.1 are shown as a percentage of household net income, by household income decile.

Figure 7.1. Distributional impacts of pay increase, income tax changes and longer-term reforms to property and wealth taxation by household income decile



Source: Landman Economics analysis of Scotland subsample of Family Resources Survey and Wealth and Assets Survey data

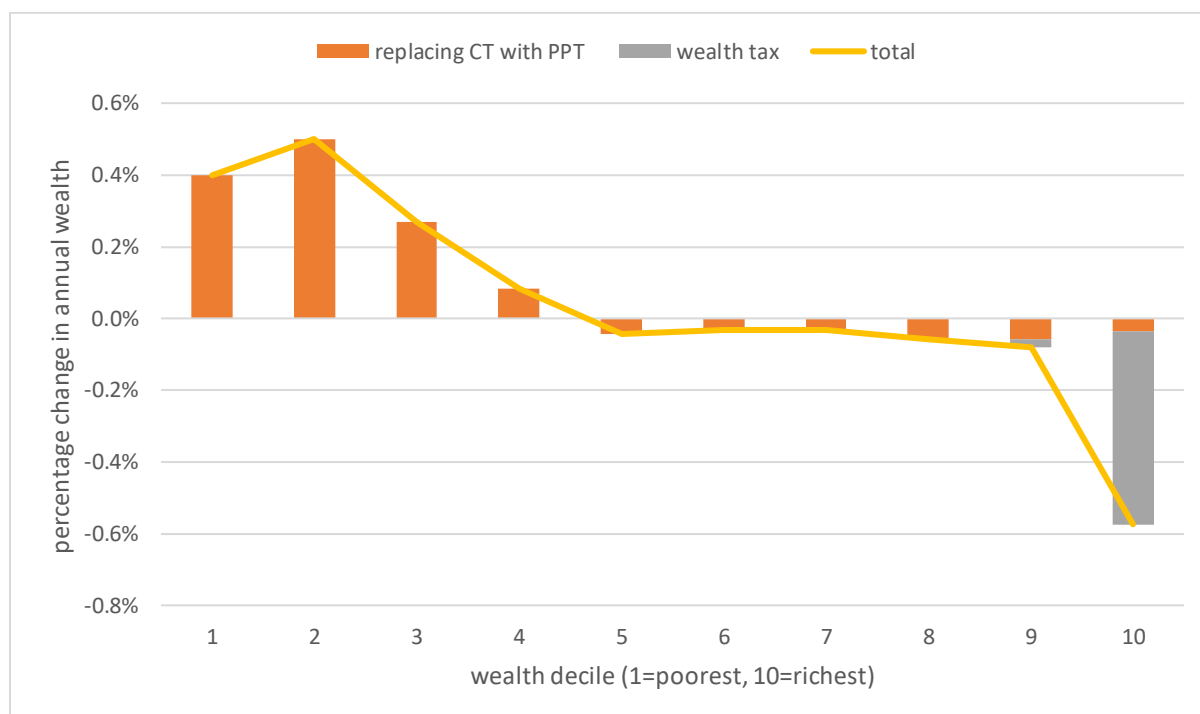
Figure 7.1 shows that the increase in public sector pay has the largest positive impact in percentage terms between the 5th and 9th deciles of the income distribution. This is mainly because the lowest deciles of the income distribution are mainly composed of households who are not in work, or who are on very low wages. As shown in Chapter 3, the income tax reforms are very progressive, with the top two household deciles paying substantially more of the extra income tax as a percentage of income (on average) than households lower down the income distribution.

The introduction of a PPT has a progressive impact on the income distribution, with average gains for households in the lowest deciles and losses for households in the top two deciles. The introduction of a wealth tax has an especially progressive impact at the very top of the household income distribution, with losses of around 20 per cent of net incomes on average. It should be noted that percentage losses are so high for the top income decile because average wealth for this decile (around £2.4 million) is much higher than average net income (just under £100,000), meaning that a 3 per cent annual charge on all household wealth above £2 million represents a

large sum compared to average net income. However, households in the top decile would not necessarily need to fund their annual wealth tax payments out of current income; they could sell assets to fund the tax, or – in the case of property wealth – the wealth tax could be deferred until the property was sold or transferred after death²¹. Overall, the combined public sector pay and tax increase package has a slightly positive average impact as a percentage of income over deciles 1 through 6, and an impact that is close to zero in deciles 7, 8 and 9, but a significant negative impact (or around 22 per cent on average) the top income decile.

Figure 7.2 shows the combined impact of the PPT and wealth tax by household wealth decile²².

Figure 7.2. Distributional impacts of reforms to property and wealth taxation by household wealth decile



Source: Landman Economics analysis of Scotland subsample of Wealth and Assets Survey data

²¹ Fairer Share (2020) gives details of how a deferral system for property taxation could be operated. This would reduce the yield from the wealth tax in the short-to-medium term but would increase it in the longer term.

²² Unfortunately it is not possible to show the impacts of public sector pay increases by wealth decile because the Wealth and Assets Survey does not contain a sector or industry variable for employees to enable them to be classified as public or private sector workers. Also, it is not possible to show the impact of the income tax package by wealth decile because the Landman Economics tax-transfer model is not currently configured to model income tax changes on the latest Wealth and Assets Survey data.

Figure 7.2 shows that the replacement of Council Tax with a Proportional Property Tax has a progressive impact across most of the wealth distribution. For low-wealth households the tax burden of PPT is lower, on average, than Council Tax (after taking account of the enhanced reduction scheme for PPT compared to Council Tax). For households in wealth deciles 5 to 9, there is a slight negative impact from the introduction of PPT due to the increased revenue yields from PPT compared to Council Tax. For households in the top wealth decile, the wealth tax plus the extra yield from PPT results in a combined tax payment of just under 0.6 per cent of total wealth per year on average. Thus, the combined impact of the tax package is strongly progressive with respect to wealth.

7.2 Other distributional impacts of public sector pay increase

7.2.1 Impacts by gender

Increasing public sector pay by 12 per cent would reduce the gender pay gap in the labour market. Table 7.1 below shows average annual and hourly earnings for men and women in Scotland (using data from the Family Resources Survey), before and after the public sector pay increase. The earnings gap between men and women reduces by about 2 percentage points after the increase in public sector pay²³. Increases in public sector pay are particularly beneficial to women in Scotland because 40 per cent of female employees are public sector workers compared to only 23 per cent of male employees²⁴.

Table 7.1. Average annual and hourly pay for male and female employees in Scotland before and after 12% public sector pay increase

	Average annual earnings		Average hourly earnings	
	Before pay increase	After pay increase	Before pay increase	After pay increase
Male	£38,497	£39,582	£17.08	£17.60
Female	£26,497	£27,967	£14.29	£15.06
Female earnings as % of male	68.8%	70.7%	83.7%	85.6%

Source: Landman Economics calculations using Family Resources Survey data

7.2.2 Impacts by disability status

Table 7.2 shows the impact of a 10% pay increase for public sector workers on disabled and non-disabled workers in Scotland (using the “core disability” definition in the FRS dataset²⁵). The pay increase leaves the pay gap between disabled and non-disabled workers virtually unchanged, whether an annual or an hourly pay measure is used.

²³ Note that the weekly earnings gap is larger than the hourly earnings gap because women are more likely to work part-time than men are.

²⁴ Source: author’s analysis of Scotland subsample of Labour Force Survey data, summer 2022

²⁵ The FRS has two definitions of disability, a ‘core’ definition and a ‘wider’ definition. The core definition is more restrictive than the Equality Act definition of disability, while the wider definition is more inclusive.

Table 7.2. Average annual and hourly pay for disabled and non-disabled employees in Scotland before and after 12% public sector pay increase

	Average annual earnings		Average hourly earnings	
	Before pay increase	After pay increase	Before pay increase	After pay increase
Disabled	£28,141	£29,293	£14.27	£14.85
Non-disabled	£33,077	£34,378	£15.89	£16.54
Disabled earnings as % of non-disabled	85.1%	85.2%	89.8%	89.8%

Source: Landman Economics calculations using Family Resources Survey data

7.2.3 Other equality impacts

The increase in public sector pay has no statistically significant on the earnings of BAME employees relative to white employees, according to the FRS data²⁶.

Unfortunately, the FRS cannot be used to assess the impact of the public sector pay increase by sexual orientation because the end user license FRS dataset does not contain this variable.

7.3 Macroeconomic impacts

It is likely that the combined package of a 10 per cent public sector pay increase, funded by tax rises, will have a stimulatory macroeconomic impact on the Scottish economy, for two reasons. One is that – as shown in Figure 7.1 – the package redistributes income from the top of the income distribution (decile 10) to households lower down the distribution (and in particular, deciles 5 to 9). The marginal propensity to consume out of an increase in income is likely to be slightly higher for households in the middle of the income distribution compared to households at the top of the income distribution, and the combined package of pay increases and tax increases could therefore lead to a rise in economic activity through increased consumption and multiplier effects. Furthermore, because the bulk of the combined (short-term and longer-term) tax package consists of taxes on wealth and property rather than taxes on incomes, it is likely that the wealthiest households will sell assets fund their annual wealth tax payments rather than making the payments out of current income. This is likely to mean that the increase in current consumption

²⁶ Note that the sample of BAME employees in the Scottish FRS data is relatively small, making it difficult to identify statistically significant effects when the sample is broken down by ethnicity and by public/private sector simultaneously.

from increased pay for public sector workers will be larger than the reduction in consumption due to wealth tax payments for the wealthiest households, even though the pay and tax package is designed to be revenue-neutral overall.

Overall, a 10 per cent public sector pay increase in Scotland leads to an increase of just over £1.3 billion in net incomes for households containing public sector workers. Without taking account of the effects of tax increases on household spending, an increase of £1.3 billion in net incomes would be expected to increase Scottish Gross Domestic Product via a multiplier effect. With the looming threat of recession in the UK in 2023 as identified by the Bank of England, it is likely that the multiplier impact of redistribution through increases in public sector wages will be larger than normal, making the case for the policy even stronger.

Research by the International Monetary Fund during the 2008-09 recession which followed the financial crash of 2008 found that multipliers were larger in recessionary periods than in periods of economic expansion. Following the IMF (2012), the multiplier for increased spending is 0.9 (the lower bound of the IMF's estimate for the value of economic multipliers during a recession)²⁷. Based on current GDP and employment levels in Scotland, this suggests that the boost to consumer spending arising from a 10 per cent increase in public sector pay could increase employment in Scotland by up to 9,000 additional jobs²⁸. As shown in Table 2.1 above, a 10 per cent increase in public sector pay would also improve the public finances, increasing income tax receipts by around £750 million and receipts of National Insurance Contributions (NICs) by just under £550 million. These are just the first-round effects; there would be additional increases in income tax and NICs receipts arising from multiplier effects. In addition to this, the increase in public sector pay would give rise to increased receipts of VAT and other indirect taxes due to increased consumer spending on goods and services subject to VAT and excise duties.

7.3 Impacts on public sector performance

Across the UK as a whole, data from the Annual Survey of Hours and Earnings shows that average hourly pay for public sector workers fell by about 7 per cent relative to private sector workers in the decade between 2011 and 2021 (source: ONS 2022a, ONS 2022d). This has led to recruitment difficulties in the public sector, especially in England (House of Lords Public Services Committee 2022, p6). In Scotland, the decline in public sector pay relative to private sector pay has been much smaller than in England (data from the ASHE shows that average hourly pay

²⁷ Note that this multiplier is larger than the Office for Budget Responsibility's preferred multiplier values for tax and welfare spending changes, which are between 0.3 and 0.6 (OBR, 2015). However, the OBR does not adjust multipliers to take account of recession, and the IMF evidence suggests that multiplier effects are larger in recessionary periods.

²⁸ The calculations are derived as follows. Scotland's GDP for 2021/22 (excluding North Sea revenues) was £173.8 billion (Scottish Government 2022a). Current employment in Scotland is around 1.35 million (ONS, 2022b). Therefore, £1 billion of GDP in Scotland supports around 7,770 jobs. Based on this estimate, an increase of £1.2 billion in GDP would support just over 9,000 extra jobs.

for public sector workers in Scotland fell by about 1 per cent relative to private sector workers between 2011 and 2021). However, Scotland is nonetheless experiencing a recruitment crisis in the public sector, particularly in nursing and social care.

A substantial pay increase for public sector workers in Scotland would help address difficulties with recruiting and retaining qualified public sector personnel. Increasing pay is also likely to improve the morale of public sector workers, which is in a parlous state after the Covid-19 pandemic (see, for example, Deakin, 2022). Overall, it is likely that a real-terms increase in public sector pay would have a positive impact on public service performance in Scotland.

7.4 Impacts on business investment

As shown in Tables 6.1 and 6.2, around 7 per cent of the combined short-term and longer-term package of tax increases comprises increased business taxation - just over £200 million in total. Some commentators would argue that there is a risk that increases in business taxation of this size would lead to an adverse impact on business investment. However, there are two strong arguments why this would not be the case. First, the evaluation of SBBS by Fraser of Allander Institute (Scottish Government, 2022d) found no statistically significant impacts of the scheme on any metrics of business performance, including business investment. Second, a shift away from Non Domestic Rates and towards a Land Value Tax for commercial land should, other things being equal, *increase* the incentive for businesses to make productive investments because LVT taxes underlying land values (which should be unaffected by the investment decision of any individual business), not overall business valuations or other metrics such as payroll or profits (which are likely to be affected by the level of investment).

7.5 Environmental impacts

Although the main focus of this report is on increasing public sector pay rather measures to address or mitigate climate change and its impacts, there is some overlap between the tax increases suggested here and policy measures which have been suggested by climate advocacy groups. For example, a recent report published by Stop Climate Chaos Scotland (Dixon, 2022) suggests replacing Council Tax and other local taxes with a land, property or local wealth tax. Another recommendation from the Stop Climate Chaos Scotland report is a tax on carbon emissions from land, which is recommended in Section 5.2 of this report. Other tax changes recommended by Stop Climate Chaos Scotland are currently the responsibility of the UK Government – for example, removing tax breaks and subsidies from the fossil fuel industry.

8 Conclusions

This report has shown that there is potential to fund increased investment in public services in Scotland – including a real-terms increase in pay for public sector workers in Scotland – using a costed package of tax increases. In the short run, the report recommends a number of reforms to the tax system which could be introduced as early as April 2023, raising around £1.3 billion of additional revenue per year as follows:

- £867 million from a series of income tax reforms
- £69 million from increases to Council Tax for properties in bands F, G and H
- £240 million from increases to Land and Buildings Transactions Tax
- £112 million from increasing the Additional Dwellings Supplement
- £35 million from increasing Scottish landfill tax.

In the longer run, the report recommends raising just an extra £2 billion per year from a series of more complex reforms to the tax system including:

- £1,426 million from a wealth tax
- £450 million by replacing Council Tax with a Proportional Property Tax
- £70 million by reforming the Small Business Bonus Scheme
- £100 million from the introduction of a Land Value Tax for commercial land
- £15 million from a carbon emissions land tax
- £18 million from increasing the Scottish Aggregates Levy.

This package of reforms could be fully in place by April 2026 if legislated for in 2023.

In combination, the short-run and longer-run packages could raise an extra £3.3 billion per year used to fund a real-terms increase in public sector pay as well as a substantial additional investment in Scotland's public services. The increase in public sector pay reduces gender inequalities in earnings, and the package of tax increases is distributionally progressive whether measured by household wealth or household income.

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