Submission to the

Scottish Commission on Local Tax Reform

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This submission notes that the Commission is empowered to consider
The revenue raising capacity of the alternatives at both local authority and national levels

Summary If the Scottish Government wishes to achieve its economic, social and environmental goals, it will need to revise its revenue system to comply with the norms of efficiency and equity. The current fiscal regime, by virtue of its structure,

- *purposefully* damages employment and the production of wealth
- *intent* is buried in that structure to disallow stewardship of natural habitats
- *systematically* victimises some communities, by discriminating in favour of one class of citizens (those with the power to operate as “rent-seekers”: Stiglitz [2012: 212, 266.])
- *inevitably* foreshortens the lives of low-income families.

There is a singular solution to these outcomes: government would need to rebase its revenue collection policies on the *direct* collection of the net income that every citizen helps to produce.

1. Definition of Taxable Capacity

The taxable capacity of any economy is the net income. This is the revenue that remains after deducting the returns to labour and capital. *Economic rent* is the technical term. It is the sole source of public revenue. Governments already raise their revenue from economic rent, but they do so *indirectly.*

Net income is composed of

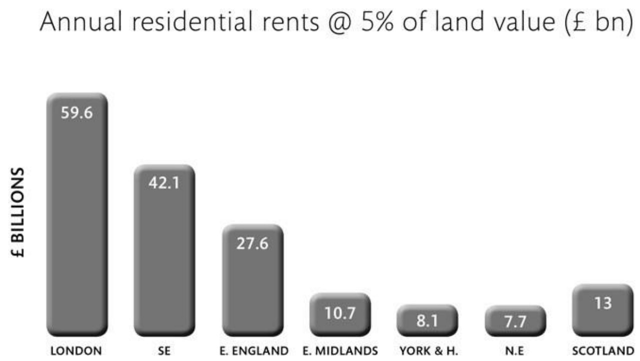
a) *current government revenue*: in the main (as with Income Tax or VAT) this is collected from net income indirectly;
b) *the privatised portion* of net income: this is created by public services, but government fails to collect it; and
c) *revenue that would be produced*, if economic incentives were not distorted by forms of taxation favoured by government.

Government has the choice of *efficiently* collecting that revenue directly; or *inefficiently* collecting it indirectly. In this paper, we will not offer estimates of 1(c); such estimates have been provided in submissions to the Tax Commission by the Scottish Land Revenue Group.

Broadly speaking, we may say that the measurable net income under the current fiscal regime is approximately half of national income. Existing taxes collect about 35% of national income. The privatised portion of net income has been estimated as being in the range of 17% to 22% of national income. For rule-of-thumb purposes, we may take the taxable capacity of a modern economy to be *circa* 50% of national income.

2. The Production of Net Income

Economic rent is a composite value of the services rendered by nature and society. The boundaries of nature and society are not confined to the borders of sovereign nation-states. In the case of Scotland, the people contribute to the production of net income across the UK economic space. This is significant, when considering that the current revenue structure favours the concentration of taxable income in London and the South-east of England. The concentration of economic rent (publicly perceived as "house" prices) is not the result of the higher productivity of either labour or capital inputs. It is the consequence of economies of scale. The "agglomeration" effect results in efficiencies that are measured as higher location values in those areas. But the people of Scotland, through their labour, capital and consumption patterns, contribute to the economies of scale in those high-productivity locations throughout the economic catchment area.



Source: Heather Wetzel (2014), *Welfare for the Rich*, London: Labour Land Campaign.

Assuming a 5% interest rate, to convert capital to annual values, the graph above shows the differences in net income for selected statistical regions across the UK. This illustrates the enormous concentration of resources in the "core" economy. Current fiscal policies discriminate against the peripheral regions through the redistribution of net income. But it needs to be stressed: through their labour power and resources (savings from Scotland, for example, are handled by banks and fund managers in the City of London), the people of Scotland contribute *as much* to the production of net income in London as do resident Londoners.

3. The Barnett Formula

Members of Parliament for English constituencies complain that Scotland is unfairly favoured in the distribution of public revenue. London's Mayor (Boris Johnson) has joined this chorus, insisting that London should be allowed to retain more of the taxes that are paid into the public purse by London residents. He points out that, in terms of Income Tax, a disproportionate amount is extracted from London-based payers, so more of it ought to be retained by Londoners.

The Income Tax is one of the revenue raisers that falls *indirectly* on economic rent. As a consequence, deadweight losses arising from that method of collecting the taxable income of the UK are significant. Furthermore, the losses so inflicted are endured by everyone within the UK. A disproportionate burden is inflicted on residents in the regions, who cannot fall back on the privatised portion of net income to cushion the deadweight effects of taxes.

Scotland (as with all the other regions within the UK) is entitled to an equal share of the whole of the union's net income; including a share of the net income that is concentrated in London. Consequently, the Barnett Formula, *far from favouring Scotland, is actually a device for camouflaging the way in which Scotland and the other UK regions are short-changed*. Public spending (as with finance for fixed capital formation) favours London, at the expense of the regions.

The Scottish Government, in its discussions with central government, may wish to propose that the Barnett Formula be

(i) *rebased*, so that revenue is shared across the regions. A *per capita* formula would be one measure for the equitable distribution of net income; and
(ii) *renamed* the *UK Rent Dividend*.

4. The Life-and-Death Dimension

In reaching its conclusions, the Commission is required to take into account the political timetable and the costs of transition to alternative fiscal policies. Consideration should also be given to the human costs of postponed reform. The damage inflicted on communities by current fiscal policies is not confined to impersonal considerations. At stake are life-and-death issues.

Ultimately, the mal-distribution of net income is the cause of the pathologies which result in the foreshortening of lives. Babies born today in Drumchapel, Glasgow, will on average live 12 fewer years than babies born in Kensington, London. Those two sets of babies are drawn from the same gene pool, and have access to the same National Health Services. And yet, the inequitable distribution of net income creates what has been called "kill zones" (in England, these include Blackpool: Harrison [2006]). These are locations where people endure the depletion of culture to a greater extent than localities that enjoy higher receipts of net income. That depletion of the vitality of communities has, as one of its manifestations, the premature deaths of tens of thousands of UK citizens every year (Miller 2003).

In considering the financial costs, political imperatives and the logistics of fiscal reform, policy-makers may wish to take into account the loss of life over which they preside.

5. Fulfilling the Aspirations of Scotland

Following last year's independence referendum and the 2015 General Election, the people of Scotland have registered their wish for new approaches to the constitution of their communities. Irrespective of what legal and political form these may take, the human aspirations *cannot* be met under current revenue-raising policies. The losses inflicted by conventional tax tools are huge, and current remedial policies are confined to palliatives. By persisting with those palliatives, law-makers implicitly declare that they are resigned to current injustices, which include the pain and damage to

(i) the collective consciousness of the population
(ii) the culture of communities, and
(iii) the natural habitats of Scotland.

No matter how much more is spent on the NHS, or in free school meals, or the other attempts at moderating the injustices of the current fiscal regime, it will not be possible to comply with norms like "sustainability" and "justice". The sole remedy is to remove the distortions to people's lives that are traceable to the way government raises the revenue needed to fund public services.

6. The Divisibility of Democracy?

Like justice, it is not possible to have a bit of democracy. Either a political system complies with the norms of democracy, or it does not. If it does, "local" democracy is part of a continuum that should engage each citizen at all levels of decision-making, and that arrangement does not need special taxes that set local government apart from central government.

The current fiscal regime offends the norms of democracy. It is not *transparent*. Most importantly, the deadweight losses attributable to tools like Income Tax and VAT are not measured, and therefore they are not published in annual budgets. This means governments are not held accountable for their actions (Banks 2002). The damage caused by conventional taxes, therefore, is concealed; leading to further policy errors as governments attempt to rebalance the social system which they persist in de-stabilising with their tax tools.

To achieve optimum outcomes, decision-making at local level needs to be synchronised with policies applied at national level. That integration is automatic when the various levels of governance draw their revenue efficiently and equitably from the same pool (the net income).

To achieve optimum outcomes, a coherent form of governance would have a single revenue-raising mechanism in which every citizen has a direct stake, both as to the

(i) production of the value that is to be collected, for public purposes; and
(ii) distribution of the benefits that are funded by that value.

The fiscal philosophy on which that arrangement is based is democratic, in that payments into the public purse are determined by each citizen. The practical arrangements are framed around the doctrine of *keeping what you create, and paying for what your receive*. The outcome would be "progressive" (as currently understood: high income earners would pay relatively more than low income earners); but it would also be symmetrical – people would pay into the public purse their share of the costs of the public services which they wish to consume.

7. Conclusions

We recommend that the Scottish Commission on Local Tax Reform

- *commends* the switch to location rents to replace revenue currently collected as Income Tax, under the powers devolved from Westminster

- *recommends* the reform of property taxes, to exclude the value of undepreciated capital improvements from the assessment base

- *encourages* the Scottish Government to negotiate with central government a new basis for the Barnett Formula: basing revenue distribution on the UK's net income, and renaming it the UK Rent Dividend

- *propose* that a further commission of enquiry be established to provide the people of Scotland with comprehensive accounts of the social, economic and ecological benefits that would arise from the switch away from taxes that damage the health and wealth of Scotland

References

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