

Breaking the Constitutional Logjam

Will Westminster break up the UK by betraying Scotland *again* on tax reform?

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To break the logjam over the proposal for sovereign Scottish independence, some Holyrood ministers are now calling for “evolutionary” reforms to the constitution.¹

Westminster’s sincerity in devolving power would be seriously tested if Holyrood chose to reform its fiscal system, the flawed structure of which is the root cause of Scotland’s socially-significant pathologies.

If Westminster blocked an attempt by Holyrood to exercise its devolved powers to significantly reduce the tax rates on earned incomes, that would trigger a constitutional crisis that could lead to the break-up of the union.

It has been estimated that zero rating Income Tax (IT), and replacing the revenue with what Adam Smith proposed – an ‘Annual Ground Rent’ – would increase the productivity of the Scottish economy, expanding total annual income by £ billions.²

MSPs could today choose to zero rate Income Tax in a revenue-neutral strategy to banish poverty. A more politically realistic *halving* of IT rates would be sufficient to reap a large proportion of those £ billions of net gains for Scots, *compelling Westminster to either follow suit or veto the Holyrood Act.*

Because of the long-established Westminster policy by which vested interests extract land rent – unearned – we cannot envisage that parliament volunteering to halve UK Income Tax rates.

The power to revise the way Holyrood raises its revenue was devolved to Edinburgh in the Scotland Act 2016. Specifically, Holyrood acquired full powers to set all Income Tax rates (“Full powers over all rates and thresholds on non-savings and non-dividend income...”) from 2017 on.

The Scotland Act 1998 provided for the alternative revenue: locally collected land rent. Taken together, the provisions of the two acts allow a visionary Holyrood administration to boost Scottish shared wealth not only by reducing Income Tax rates, but also by simultaneously replacing the regressive Council Tax and Non-domestic Rates with a levy on land rent.

Adding impetus to and approval for the migration to land rent as revenue, the Scottish Land Commission recommended in 2022 that a cadastral land value map be drawn up to “enable the integration of information on land ownership, use and value” and to bring all land on to the valuation roll.³

1. Lukanyo Mnyanda and Mure Dickie (2023), “SNP urged to weigh ‘evolutionary’ change”, *Financial Times*, Feb. 17.

2. *Post-corona Balanced-Budget Super Stimulus: The Case for Shifting Taxes onto Land*, Centre for Economic Policy Research, Oct 2021. The same authors are presently engaged in a study to estimate the net gains available to Scotland by exchanging various proportions of Income Tax for levies on land rental value.

<https://cepr.org/publications/dp16652>

3. *Land Reform and Taxation: Advice to Scottish Ministers*, Scottish Land Commission, Jan 2022. https://www.landcommission.gov.scot/downloads/61efa506191e2_Land%20Reform%20and%20Taxation%20-%20Advice%20to%20Scottish%20Ministers.pdf

Apoplexy

Would Westminster tolerate such a reform initiative by the Scottish Government? The historical record is not encouraging. When, in 1906, Glasgow Corporation endorsed such a shift in the tax burden off people's homes and onto the rent of land, the Liberal Government enacted *The People's Budget* (1910). It took just five years to value 95% of the land of Scotland. But in 1920, the policy was scrapped by the landlords in Westminster, and every penny was paid back to them. We predict general outrage at Westminster. Outrage that can never be logically justified.

Tried and tested

Over the past century, the rent as revenue mechanism has been tried and tested both theoretically and empirically. Doubts about the policy were examined by the authors of a study published by the IMF. They rejected the objections, and concluded:

The theory of taxation has developed powerful approaches to debate the optimal level and distribution of individual taxes. Land value should be evaluated by the same standards as other tax bases like labour and capital.

The IMF study concluded that a public charge on the rents of land would be both equitable and efficient.⁴

Ignoring such evidence, the Parliament in Westminster has inflicted a century of avoidable pain on the peoples of the British Isles with its "deadweight" taxes on earned incomes. The ripple effects are plain to see:

- ▶ Insufficient funds to support essential public services.
- ▶ Distressed families who cannot afford the price of dwellings.
- ▶ Despair driving people to alcohol and drugs, and worse.

Such are some of the ripple effects of the taxes that damage people's wealth and welfare (see Fig. 1). Those ripples were recently analysed by John Muellbauer, a professor at Nuffield College, Oxford, for the OECD. He explained that the tax regime favoured landowners, at the expense of people who work for their living. The fiscal regime splattered its effects through a variety of channels.

- ▶ A credit-fuelled housing boom; the UK's price volatility was worse than in countries of comparable size; which contributes to poor productivity.
- ▶ House prices that inhibit labour mobility. "We have high taxes on moving and low taxes on homeownership...we have the highest commuting times in Europe. The whole system is clogged up."
- ▶ Higher land values than other countries: "So much of the money has gone into increasing land values and not into improving infrastructure."
- ▶ A broken planning system that curtails the provision of social housing and traps money in land instead of investment in productive economic enterprises.⁵

Professor Muellbauer estimated the financial impact on an average home. In 2022, average house prices were over three times more expensive than their cost of construction. A house that cost £100,000 to build would sell for £317,000. *Therefore, £217,000 was tied up in land value.*

Fig. 1 The tax burden



4. G. Schwerhoff et al (2022), *Equity and Efficiency Effects of Land Value Taxation*, Washington, DC: IMF Working Paper WP/22/263, p.23.

5. John Muellbauer (2022), *Why we need a green land value tax and how to design it.* <https://www.oecd.org/tax/federalism/local-housing-equity-workshop-agenda.pdf>

The human cost

To understand the depths of despair that is ultimately rooted in the distribution of income in Scotland, we have to recall how many people are forced into personal tragedies. Scotland has

- ▶ the lowest life expectancy in the UK. Men born today are predicted to live two years less than in England.
- ▶ become the world's drug capital, with addiction claiming the most victims per head of population.
- ▶ a gap in education that disgraces the nation: a 20% gap between rich and poor households in literacy and numeracy.

It is all too easy to blame the victims for their plight. But such social pathologies can be traced back to the earliest times, when people were cleared from their clan lands by the lairds. Having lost their right to remain in the communities of their birth, many felt forced to migrate, creating one of the largest national diasporas in the world.

The time has come to reverse this tragic history, and the inter-generational traumas caused by the landed nobility's fiscal regime by which wages and trade are taxed instead of land rents. This does not mean taking back the land from those who currently hold it. Instead, personal rights need to be complemented with responsibilities. In plain language, that means pooling the rents of Scotland into the public purse to fund the services shared in common; and cancelling the taxes on earned incomes that disrupt people's behaviour in a thousand and one ways.

Riches from tax reform

Ideally, tax reform should be applied throughout the UK. That would raise productivity and attract investment from abroad. Real wages and living standards would rise, raising people's hopes for a better future. And house prices would be moderated, helping to reduce or even remove homelessness.

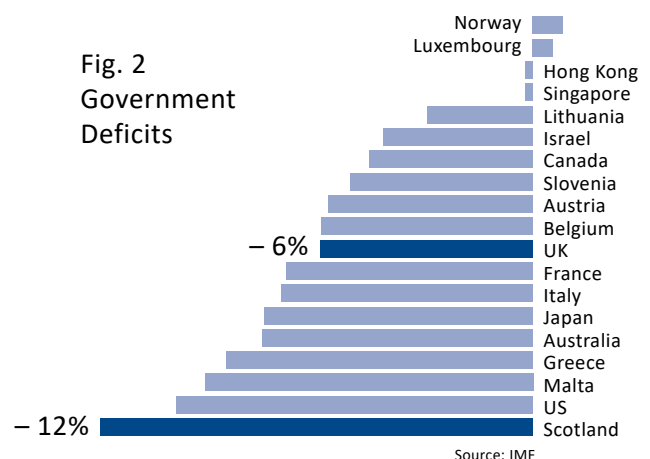
But what if Westminster refuses to follow Holyrood's lead? That would give Scotland a competitive advantage within the UK economy. Entrepreneurs would cross the border to invest in production within Scotland. Skilled workers would migrate northwards to benefit from zero-rated (or very low-rated) wage and salary taxes. A boom would follow which would create an awkward problem for the Treasury in London.

Would the Westminster Parliament veto Scotland's exercise of its devolved powers? If it did, that would provoke a constitutional crisis. One playing into the hands of a Scottish Government demonstrably intent on boosting shared prosperity across Scotland.

The debt

Scotland's economy under Westminster's flawed fiscal structure, as a country on the periphery of the UK economy, has performed predictably. The government's deficit is the worst in the developed world (Fig. 2) a status that even a devolved Scottish Government need not perpetuate. This state of affairs can only get worse as the UK economy heads towards the predicted depression at the end of the current housing cycle in 2026.⁶

Fig. 2
Government
Deficits



6. Fred Harrison (2022), # We Are Rent Book 2 Rent seeking: the Crime against Humanity, London: Land Research Trust.

The collectable proportion of annual Ground Rent, as limited by the powers currently devolved to Holyrood, would not be sufficient to solve *all* problems. But the net gains would form an important start, and would be an important learning experience both at home and for other nations. As people spent their untaxed incomes, the private markets would be more harmoniously aligned with the public sector. Instead of working against each other, investment in public infrastructure would be synchronised with people's private needs.

Phasing in the reform

This fiscal strategy meets the need for constitutional reform. While Westminster was panicking, Holyrood would begin the immediate task of stimulating a public discussion on the tax reform, and scope out the strategy for its phased introduction.

To avoid disruption, a 2-year phase-in could be adopted: with 25% cuts to Income Tax rates each year (longer if reducing IT rates by more than half), the revenue being replaced by collecting revenue via the local levy on the rent of land.

Synchronising the change with a sweeping reform of the Council Tax and Non-domestic Rates (no phase-in period required) would transform Scotland's fortunes. About one tenth of total revenue is raised from local taxation. The reform would render local taxes fair and efficient.

The devolved formula calls for the replacement revenue from reduced IT to be added to local taxation. IT raises about one third of total tax. Halving that proportion would enlarge local tax revenue from 10% to about 27% of total revenue after year one, 90% of which would be from urban locations.

If Scotland reached a point where a quarter of its tax was composed of collected land rent, not only would wages and trade be *correspondingly untaxed* and the collected wealth (all unearned) fairly shared, forces would also be set in motion to cancel a quarter of the nation's avoidable deadweight losses, boosting the output of Scottish enterprises by at least the same percentage.

We predict the positive experience and net gains reaped by migrating as little as half of Income Tax to rent as revenue would render most Scots keen to swap the other half for the rent levy at the earliest opportunity. Thereafter, the continuing damage inflicted by Scotland's remaining non-devolved deadweight taxes on wages and trade (National Insurance, VAT and Corporation Tax) would be brought into sharp political focus.

This strategy not only opens up a new phase in the debate on the status of the constitution; it would also avoid the resort to rent controls. Holyrood proposes to introduce a 3% cap on rent increases in April 2023: far from alleviating the housing crisis, that would deepen the disruptions caused by the current tax regime.

Holyrood now has the tool for resolving many social problems in one full swoop: will it rise to the challenge?