

BETTER THAN BEFORE

A 'SOCIAL RENEWAL SUPPLEMENT' ON HIGHER EARNERS IN SCOTLAND

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This briefing marks the first in a series looking ahead to the Holyrood elections in May. It builds on IPPR Scotland's Better Than Before report, released in September 2020, outlining the key priorities facing the Scottish government over the next few years in recovering from Covid-19 (Gunson and Statham 2020).

INTRODUCTION

After the last year we know that looking too far ahead during a global pandemic can be close to impossible, if not dangerous. With the continuing roll-out of vaccines, and plans in place for easing restrictions, we can begin to very tentatively plan for the next few months. And following last week's UK budget and the passing of the Scottish government's budget this week, we can also begin to get a better idea of what tax and spending decisions will look like for the next year, assuming we can get Covid-19 under control.

However, with less than two months to go until May's Scottish parliament elections, voters and politicians will soon face a harder task, looking ahead to the big decisions facing Scotland over the next five years.

There are few words to describe the last year we have faced. The luckiest of us have had some of the things we hold dearest in our lives taken away. But the unluckiest have seen far worse, with thousands of people losing their lives, their health and their livelihoods, and an epidemic of financial insecurity sweeping the country. But in many ways luck has had very little to do with it. The structural inequalities and weaknesses visible in Scotland before the pandemic, have been

exposed and exacerbated through the pandemic in some of the most extreme ways imaginable.

While we all hope the health crisis will recede later this year, the scale of the economic crisis means the recovery will be with us throughout the next parliamentary term. The task for the next Scottish Parliament will be to build a Scotland that is fairer and stronger, and more resilient, than the Scotland that went into the crisis. A Scotland better than before.

Tax and spend over the next parliamentary term

And so what can we learn from the UK and Scottish government budgets that might tell us what the spending environment will look like over the next term?

Despite significant devolution to Scotland in recent years, Scotland's budget is still in many ways pegged to tax and spend decisions taken in Westminster for the rest of the UK. Therefore, the UK Chancellor's announcements of a combination of significant spending cuts and tax rises from 2022/23 onwards could have worrying implications from Scotland's perspective.

The Chancellor's budget falls far short of what is needed to secure a sustainable recovery. This could mean unnecessary spending cuts and limits on borrowing now simply feed further unnecessary spending cuts later, worsening the economic damage from the pandemic.

But, more specifically for Scotland, the combination of spending cuts and tax increases from 2022 onwards could also see Scotland's budget take a double hit.

It is generally well-understood that spending cuts or increases at Westminster feed into Scotland's block grant, which is still used as the starting point in setting how much the Scottish parliament has to spend. Here the UK government's budget points to incredibly tight spending outside of health in Scotland for the next few years.

What is more often overlooked is that tax increases or cuts in the rest of the UK also have a direct effect on Scotland's budget. If a tax devolved to Scotland goes up in the rest of the UK, Scotland must follow suit just to stand still and to ensure spending plans in Scotland do not fall behind those seen in the rest of the UK.

The UK government's decision to raise income tax revenue – through freezing income tax thresholds for the rest of the UK between 2022 and 2026 – will therefore mean that the Scottish government will need to at least match this increased revenue in Scotland just to ensure that spending cuts in Scotland are no worse than in the rest of the UK¹. To reduce cuts in Scotland or, better still,

¹ Technically, Scotland will need to see the increase in tax revenue per head on devolved taxes match increases in tax revenue per head for equivalent taxes in the rest of the UK to ensure spending plans are no worse than those passed on to the Scottish parliament through its block grant.

to reject austerity entirely, devolved taxes will have to rise in Scotland by significantly more than in the rest of the UK throughout the next parliament.

Our very early calculations would suggest that tax rises in Scotland might need to reach hundreds of millions of pounds per year by the end of the next parliament just to ensure spending cuts in Scotland are no worse than those planned for the rest of the UK. This figure would be higher if earnings in Scotland rise more slowly than in the rest of the UK, as we have seen in recent years.

While reprioritising spending within the current budget has to be part of the solution, it is unlikely this will be enough on its own. To deliver on ambitions around social renewal and economic recovery Scotland will therefore likely have to see tax rises beyond the UK government's plans and beyond anything we have seen in the history of devolution.

Scotland's priorities – who pays for the crisis?

So, what should the next Scottish government's tax plans look like?

When it comes to paying for the costs of the Covid crisis, we must therefore remember who lost the most and who lost the least through the crisis. There is growing evidence that higher earners have seen their costs fall and have been able to build savings (Davenport et al 2020), while those on lower incomes have seen their costs rise (particularly for those with children) and levels of debt and financial stress increase (Brewer and Patrick 2021a). Those who own their own homes have benefited from significant house price rises throughout 2020, increasing wealth among the wealthiest (Registers of Scotland 2021). And as IPPR Scotland has found, those hit hardest by income reductions through the crisis have been those who were already struggling before the pandemic hit (Statham et al 2020).

Many commentators have begun to talk of a k-shaped recovery, where – without action – the recovery from Covid-19 could be much slower for some parts of the economy and society, than others, with huge risks of widening inequalities coming out of the Covid-crisis. The next Scottish government must work to ensure this does not become reality.

Going into the pandemic Scotland had the start of a good story to tell on using its powers to deliver a more progressive Scotland. Indeed, IPPR Scotland has pushed for many of the progressive changes achieved throughout this last parliament. Income tax reform in Scotland sees a more progressive income tax system in Scotland compared to the rest of the UK, with greater numbers of tax bands, lower tax levels on lower earners, and higher tax levels on higher earners, and hundreds of millions of pounds of additional revenue raised each year. Likewise, the introduction of the Scottish Child Payment earlier this year, a £10 per week payment paid to low-income families in Scotland, is hugely welcome, delivering payments worth around £180m per year to over 350,000 children once fully rolled out in 2022/23.

These progressive policies always needed to be first steps not last steps. But Covid-19 changes everything. To illustrate, recent work by Joseph Rowntree

Foundation showed that to meet Scotland’s child poverty reduction targets for 2023/24, targets which passed with unanimous support across parliament only a few years ago, we would need further action to lift another 40,000 children out of relative poverty over the next few years (Birt and Milne 2021). Separate work from the Resolution Foundation showed a similar story – without action we will not only miss our legally binding child poverty targets, but child poverty will actually increase in Scotland, despite progressive reforms over the last few years (Brewer et al 2021b).

In short, pre-pandemic policies will not be enough to deliver on the promise of a fairer Scotland.

A Social Renewal Supplement for Scotland

That is why we are calling for the next Scottish Parliament to introduce a ‘Social Renewal Supplement’ on higher earners in Scotland, reducing the Higher Rate Tax Threshold down to £40,000 over the next three years from 2022 onwards. This would see tax increases of around £5 per week for higher earners in Scotland each year for three years. This would raise around £690m of additional tax revenue by 2025/26², providing the investment needed to double the Scottish Child Payment to £20 next year before increasing it up to £40 per week by the end of the parliament. This would lift 50,000 children out of relative poverty by 2025/26.

Table 1 – Revenue and poverty effects of reduction in Higher Rate Tax Threshold and increase in Scotland Child Payment

	Reducing Higher Rate Tax Threshold in Scotland to £40k (2025/26)	Increasing Scottish Child Payment to £40 p/w (2025/26)
Revenue/costs (in static terms, positive = revenue)	+£690m	-£500m
Relative child poverty impact	Negligible	-50,000

Source: IPPR Tax/benefit microsimulation model using Family Resources Survey 2018/19, 2017/18 and 2016/17

Note: We have modelled reducing the Higher Rate Tax Threshold in static terms but have left significant headroom (28%) to allow for behavioural effects.

This alone will not be enough to meet our ambitions on child poverty, never mind our aspirations across the policy areas devolved to Scotland. We may need to see further tax rises, whether on income taxes or local taxes. Equally, increases in social security cannot do it all, with fair work and wider public services with significant roles to play. And, of course, the next Scottish

² We have modelled the reduction in the Higher Rate Tax Threshold in static terms. However, we have left significant headroom (of around 28 per cent) between revenue raised and spending on increasing the Scottish Child Payment. This is to allow for behaviour change in consequence of a tax increase. As an illustration, the Scottish Fiscal Commission’s analysis for the 2020/21 Higher Rate Tax Threshold freeze estimated behaviour change may see around a 16 per cent reduction by 2024/25 in revenue raised compared to their static estimate.

government will need help from their counterparts at Westminster and from within Scotland too.

However, our proposal for a Social Renewal Supplement could make a big difference, offer a significant next step in tackling child poverty, building on the progressive reforms seen in the last parliament, and signal that the next Scottish Parliament will work harder to turn the good ambitions we have set ourselves in recent years into reality for people across Scotland.

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