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Healthy finances?
Options for funding an NHS spending increase

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Summary

The National Health Service will turn 70 on 5 July 2018, but public concern about its condition is at its highest since the early 2000s. This mirrors notable declines in many performance measures over recent years. And looking ahead, funding needs will only increase as the population ages and health care costs rise. This paper looks at the scale of any additional NHS spending the government might announce in the near future and the approaches that could be taken to meet those costs.

Although health spending has continued to rise as a share of total government expenditure over the post-2010 austerity period (now making up almost a fifth of the total), ***average annual spending growth is on course to be lower this decade than at any other time in the NHS's history.*** *Real terms per capita spending is set to grow by an average of just 0.4 per cent a year between 2010-11 and 2019-20, down from an average of 5.9 per cent a year in the preceding decade.*

But speculation is growing that the NHS will receive a significant funding boost as a birthday present, thereby changing this outlook. The Prime Minister has called for a new "long-term plan" and the Health Secretary is believed to be arguing for a settlement that provides for real terms spending rises of 4 per cent a year – broadly in line with historical averages. That would mean increasing health funding by £23 billion a year by 2022-23. Longer-term, ***demand for health spending is likely to continue growing, with demographic shifts increasing the costs of the current health and social care system from roughly 8 per cent of GDP in 2017 to 9 per cent in 2027 and 10.8 per cent in 2037****.*

Taking the opportunity offered by the 70th birthday celebrations to recognise such immediate and longer term pressures would be very welcome, but is far from straightforward given political and economic constraints.

Faced with no outright majority in parliament, and reduced immediate pressure on the deficit, ***the government is almost certain to deliver any increase in NHS spending of the order of £20 billion in 2022-23 partly by utilising the headroom the Chancellor has against his fiscal targets to increase borrowing****, rather than solely by raising funds from tax rises. The Chancellor indicated in the Spring Statement that he would share the proceeds of any sustained improvement in the public finances at the Autumn Budget, and the signs are that he could meet roughly half the funds associated with an annual increase of 4 per cent (or indeed the Conservative manifesto commitment to an as yet unidentified £8 billion of extra funding) by choosing not to lower borrowing any more quickly than previously set out.*

But while the Chancellor can choose to borrow more on this scale without jeopardising his immediate fiscal 'mandate', he will be conscious that doing so will reduce the credibility of his other targets of delivering a sustainably falling debt-to-GDP ratio and an absolute surplus "at the earliest possible date in the next parliament". As a result, and because further squeezes on other areas of spend are much harder to achieve than in recent years, ***tax rises alongside higher borrowing appear inevitable if the government wishes to return to historically normal NHS spending increases.***

For reasons of public support and good public policy ***we recommend the government consult on such tax rise options over the summer****, with final decisions announced in the Autumn Budget. Such a period of discussion should be underpinned by a full understanding of the pros and cons of different tax rise options. Providing that evidence base is a core purpose of this paper.*

The most discussed option is a National Insurance rise, which underpinned the last significant health spending boost undertaken in the 2000s and which is relatively popular with voters. Such an approach has also been advocated recently by Gordon Brown. A 1p increase in all rates could raise £12 billion by 2022-23, or £6 billion if the employer rate were left unchanged. But, ***while a National Insurance rise would be progressive across the income distribution, it would be unfair from a generational perspective****. National Insurance contributions are only payable*

on the earnings of working-age adults, meaning that those older cohorts most likely to benefit from improved health funding in the medium-term would not be asked to make any contribution.

A better approach in this area – and one advocated by the Intergenerational Commission – would be to extend National Insurance contributions to the earnings (and to some elements of occupational pension income) of those above the state pension age**. This would only affect the highest income pensioners and could generate an 'NHS Levy' of £2.5 billion in 2022-23. **Putting health funding on a generationally fair footing should also involve some major reform of the UK's approach to wealth taxes – particularly council tax.

***More directly comparable to a National Insurance rise, a 1p increase in all Income Tax rates could raise £7 billion in 2022-23 and would have the advantage of avoiding the significant generational unfairness of any move on National Insurance**. It would be marginally more progressive too. With the Lib Dems having pledged such an increase in their manifesto, the parliamentary numbers might also look a little better, if still very challenging, for the government. **More realistically the government might freeze the personal tax allowance and higher rate threshold once the respective manifesto commitments of £12,500 and £50,000 have been met, along with freezing National Insurance thresholds**. This would raise £3.7 billion by 2022-23, but be less progressive than either an Income Tax or National Insurance rate rise, with the top tenth of the income distribution paying proportionally less than middle income households.*

*Another option is to reverse planned cuts to Corporation Tax. The UK's rate has already been cut significantly over recent years, taking it well below OECD and EU averages. George Osborne legislated for a reduction from 19 per cent to 17 per cent in April 2020, but the estimated cost of this move has doubled relative to initial HM Treasury analysis – now standing at roughly £5.7 billion in 2022-23. **Philip Hammond might therefore reasonably argue that the new assessment makes it clear that lowering Corporation Tax any further is too expensive in the current climate**. It is hard to imagine Labour voting against such a cancellation – especially as the party's manifesto included a pledge to increase the tax – meaning such a move is likely to be relatively straightforward to achieve in terms of parliamentary arithmetic.*

*The final broad-based tax rise that might be on the agenda is VAT. Increasing the main rate by 1p would raise in the region of £7 billion, which would go a long way to meeting any new NHS pledge. However, **increasing VAT is mildly regressive unlike all the other tax options discussed here and would face very significant opposition in parliament**.*

Any announcement of new money for the NHS on 5 July will rightly be welcomed. Securing the scale of resources required to put the service onto a firmer footing will not be straightforward however. The currently most discussed tax rise option of a National Insurance rise is not desirable. Instead of simply following the precedent of history and going ahead with such a rise, the government should consult on wider options, with the ensuing debate fully informed by the impact of such changes across the income distribution and different generations.

The NHS is turning 70, but there are concerns for its health

The NHS was born on 5 July 1948, with Aneurin Bevan setting out three core principles: that it meet the needs of everyone, that it be free at point of delivery, and that it be based on clinical need rather than ability to pay.[1] The service has of course undergone many changes since then but, as it approaches its 70th birthday next month, the same three principles remain firmly in place.

Adhering to these principles as the population has grown and as both the conditions being treated and the potential for intervention have expanded has inevitably come at a cost. The government spent £0.4 billion (or 3.6 per cent of GDP) on health in the NHS's first full year of operation; a figure that had jumped to £144 billion (or 7.3 per cent of GDP) by 2016-17.[2]

Yet there are concerns that this increased level of funding falls short of what is needed – particularly with spending growth in the middle of a prolonged period of constraint as part of the post-2010 austerity drive. Focusing on health needs in England for example, the Nuffield Trust, Health Foundation and King's Fund together claim that the Department of Health is on course for a funding gap of £22 billion by the end of the current parliament.[3]

And the public is concerned too. The performance of the NHS has deteriorated on a number of measures in recent years – from ambulance response times to A&E delays and treatment waiting times[4] – causing healthcare to become the issue most cited by the British public as an area for concern. Figure 1 tracks the proportion of respondents to the Ipsos MORI *Issues Index* pointing to the NHS/hospitals/healthcare as an "important issue facing Britain today" since 1989. It shows that the proportion identifying this topic as a key issue stood at around 35 per cent on the eve of the financial crisis. It subsequently fell sharply, but has been growing since roughly 2013 and currently stands at just under 50 per cent – significantly above the historic norm and topped only by the early 2000s (where concern led to significant spending and tax increases).

[1] "The history of the NHS in England", *NHS choices*

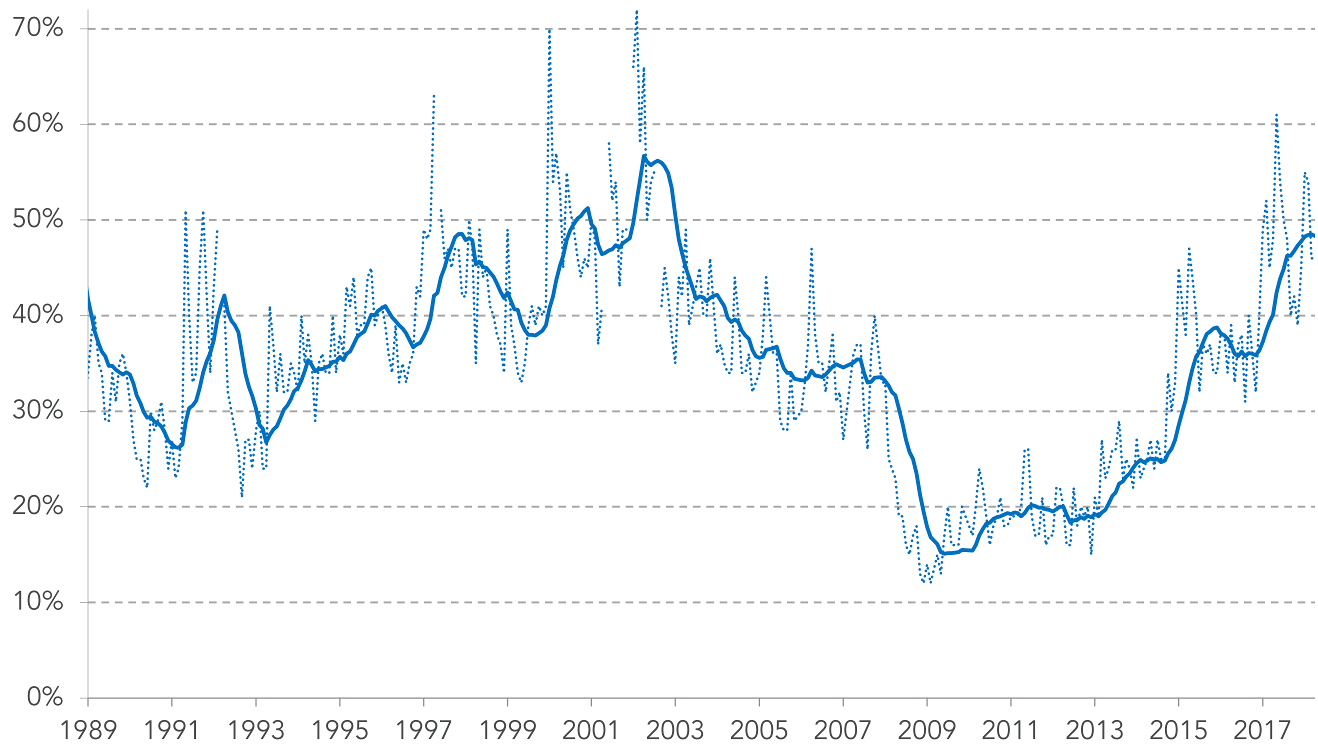
[2] R Harker, *NHS Funding and Expenditure*, House of Commons Library, Briefing Paper 0724, 13 April 2018

[3] For context, note that health spending in England amounted to £123 billion of the £144 billion UK total in 2016-17. Spending on NHS England – that part of health expenditure which recent government pledges have related to – accounted for £108 billion of the total. Spending in other parts of the UK is determined by the devolved administrations. See *The Autumn Budget: Joint statement on health and social care*, Nuffield Trust, The Health Foundation, The King's Fund, November 2017.

[4] *Performance of the NHS provider sector for the year ended 31 March 2018*, NHS Improvement

Figure 1: Around half of those surveyed list the NHS as an important issue

Proportion of British adults declaring NHS/Hospitals/Healthcare as the most/other important issue facing Britain today (12-month moving average)



Source: Ipsos Mori

Against this backdrop, there is widespread speculation that the government will announce a funding boost for the NHS to coincide with its birthday celebrations.[5] But, popular though such a move would be, sourcing additional funds is likely to be far from straightforward. After seven years of austerity there is far less opportunity for diverting resources from other parts of government, while the still-elevated level of the debt-to-GDP ratio will mean the government is reluctant to rely on borrowing as a means of plugging its funding gap. Tax rises therefore appear inevitable, but the government's lack of parliamentary majority raises questions over its ability to win a vote on any such measures.

This note considers the feasibility and fairness of different approaches to boosting health spending. In doing so, it draws on the work of the Intergenerational Commission[6] to set out a preferred approach to putting NHS funding on a sustainable setting in a way that is progressive and generationally fair. However, it also reflects on other more immediate approaches to raising funds that the government might be considering, providing an assessment of different options against a number of key tests.

[5] S Neville & L Hughes, "Theresa May signals imminent extra funding for the NHS", *Financial Times,* 27 March 2018

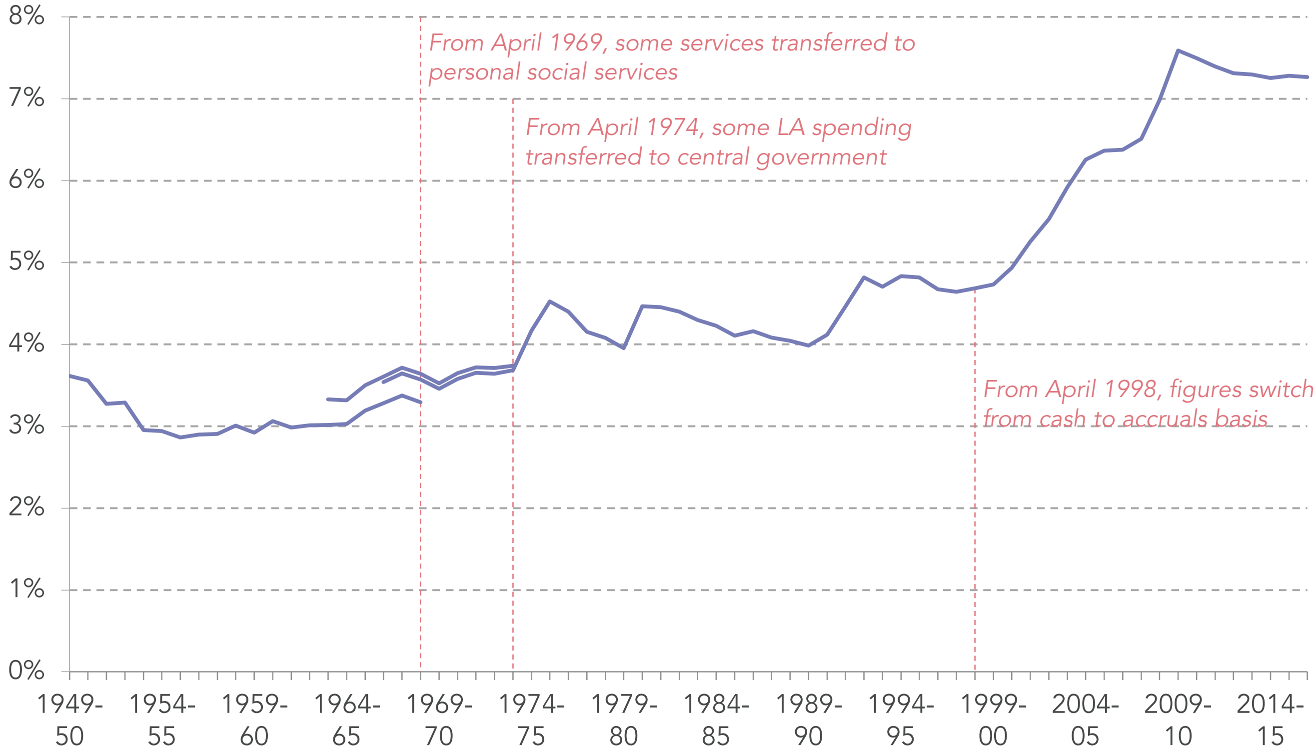
[6] *A new generational contract: The final report of the Intergenerational Commission*, Resolution Foundation, May 2018

Recent growth in health spending has fallen well short of historical averages

Figure 2 sets out total government spending on health (net of receipts from patients, such as prescription payments) across the UK in the period following the establishment of the NHS. Changes in responsibilities mean the series is not directly comparable over the entire period, but the very sizeable growth in spending relative to the size of the economy is nonetheless very apparent.

Figure 2: Spending on health has doubled as a share of GDP over the past 70 years

General government spending on health as a share of GDP: UK



Notes: Breaks in the series mean the figures are not directly comparable over time and are presented as overlapping trends instead.

Source: House of Commons Library, *NHS Funding and Expenditure*; HMT, *Public Expenditure Statistical Analyses*, Table 4.2; ONS series YBHA, ABMI and YBGB

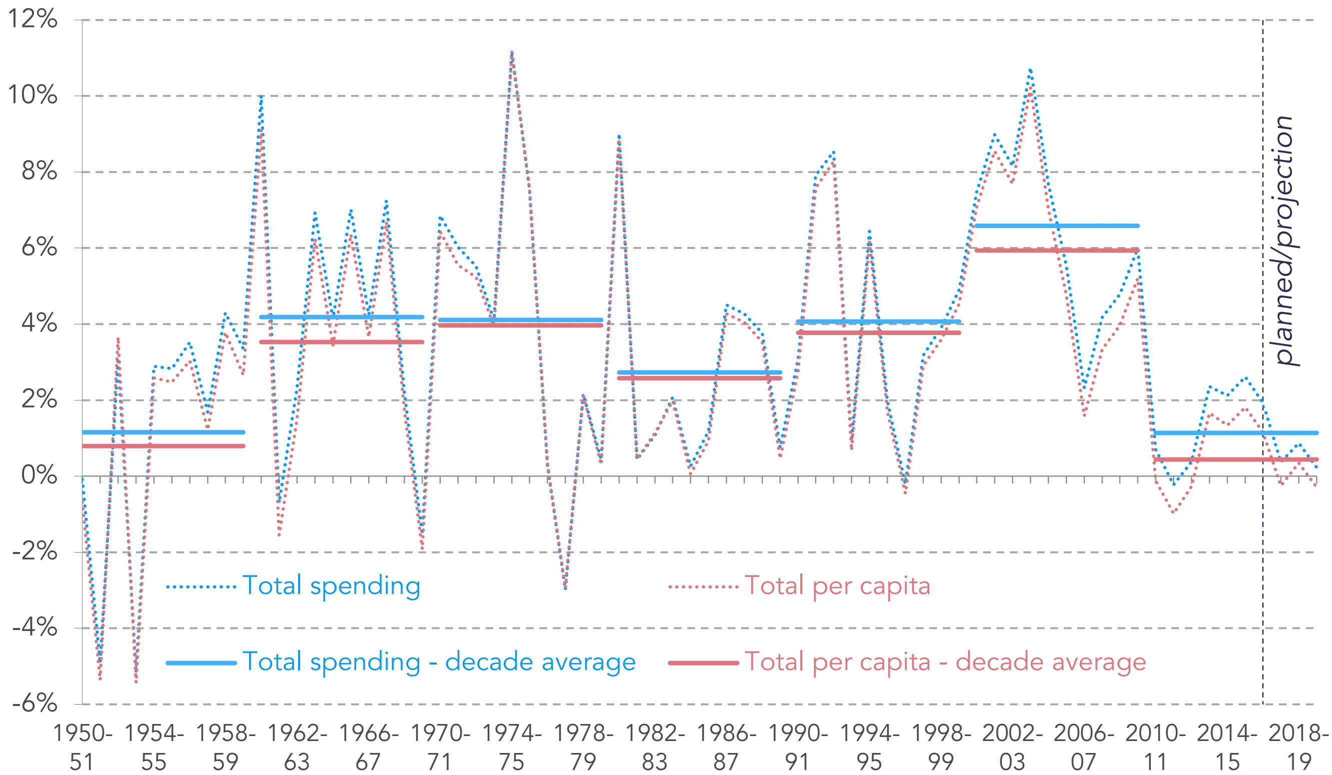
Health spending amounted to 3.6 per cent of GDP in the NHS's first full year of operation (1949-50), before falling to a 'steady-state' level of roughly 3 per cent between 1953-54 and 1964-65. Thereafter, the pattern became one of steady growth for a number of years followed by plateau. As such, health spending increased as a share of GDP over the second half of the 20th century in a series of 'steps'. Spending grew especially rapidly from the turn of the 21st century, with the share of GDP allocated to health jumping from 4.7 per cent in 1999-00 to 6.5 per cent in 2007-08. A post-crisis spike (associated in part with falling GDP) has been followed by a long plateau. In 2016-17, health expenditure amounted to 7.3 per cent of GDP.

Taking the full period up to 2009-10, health spending has grown by an average 3.8 per cent a year in real terms. Figure 3 shows that, on current plans, average annual growth in the decade from 2010-11 is set to fall to 1.1 per cent. That would be the lowest average since the introduction of the

NHS, dropping below the figure of 1.2 per cent recorded between 1950-51 and 1959-60. Adjusting for population growth, the latest decade average drops to 0.4 per cent a year – again the lowest average recorded across the entire period, and down from 5.9 per cent a year in the decade up to 2009-10.

Figure 3: The current decade marks the slowest growth in health spending since the introduction of the NHS

Year-on-year real terms growth in general government spending on health: UK



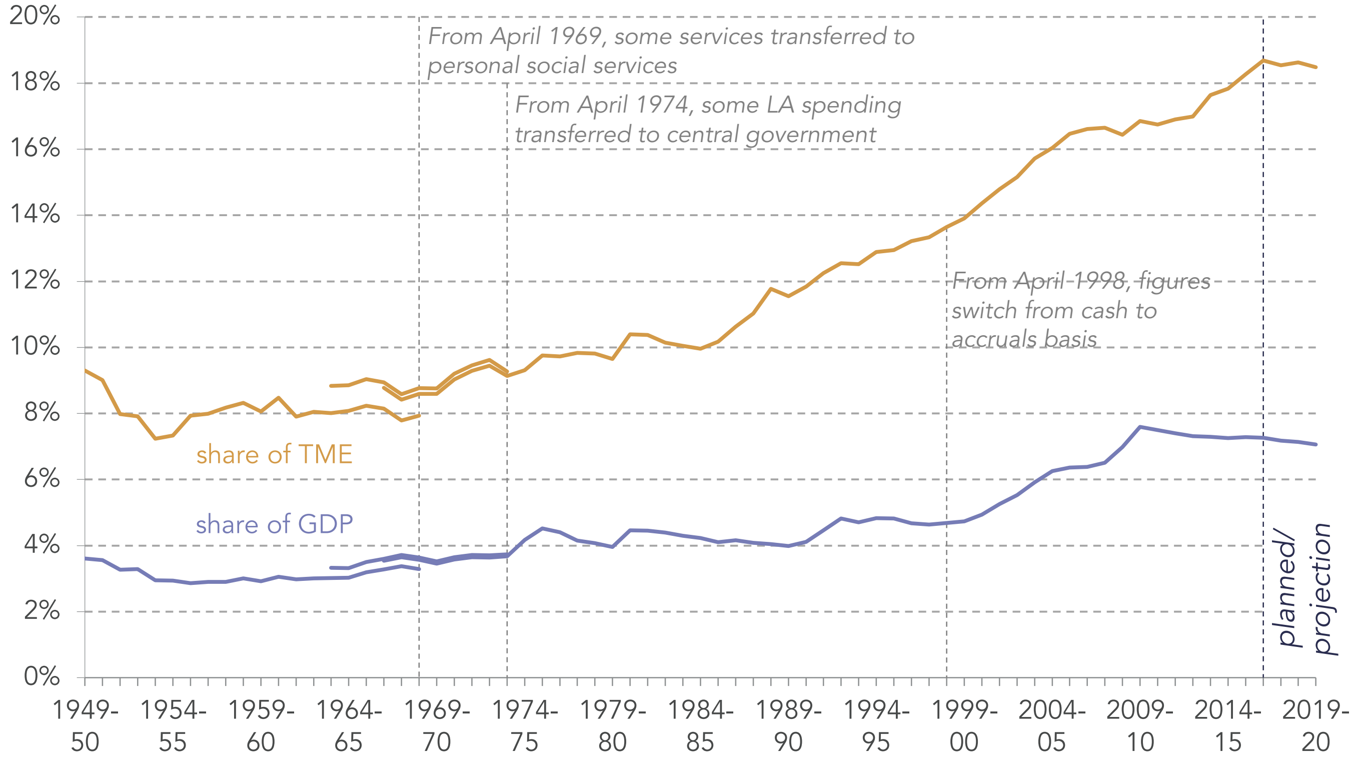
Source: House of Commons Library, *NHS Funding and Expenditure*; HMT, *Public Expenditure Statistical Analyses*, Table 4.2 & Table 6.4

But the NHS remains a clear government priority, with new funds likely to be announced in the coming weeks

Subdued though spending growth has been, it has of course been stronger than recorded for many other public services in the post-2010 period of austerity. As such, even as growth in health expenditure has slowed it has come to account for a larger share of total government spending. Figure 4 highlights this, presenting health spending as a share of total managed expenditure (TME). This share hovered around 8 per cent during the first few years of the NHS's existence, before rising steadily from the 1970s onwards. It stood at 17 per cent immediately before the financial crisis, but has since increased sharply – reaching just short of 19 per cent in 2016-17.

Figure 4: Spending on health has continued to rise as a share of total government expenditure, even in the last decade

General government spending on health as a share of GDP and total managed expenditure: UK



Notes: Breaks in the series mean the figures are not directly comparable over time and are presented as overlapping trends instead.

Source: House of Commons Library, *NHS Funding and Expenditure;* HMT, *Public Expenditure Statistical Analyses*, Table 4.2 & Table 6.4; ONS series YBHA, ABMI and YBGB; OBR, *Public finances databank*

On current plans, this upward trend is set to pause over the next few years. Total spending on health is set to rise by just 0.5 per cent a year in real terms in the three years from 2017-18 to 2019-20, representing a flat-lining against total government expenditure.

However, the expectation is that these current plans are likely to change. Ahead of the 2017 general election, the Conservative manifesto pledged that:

> *The next Conservative government will give the NHS the resources it needs. First, we will increase NHS spending by a minimum of £8 billion in real terms over the next five years, delivering an increase in real funding per head of the population for every year of the parliament.*[7]

The subsequent Autumn Budget of 2017 provided some additional funds (included in the figures above) spread across 2017-18, 2018-19 and 2019-20, but nothing contributing to the pledge to lift annual spending by £8 billion by the end of the parliament. And there is good to reason to suppose that the government will want to identify significantly more than this. Earlier this year, the Prime Minister made the case for drawing up a new long-term settlement even ahead of next year's Spending Review:

[7] The Conservative Party, "Forward, Together: Our Plan for a Stronger Britain and a Prosperous Future", *The Conservative Manifesto, p66*

> *We also need to get away from this annual approach to the NHS budget and recognise that for the NHS to plan and manage effectively, we need to get away from those annual top-ups of the budget… This is a critical priority for me, so this year and in advance of next year's spending review I do want to come forward with a long-term plan… The Government will provide a multi-year funding settlement in support of the plan, consistent with our fiscal rules and balanced approach, but ensuring that the NHS can cope with the rising demand ahead of the spending review.*[8]

And more recently Jeremy Hunt has said that Theresa May wants to mark the NHS's 70th birthday by providing "a significant increase" in its budget.[9] It is worth considering however – as we do in Box 1 – which elements of health spending are likely to be within and outside the scope of any such announcement.

i Box 1: What's covered by an increase in 'NHS' spending?

Any forthcoming promise of extra money for the NHS is unlikely to feed through pound for pound into new spending on UK 'health'. In part this is due to the fact that, since 1999, health spending has been a devolved responsibility. Changes in the English budget feed through to public finances in Scotland, Wales and Northern Ireland via the Barnett consequentials,[1] but it is up to the devolved administrations themselves to determine how much of any funding increase to allocate to health spending. As such, the UK government can't directly specify the pace of future increases in total health spending.

But even in England, any new funds are likely to relate narrowly to the NHS rather than to broader health expenditure. The definition of health expenditure used in Figures 2-4 covers not just spending in the devolved administrations, but also spending across a combination of Whitehall departments. The Department of Health is of course the single biggest recipient of funds but small items of expenditure were administered by DCMS and BEIS in 2016-17.[2]

And the total for the Department of Health covers both NHS England and non-NHS elements of spending (including on training, capital and investment in public health). Figure 5 provides a breakdown of total UK 'health' spending in 2016-17. It shows that NHS England accounted for just under three-quarters of the total, with the devolved administrations accounting for a further 16 per cent.

[1] The Barnett formula multiplies any change in departmental spending by a specific 'comparability' percentage (which reflects the extent to which spending by the UK government department corresponds to services provided by devolved administrations and stood at 99.4 per cent in relation to health at Spending Review 2015) and by appropriate population projections. See M Keep, The Barnett formula, House of Commons Library, Briefing Paper 7386, 23 January 2018

[2] HMT, Public Expenditure Statistical Analyses, July 2017, Table 5.1a & Table 5.1b

[8] Liaison Committee, *Oral evidence: The Prime Minister*, HC 905, 27 March 2018, Q76

[9] D Campbell, "May to give NHS 'significant' cash boost, Jeremy Hunt reveals", *The Guardian*, 6 June 2018

What's covered by an increase in 'NHS' spending? (continued)

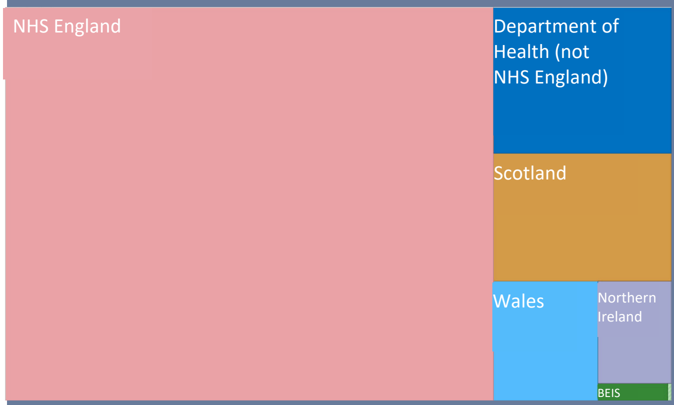


Figure 5: **NHS England accounted for 73 per cent of all UK health spending in 2016-17**

Composition of total government spending on 'health' in 2016-17

Source HMT, Public Expenditure Statistical Analyses, Table 5.1a & Table 5.1b; Nuffield Trust, The Health Foundation & The King's Fund, The Autumn Budget: Joint statement on health and social care, November 2017, Table 1

By way of considering what this means for funding, we can work through an example. A government pledge to increase NHS funding by 4 per cent would raise the budget for NHS England by roughly £4.2 billion. Applying the Barnett formulas would generate an additional £800 million for the devolved administrations – equivalent to a 3.4 per cent increase in their combined health budgets (the administrations themselves must then choose whether or not to allocate those funds to health of course). Assuming the other elements of health spending in England (non-NHS England spending within the Department of Health and other Whitehall expenditure) remained unchanged, the overall increase in UK 'health' spending associated with the 4 per cent pledge would be just 3.5 per cent.

This point has been picked up by others, with the King's Fund highlighting the fact that an announcement of an extra £10 billion for NHS England at Spending Review 2015 (for the period 2014-15 to 2020-21) was in part offset by real terms cuts in unprotected parts of the Department of Health's budget. The King's Fund has calculated that the overall real terms increase in health spending in England is instead set to amount to £4.6 billion.[1]

[1] The King's Fund, *Does the NHS need more money?*, 20 November 2017

Meeting the country's health needs over the coming decades will require very significant new funding

In thinking about what a "significant increase" might constitute, it's worth in the first instance taking a 'bottom-up' approach to ascertain what level of resource will be required in the face of a changing demographic and technological backdrop.

Modelling for the Intergenerational Commission concluded that demographic pressures alone would push spending on health and social care combined from roughly 8 per cent of GDP in 2017 to 9 per cent in 2027, 10.8 per cent in 2037 and 12.2 per cent in 2047.[10] Using the 2017-18 level of GDP as a guide, those proportions are equivalent to increases in annual spending of £20 billion, £57 billion and £95 billion respectively.

A comprehensive recent paper from the IFS and Health Foundation took a similar approach to estimating health funding need, concluding that real terms increases of 3.3 per cent a year would

[10] *A new generational contract: The final report of the Intergenerational Commission*, Resolution Foundation, May 2018, Figure 5.3

be required over the next 15 years "just to maintain current service levels".[11] That is, by 2033, UK-wide real health spending would need to account for 8.9 per cent of GDP (10.4 per cent once social care is included). To modernise the NHS rather than just continue the status quo would mean raising health spending to 9.9 per cent of GDP (11.4 per cent including social care).

Clearly the numbers are subject to considerable uncertainty, and there will always be important political choices to make about just what level of care should be provided. But the similarity between the IFS/Health Foundation and Intergenerational Commission findings is striking. Whatever the precise figures prove to be, it is clear that the ageing population and changing nature of health care is set to place a very large demand on the government's resources in the coming years. But alongside thinking about what the service might *need* it's also worth considering what it might reasonably *expect*. To do so, we can dig into the various figures that have been floated in recent weeks.

For example, Simon Stevens has argued that lifting funding in Britain to the sorts of levels recorded in Germany, France and Sweden would require in the region of "£20-30 billion a year".[12] Alternatively, Gordon Brown has taken what's possible via raising National Insurance as his starting point, arguing that an extra 1p would raise £11 billion that could "transform the service".[13] Others have argued that the government should simply deliver on the "£350 million extra a week for the NHS" (equivalent to £18 billion a year) that was promised as part of the Leave campaign during the EU referendum.[14] Within government itself, it has been suggested that the Health Secretary, Jeremy Hunt, favours an increase of close to 4 per cent a year in the near-term; but that Philip Hammond wants to cap it at 2.5 per cent a year.[15]

By way of illustration, Figure 6 presents the nominal increases associated with a range of potential real terms growth targets over the next four years. The figures relate to NHS England and the Barnett consequentials for the devolved administrations, but not the non-NHS England elements of the Department of Health budget. They therefore show the total additional funds that the government would need to release (above and beyond existing settlements) in order to make good on a number of different potential pledges. We can see that the reported Hammond 'cap' of 2.5 per cent would require an increase in the annual budget of £14 billion by 2022-23; whereas the reported Hunt preference of 4 per cent would necessitate an additional £23 billion a year by the same point.

[11] A Charlesworth, P Johnson et al, *Securing the future: funding health and social care to the 2030s*, IFS and Health Foundation, May 2018

[12] S Stevens, "The NHS approaching 70 – Progress and Prospects", *speech to NHS Providers*, Birmingham, 8 November 2017

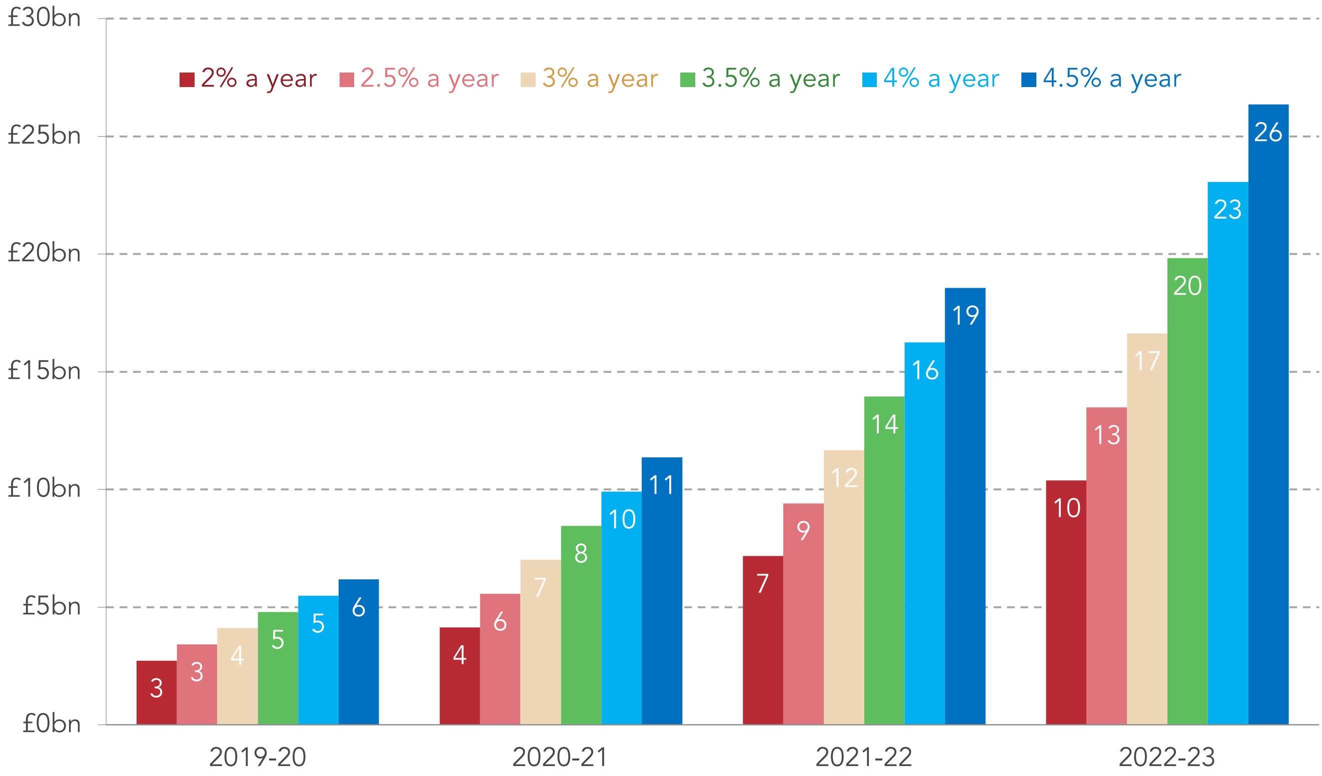
[13] G Brown, "The NHS is in mortal danger – this is how we can save it", *The Mirror*, 5 June 2018

[14] F O'Grady, "Let's have that Brexit-promised £350m a week now – the NHS can't afford to wait", *The Guardian*, 9 November 2017

[15] D Campbell, "Hammond and Hunt in battle over NHS funding boost", *The Guardian*, 10 May 2018

Figure 6: After just four years, annual real terms increases of 4 per cent would compound to £23 billion of extra spending

Extra nominal funding required for real NHS spending to have risen each year by a set percentage



Notes: The baseline used in these calculations relate to NHS England totals for 2018-19, 2019-20 and 2020-21. Beyond this point, we assume spending is held constant in real terms. Other elements of health spending in England (non-NHS England spending in the Department of Health and spending by other Whitehall departments) are excluded. Barnett consequentials are then added for Scotland, Wales and Northern Ireland.

Source: Department of Health and Social Care, *The Government's mandate to NHS England for 2018-19*; OBR, *Economic and Fiscal Outlook*, March 2018

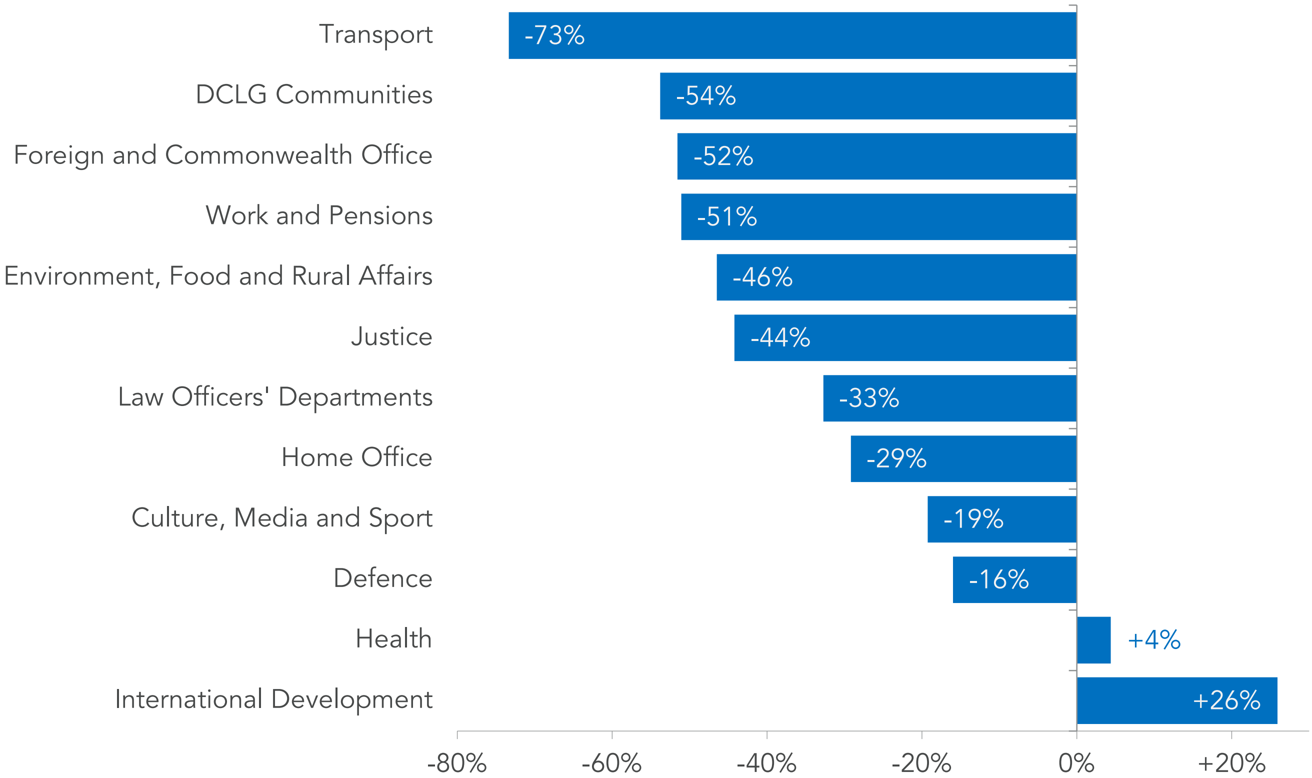
For the purposes of illustrating what we might reasonably expect to happen on 5 July, we assume in the rest of this note that any new announcement provides for real-terms growth of somewhere between 3 per cent and 4 per cent – in the region of £17 billion to £23 billion a year by 2022-23.

We can expect any 70th anniversary pledge to make use of the Chancellor's fiscal headroom and more 'mainstream' tax rises

One option for providing such resources is to cut back on other areas of government expenditure. With a Spending Review due in 2019, there is in theory the opportunity to extend spending restraint across non-health government departments for a few more years. However, as Figure 7 makes clear, the post-2010 period of austerity has already drastically reduced the budgets of many departments. And, while many spending cuts were initially delivered with less fall-out than some had expected, there are now clear signs of pressures across a range of public services (from prisons to pot holes) that make it hard to imagine a new settlement that ploughs significant sums into health at the expense of other departments.

Figure 7: Many non-health departments are already facing huge budget cuts over the decade

Real terms change in resource DEL per capita: selected departments, 2010-11 to 2019-20



Notes: Analysis excludes those departments that have been changed or gained/lost significant areas of responsibility over the period.

Source: HMT *Autumn Budget 2017*; HMT, *PESA*, various

It's clear too that there is very little if any room for manoeuvre in relation to the other major element of government expenditure, welfare. A large part of the £14 billion of cuts to working-age welfare announced after the 2015 general election are still to bite, and many households are already facing significant pressure. The government has previously promised "no new cuts",[16] and any change in that policy would exacerbate an already grim outlook for poverty and inequality in the coming years.[17] In any case, with welfare cuts generally requiring legislative change, finding a majority in the House of Commons would be difficult given the likelihood of at least some dissent among Conservative members.

A second option is to make use of some of the Chancellor's fiscal headroom. The public finances are in a much-improved position relative to earlier post-crisis years. The current budget (i.e. excluding investment) – previously the government's main fiscal target – is forecast to be in surplus in 2018-19 and thereafter. And the Chancellor's 'fiscal mandate' – for cyclically-adjusted net borrowing to be below 2 per cent of GDP in 2020-21 – is currently forecast to be met with £15 billion of headroom to spare.[18] Indeed, in the Spring Statement, the Chancellor said that:

[16] J Elgot, "No more welfare cuts to come under Theresa May, says minister", *The Guardian*, 18 September 2016

[17] A Corlett, G Bangham & D Finch, *The Living Standards Outlook 2018*, Resolution Foundation, February 2018

[18] Resolution Foundation, *Sugar Rush: Spring Statement response*, March 2018

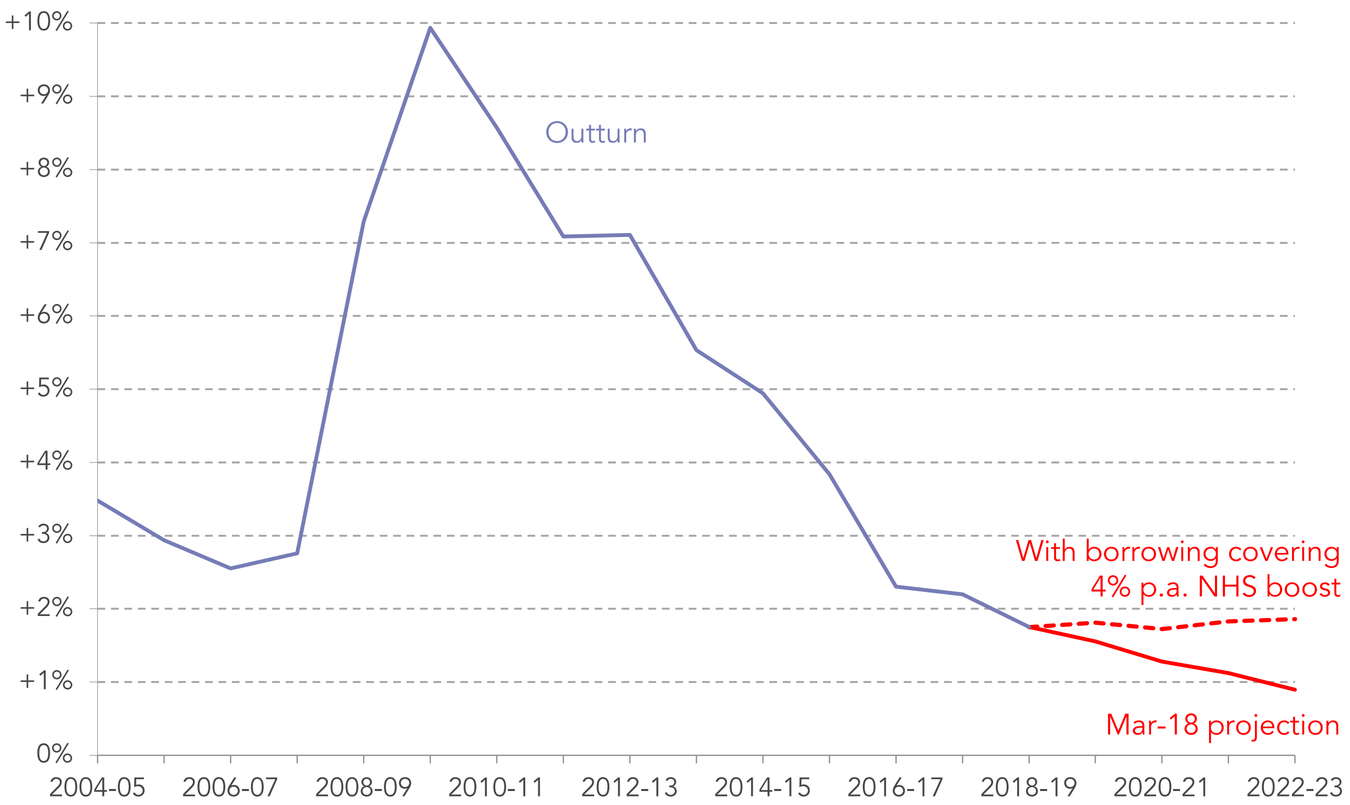
> *If, in the Autumn, the public finances continue to reflect the improvements that today's report hints at, then, in accordance with our balanced approach, and using the flexibility provided by the fiscal rules, I would have capacity to enable further increases in public spending and investment in the years ahead.*[19]

And there is political room for such a move too. A majority (59 per cent) of voters say they "would be prepared for the UK national debt to rise to facilitate additional investment in public services", with health by far the top area specified for extra spending.[20]

But borrowing cannot be expected to take all the strain. Figure 8 shows public sector net borrowing as currently forecast and if the 4 per cent a year spending increase scenario (shown in Figure 6) were not met at all through spending cuts or tax rises. In this case, and on current economic forecasts, the £15 billion headroom in 2020-21 would be greatly reduced – though the fiscal mandate would still narrowly be met – and borrowing would (at 1.9 per cent of GDP) be slightly higher in 2022-23 than in 2018-19.

Figure 8: Funding a large short-term NHS boost entirely through borrowing would cancel out planned borrowing reductions

Public sector net borrowing as a share of GDP: UK, outturn and projected



Source: RF analysis of OBR, *Economic and Fiscal Outlook*, March 2018

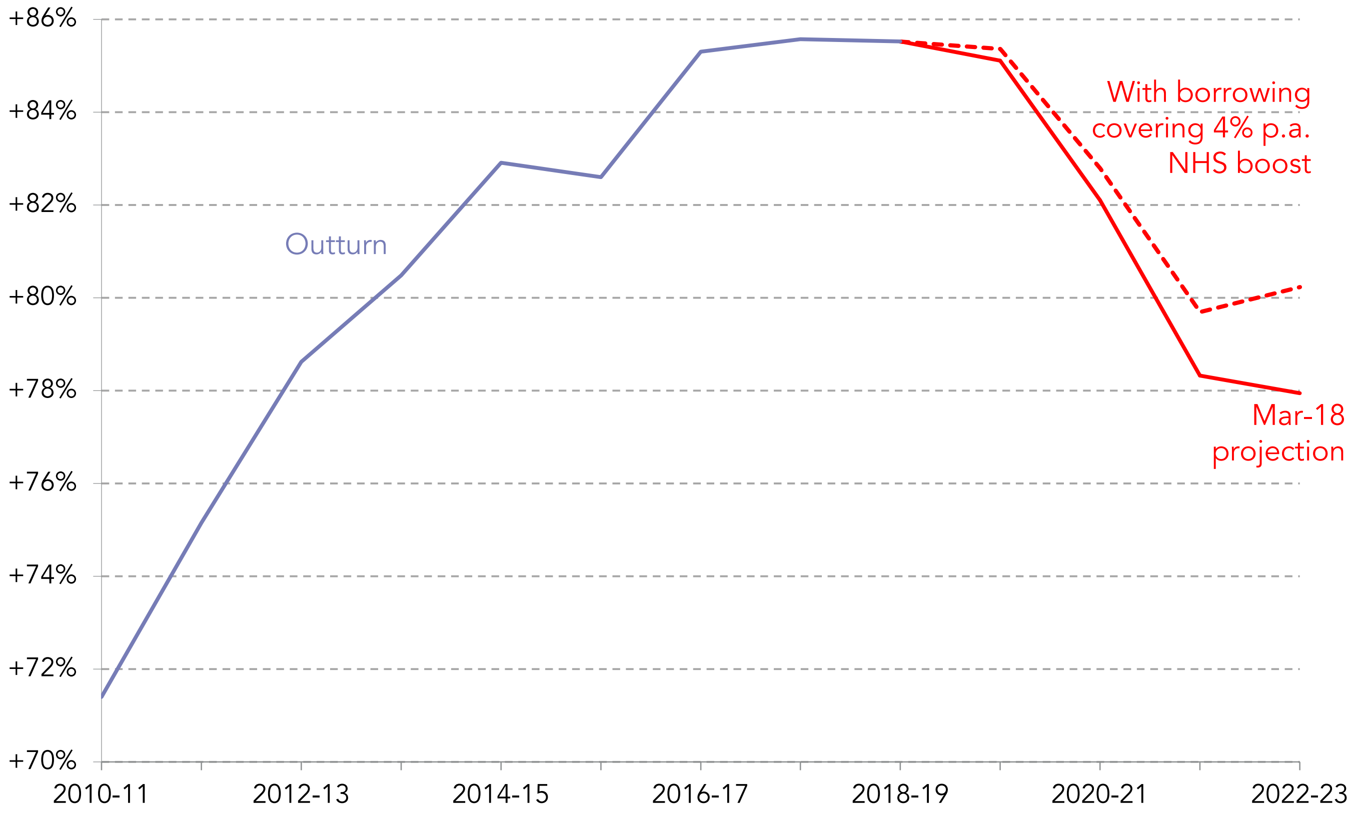
[19] HMT, "Spring Statement 2018: Philip Hammond's speech", 13 March 2018

[20] D-CYFOR polling

Such higher borrowing would however make very clear that the government's long-term objective – to deliver an overall surplus "at the earliest possible date in the next parliament" – is not a very serious intention. And although borrowing is no longer unusually high, the same cannot be said for the national debt. As Figure 9 shows, relying on borrowing would be inevitably slow the pace of that reduction and increase the chance that net debt would not fall in every year, as the Chancellor wishes.

Figure 9: Funding a short-term NHS boost entirely through borrowing would increase national debt slightly, though it would still fall overall over the parliament

Public sector net debt as a share of GDP



Source: RF analysis of OBR, *Economic and Fiscal Outlook*, March 2018

Of course, the amount of money available to the Chancellor will greatly depend on the economic outlook. Whether productivity and wages outperform or underperform relative to current forecasts will be more important for the public finances than the potential spending increase shown above. Earlier OBR forecasts showed how public sector net borrowing in 2022-23 could feasibly be as high as 2.5 per cent of GDP (if productivity underperforms) or as low as -0.2 per cent (if it does well).[21] Some may therefore wish to wait and see what new fiscal forecasts bring. But the government must work with the forecasts it gets.

At this stage we have no way of knowing quite how much fiscal space the Chancellor might be prepared to use of course. His Spring Statement made it clear that he is prepared to share some of the proceeds of upside performance (rather than simply paying down the debt), but he is very unlikely to feel comfortable funding the entirety of any NHS funding boost in this way. If we assume an announcement of new spending in the region of £17 billion to £23 billion a year by 2022-23, then it feels reasonable to suppose that he might be prepared use fiscal space for roughly

[21] OBR, *Economic and Fiscal Outlook*, November 2017

half this amount. Given that the Conservative manifesto pledge to increase NHS funding by £8 billion was unfunded, this approach would be consistent with the notion that he always intended to release some funds for the NHS in this way.

In thinking about which tax rises to prioritise, the government should focus on progressivity, generational fairness and practicality

Tax rises are never popular, but squaring the circle of wanting to put more money into the NHS without further cuts to other elements of government spending and without significantly changing plans for deficit reduction means some form of tax rise or rises looks inevitable.

In order to ensure public support for any move – and in the interests of good public policy making – we believe the government should consult on tax rise options over the summer before setting out its final approach in the Autumn Budget. But how should the government approach what is always a sensitive topic? This paper aims to provide information about potential tax rises to allow them to be considered against three tests:

1. Is it broadly progressive? Any tax rise should reflect ability to pay rather than exacerbating the current squeeze on low to middle income households.

2. Is it fair across generations? Improving the health system for all generations – particularly today's older ones – should also require all generations to pay in.

3. Is it politically possible? Any tax rise must be able to pass through the current parliament, raise money relatively quickly and would ideally not be too unpopular (as tax rises go).

Meeting these tests while raising significant sums is not impossible. As Box 2 shows, there is public support (at least in theory) for tax rises to help the NHS. And, while limited, the Conservatives and DUP do together hold a majority in parliament. The two parties have 326 seats, with 320 needed to win a vote in practice.[22] Given the potential for some Conservative MPs to be reluctant to vote through tax rises however, the government may need some further cross-party support to guarantee success.

Box 2: Opinion polls show potential support for some tax rises

As we showed earlier, public concern about the NHS is high. And people in Britain seem happy to support higher taxes – at least in principle. The British Social Attitudes Survey (BSA) has asked an annual question about people's willingness to increase tax and spending since 1983, and the proportion of people saying they would be willing to increase taxes and spending in 2016 (48 per cent) was at its highest level since 2004. In contrast, just 4 per cent of respondents in 2016 (and 2015) said they would like less tax and spending.[1]

[1] NatCen, *British Social Attitudes 34*

Support for higher taxes appears to be even stronger if tied specifically to health spending. There is majority support for raising any of National Insurance, Income Tax, Corporation Tax and borrowing – as explored in the rest of this report. And a slim majority (51 per cent) said they would "definitely" or "probably" be willing to change their vote at the next general election "in favour of a party which pledged additional funding for the NHS".[2]

[2] ComRes, *Daily Mirror NHS Poll: A survey of 1,073 adults on attitudes towards the NHS*, June 2018

[22] There are 650 seats overall but Sinn Fein do not take theirs and the speaker and deputy speakers do not vote.

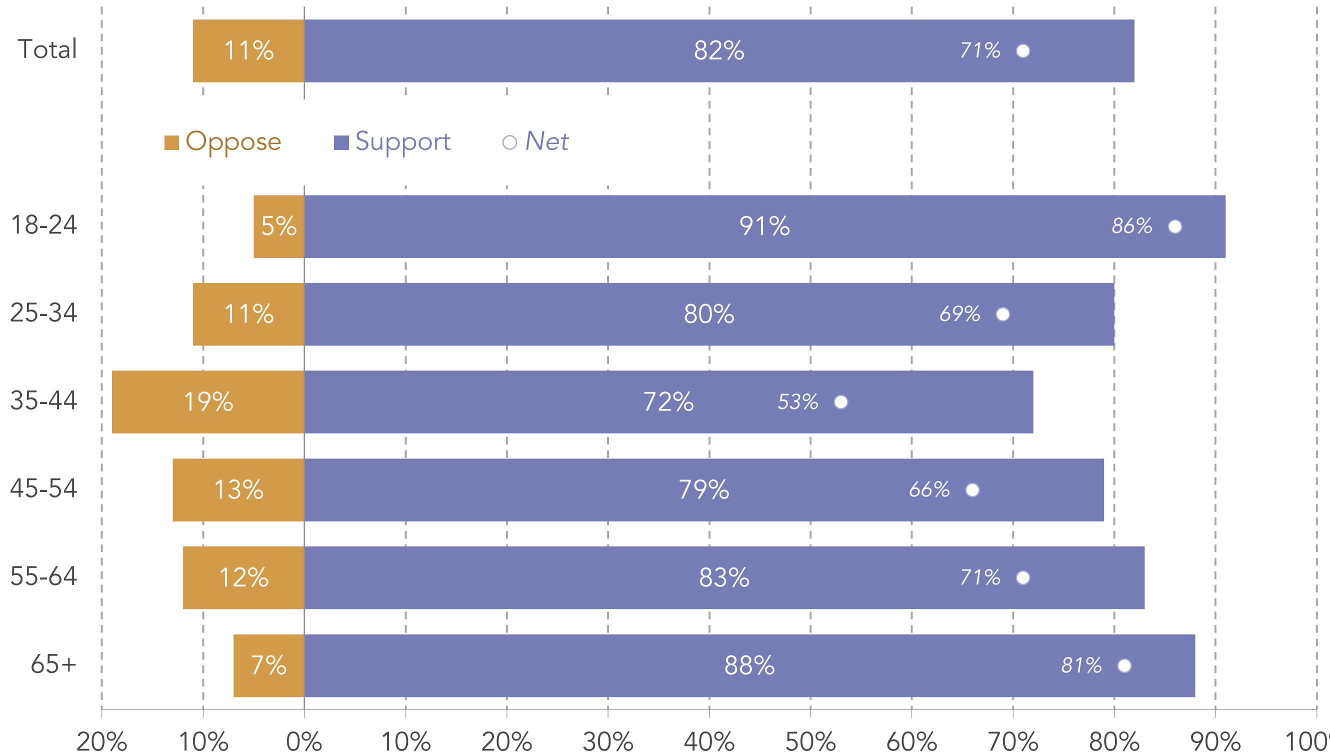
Raising National Insurance in isolation would be progressive, but generationally unfair and hard to get through parliament

The last time a government raised taxation specifically to increase health funding came in 2003-04, with Chancellor Gordon Brown opting to lift NICs rates by 1p. And Gordon Brown has advocated a similar approach again in recent days, saying that a 1p increase for both workers and employers would raise £11 billion from 2019-20.[23]

There is a clear attraction to repeating the trick. Further to the general shift in attitude to raising taxes outlined in Box 2, NICs rises appear to poll most favourably when it comes to funding the NHS.[24] Indeed, only 11 per cent of voters say they would oppose "a 1p rise in national insurance contributions if the Government promised that all the money raised would be ring-fenced to fund only the NHS".[25] Support is especially strong (and opposition particularly low) among the youngest (18-24) and oldest (65+) age groups, as Figure 10 shows.

Figure 10: There is strong public support for a National Insurance rate rise to fund the NHS, particularly among those age 65+

"Would you support or oppose a 1p rise in national insurance contributions if the Government promised that all the money raised would be ring-fenced to fund only the NHS?"



Notes: 'Don't know' not shown
Source: ComRes

[23] £4.88 billion from employees, £5.75 billion from employers and £0.58 billion from the self-employed. See HMRC, *Direct effects of illustrative tax changes*, April 2018

[24] M Smith, "Majority of people would support raising National Insurance to fund the NHS", *YouGov*, 12 January 2017

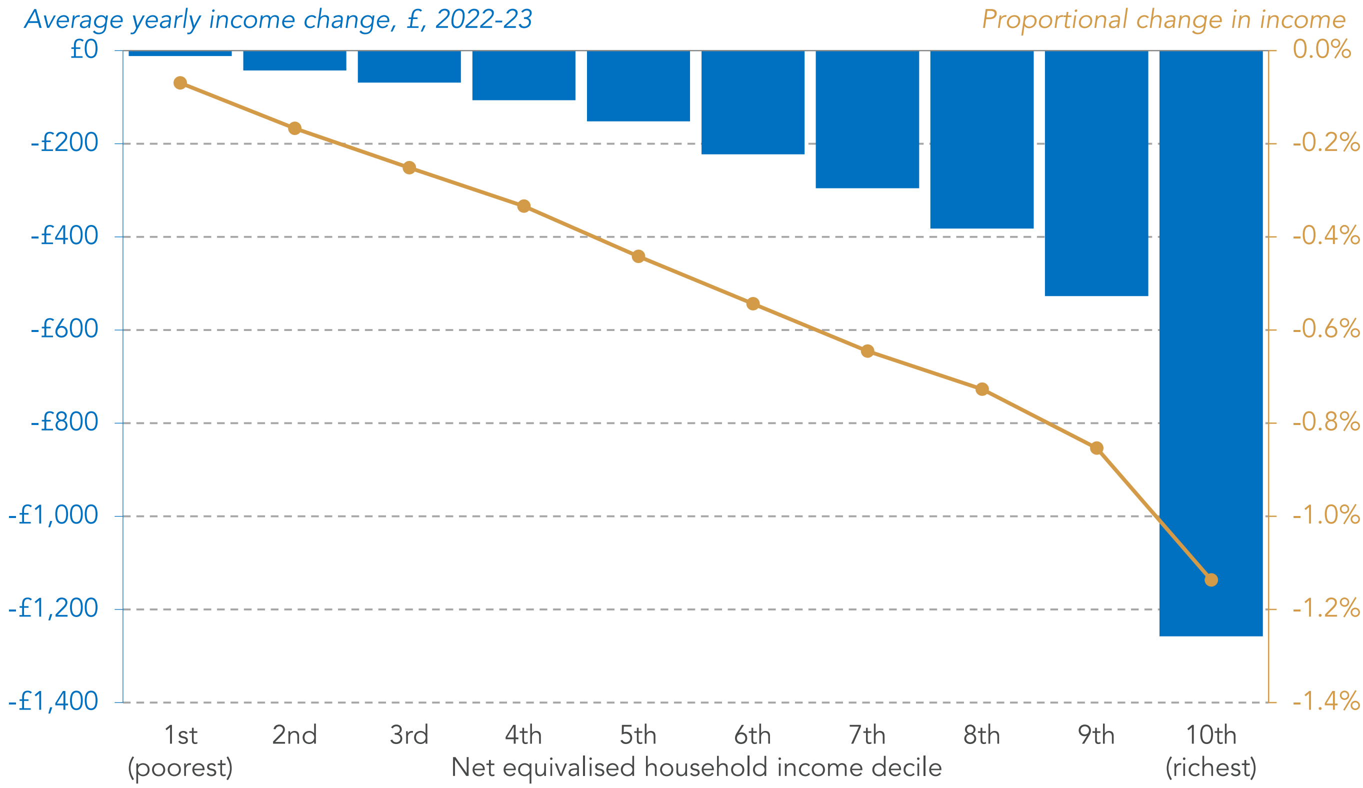
[25] ComRes, Daily Mirror NHS Poll, June 2018

And there is already some link between NICs and the NHS, with a certain proportion – equating to around £24 billion last year – going to the NHS rather than the National Insurance Fund.[26]

A NICs rise would also be progressive across the income distribution. A 1p rise in the employee rate would lift the basic rate from 12 per cent to 13 per cent (and the self-employed rate from 9 per cent to 10 per cent), and raise the rate for higher earners from 2 per cent to 3 per cent. As Figure 11 shows, an increase of this form would lower the incomes of higher income households by significantly more than those of lower income households. Overall it would raise an estimated £5.9 billion in 2022-23. Simultaneously increasing the employer rate from 13.8 per cent to 14.8 per cent would raise a further £6.3 billion.

Figure 11: A NICs rise would be progressive by income

Change in average household disposable income from 1p increase in personal NICs rates by equivalised household disposable income decile, before housing costs, 2022-23



Source: RF analysis of DWP, *Family Resources Survey* using the IPPR tax-benefit model

However, relying on NICs would be unfair in four ways. First, they do not apply to people over state pension age (which will soon be 65 for all and will then rise to 66). Secondly, they apply only to 'earned' rather than investment income (such as from pensions, dividends, rent or royalties). Thirdly, employer NICs do not apply to the self-employed, meaning any increase would encourage firms to rely on contracted labour rather than employment and all the rights that entails. And finally, while increases are undoubtedly progressive overall, it should be noted that NICs start at a

[26] Government Actuary's Department, *Report by the Government Actuary on: The draft Social Security Benefits Up-rating Order 2017; and The draft Social Security (Contributions) (Rates, Limits and Thresholds Amendments and National Insurance Funds Payments) Regulations 2017*, January 2017

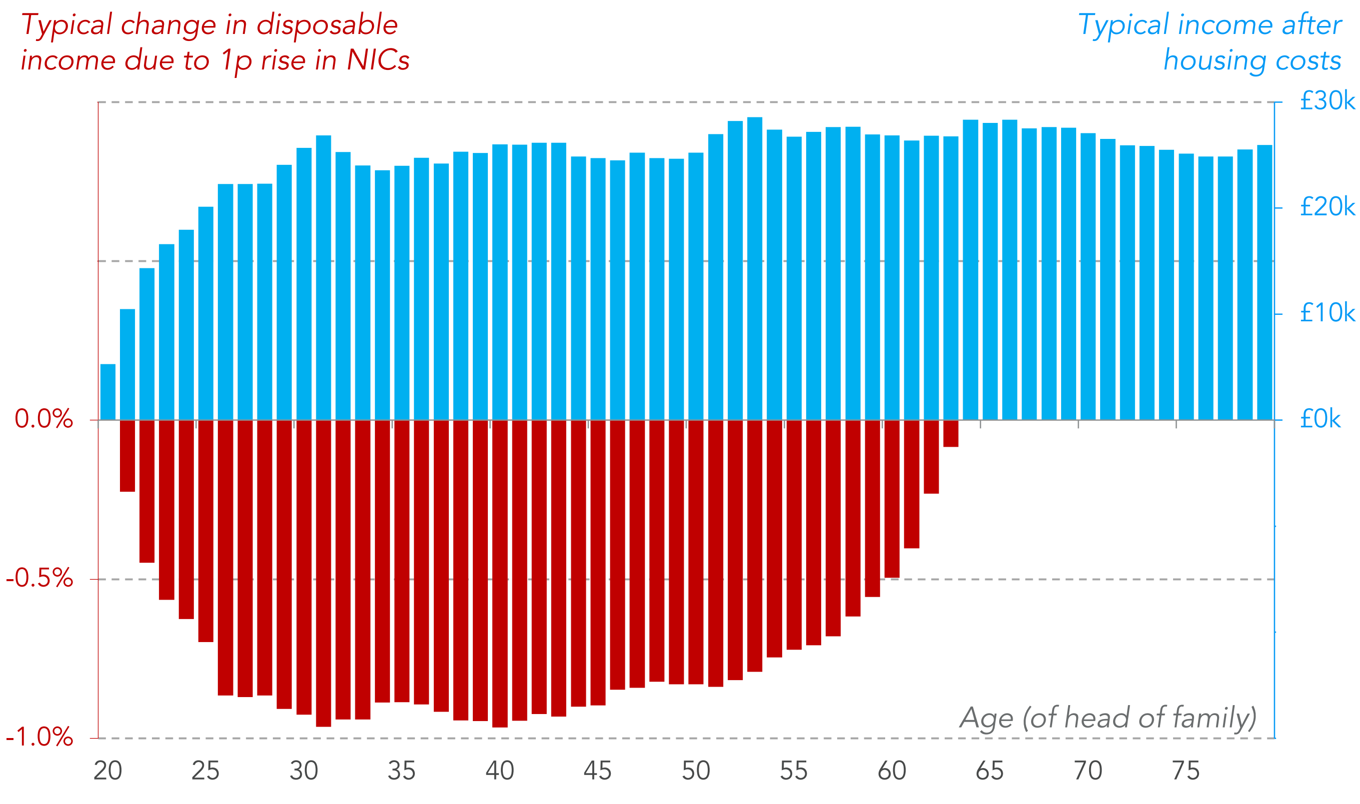
lower income than Income Tax (currently around £8,400 compared to the Income Tax allowance of £11,850).

And the unfairness of any new rise would be on top of many previous increases, with politicians repeatedly preferring to increase NICs rather than Income Tax, compounding tax differences between different groups and income sources.

Perhaps most significant among these issues is the extent to which relying on NICs to fund increased health spending would be generationally unfair. Figure 12 shows how a 1p rise in employee and self-employed NICs would be distributed across the age distribution (on a household basis), with individuals over state pension age being unaffected. Those above state pension age would – having paid NICs at lower rates in their working lives – benefit from increases in NHS spending while asking subsequent generations to foot all of the bill.

Figure 12: A 1p rise in NICs would have no effect on those above state pension age

Typical equivalised household disposable income after housing costs in 2022-23, and proportional change due to 1p increase in personal NICs rates



Notes: Based on pension ages in 2016-17 (the latest data). Figures are smoothed across rolling three-year age bands.

Source: RF analysis of DWP, *Family Resources Survey* using the IPPR tax-benefit model

The government would also face a significant problem of practicality in relation to raising NICs. The policy didn't feature in any party's manifesto – and Labour explicitly ruled out increasing "personal" NICs – meaning opposition parties are likely to feel inclined to vote against it. It should also be noted that NICs changes are – for arcane reasons – done separately from Finance Bills, and must be passed by the House of Lords as well as the Commons.

While progressive overall then, NICs rate rises clearly discriminate against working-age earned income and should not by themselves be considered an equitable way to fund increased NHS spending.

Any NICs rise for non-pensioners should be accompanied by a NICs rise for pensioners

One NICs reform that the government *should* review however, is the age-based cut off. Applying it to people over state pension age would mean introducing at least some NICs on employees and the self-employed over state pension age (note that their employers already pay) and could also include charging at least some NICs on private pension income.

At a minimum, this might mean – if rates for non-pensioners were increased by 1p – introducing a 1p rate for pensioners. In the case of employment income this would be administratively easy – and raise around £100 million. Extending some NICs to pension income would be more complex but would raise over £200 million. This limited option would not address existing disparities in income taxation, but would (with the exception of rental and dividend income) ensure they were not worsened.

More ambitiously, as set out in the final report of the Intergenerational Commission, the NICs employment exemption over state pension age could be removed entirely, raising £0.9 billion in 2020-21 (or more if NICs rates were increased by 1p). And NICs could be introduced on private pension income but with a higher threshold and lower rate, raising £1.4 billion in 2020-21. In part, this more generous treatment compared to other income would reflect the fact that NICs has already been paid on some pension contributions – making it undesirable to levy it in full when the pension is drawn down too. By 2022-23, the combined resources raised could amount to £2.5 billion, with 80 per cent of this coming from the richest fifth of pensioners.

The Intergenerational Commission argued that these funds would form a "NHS levy" that would help to ensure older cohorts contributed to supporting the health service that they (and those who followed) would expect and deserve as they aged.[27]

Given the country's health and social care needs – and bearing in mind that the proportion of people above state pension age is projected to hit a low point in 2020 due to the rising age threshold[28] – we believe that extending NICs to pensioners should be seriously considered.

However, this reform would be no easier – and indeed, quite possibly harder – than a standard NICs rise to get through parliament. The Health and Social Care Commission convened by the Liberal Democrats did recommend ending the NICs exemption for workers beyond state pension age,[29] but even with the support of their 12 MPs, such a tax rise would remain difficult. Note too that, even before the 2017 election, the government was unable to slightly narrow the NICs gap between employees and the self-employed.

[27] *A new generational contract: The final report of the Intergenerational Commission*, Resolution Foundation, May 2018, Chapter 10

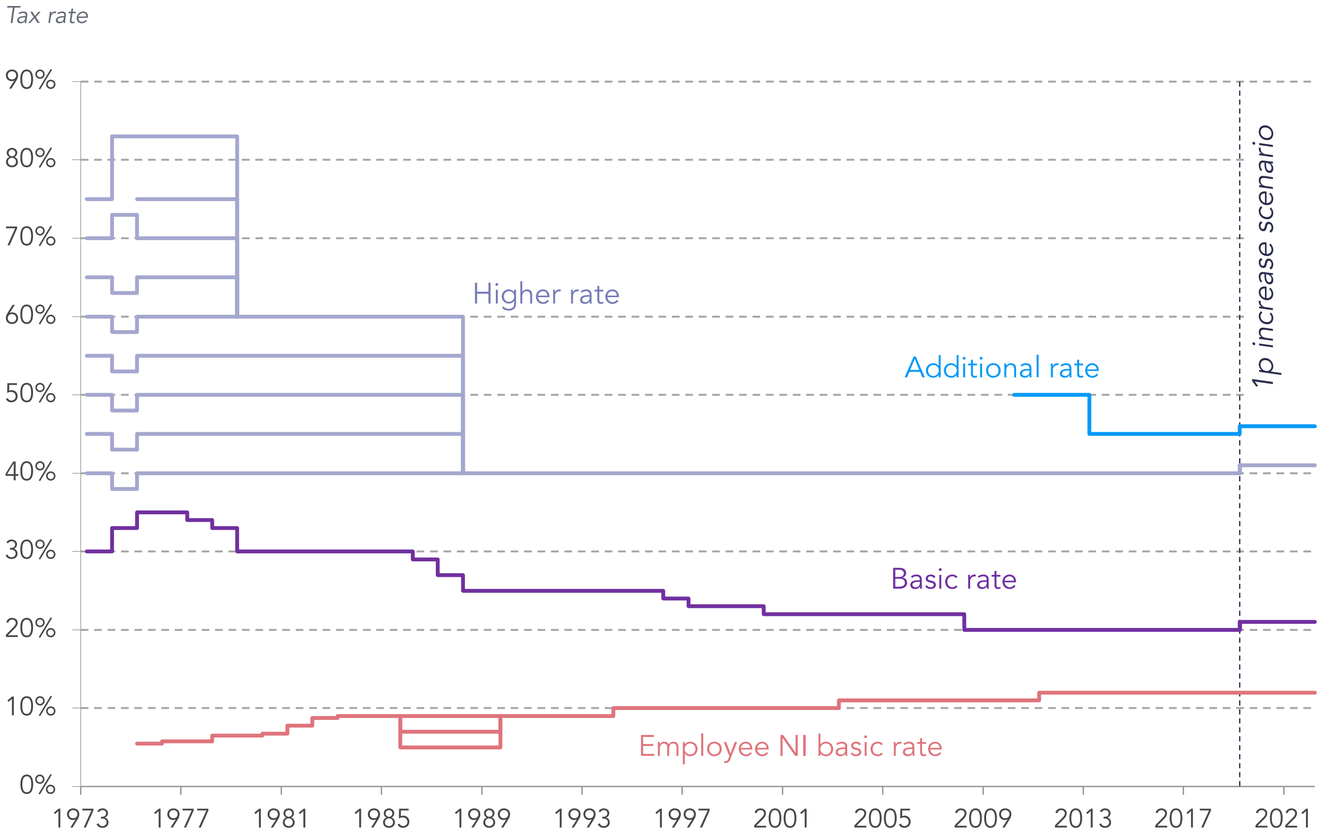
[28] ONS, *2016-based National Population Projections*, October 2017

[29] Health and Social Care Commission, *Health and social care: delivering a secure funding future*, Liberal Democrats, February 2018

Increasing Income Tax would be a progressive way to raise money, less generationally unfair than NICs and would have some support from other parties

Income Tax raises more than any other tax. A 1 percentage point increase in every rate of the tax (from 20, 40 and 45 per cent to 21, 41 and 46 per cent) would raise around £7.4 billion in 2022-23 (including raising dividend tax rates, as these are a form of Income Tax). As Figure 13 shows however, the basic and higher rates of Income Tax have not been altered since 2008 and not increased since 1975 – meaning a rise would represent a very significant change of direction. That said, a basic rate of 21 per cent would still be lower than at any time prior to 2008-09.

Figure 13: Any rise in the basic or higher rates of Income Tax would be the first since 1975

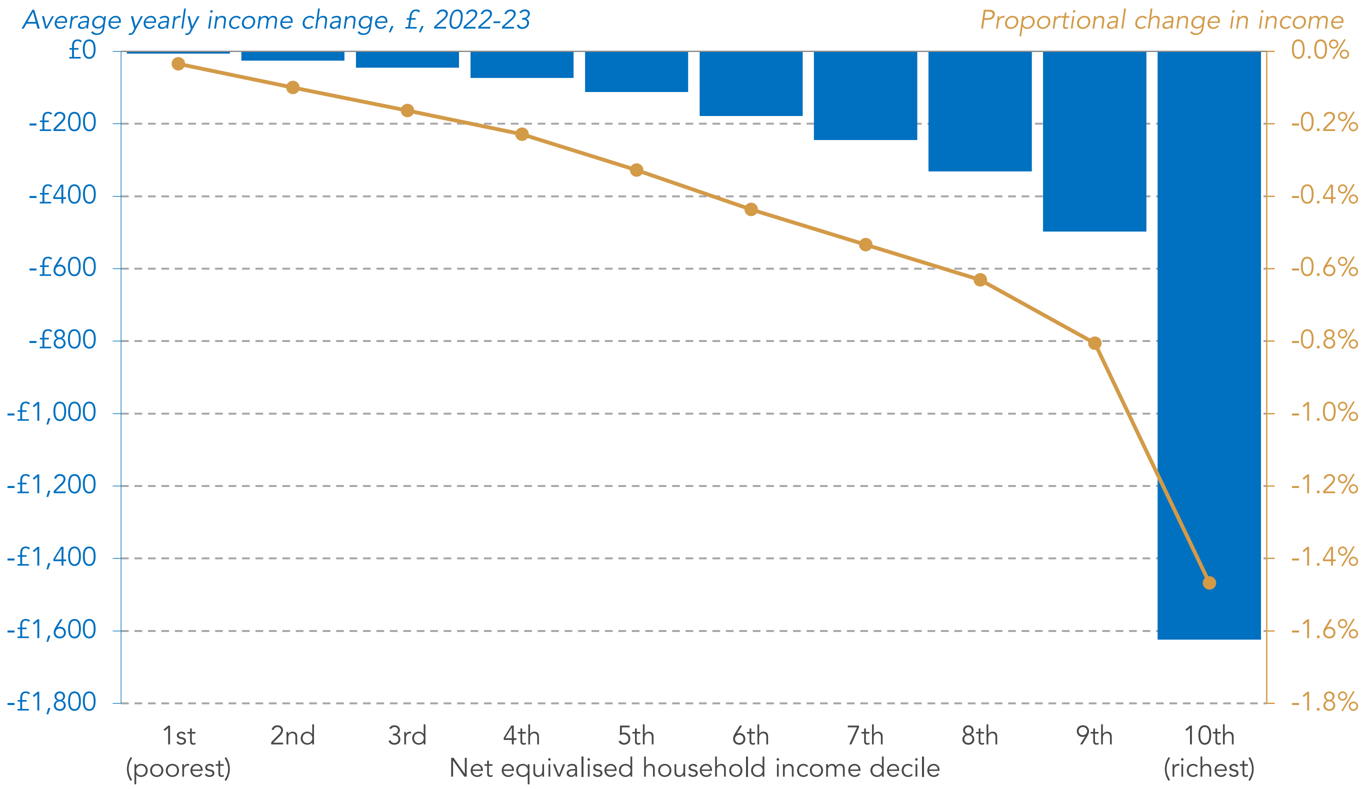


Source: RF analysis of HMRC and IFS

Like NICs, an increase in Income Tax rates would be progressive, with the largest proportional tax rises occurring for higher income households, as Figure 14 demonstrates. Those households in the top 10 per cent of the distribution may see net income reduced by 1.5 per cent (though in a growing economy this may only reduce income growth, rather than being an absolute fall overall), whereas those in the bottom half would experience falls of just 0.3 per cent on average. If the 'gains' from a higher quality NHS are considered too, it is clear there would be a lot of winners. It is also worth noting that households on Universal Credit would be protected to some degree, because every £100 increase in Income Tax for them would be offset by a £63 benefits increase due to the way the Universal Credit means-test operates.

Figure 14: Income Tax rate increases would fall almost entirely on the top half of the income distribution

Change in average household disposable income from 1p increase in Income Tax rates by equivalised household disposable income decile, before housing costs, 2022-23



Notes: We include a dividend tax rate increase, and apportion this entirely to the top decile.

Source: RF analysis of DWP, *Family Resources Survey* using the IPPR tax-benefit model

So an Income Tax rise would be progressive and would avoid the generational unfairness of the NICs increase, but could such a tax rise to fund the NHS pass through the Commons?[30]

Labour would almost certainly oppose such a move – their election manifesto included an explicit pledge not to increase taxes on those with incomes below £80,000. And there may again be some Conservative members who would vote against the proposal. However, the Liberal Democrats (with 12 MPs) proposed exactly this policy in their manifesto, so the government could presumably count on their support.[31]

The position of the SNP is also interesting. Income Tax rates in Scotland were increased in just such a way in April 2018 (though with the addition of some new tax bands such that they now progress through 19, 20, 21, 41 and 46 per cent). The SNP's 35 MPs might therefore find it hard to vote against broadly the same policy in the rest of the UK – particularly when Scotland has expressed concern that its higher tax rates might lead some high income individuals to relocate within the UK.[32] Countering this is the fact that tax increases outside Scotland reduce Scotland's Block Grant (i.e. it is the difference between Scottish and UK tax rates that matters for the Scottish finances – not just the Scottish system). However, an associated increase in NHS England spending would of course boost funding to Scotland through the Barnett formula. At worst then, the SNP may abstain on a 'rUK' Income Tax rise.

[30] Note that Finance Bills do not require approval by the Lords.

[31] *Liberal Democrat website*, "Our plan for health"

[32] Scottish Government, *Additional Rate of Income Tax analysis*, December 2017

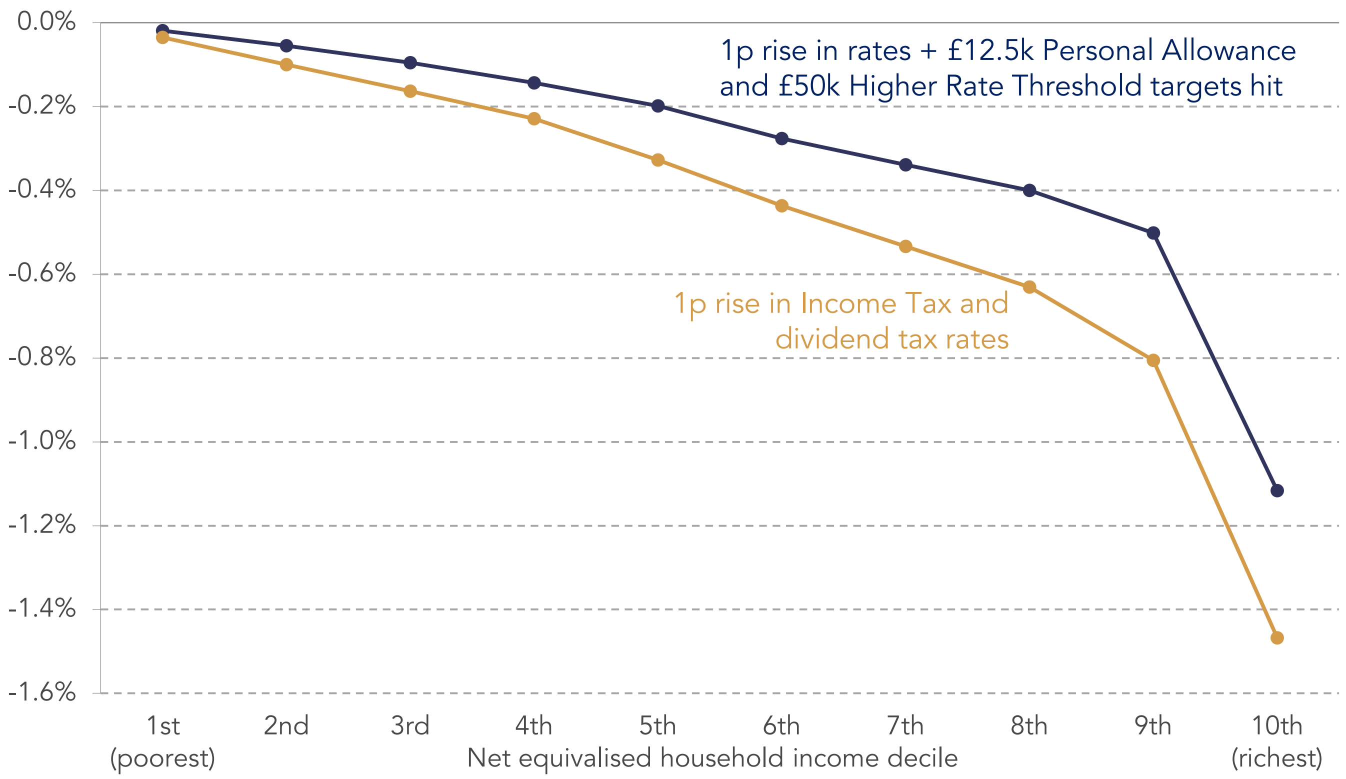
The government could choose to freeze tax thresholds instead, reversing some of the expensive and regressive increases introduced since 2010

One complication for a government seeking to raise taxes is the Conservative manifesto pledge to raise both the point at which Income Tax becomes payable (to £12,500) and the point at which the higher rate kicks in (to £50,000) by the end of the parliament.[33] These changes have not been legislated for or funded, and on current inflation projections alone the government would fall short of these targets.

Following through on the pledge would cost around £1.6 billion. This would reduce the impact of a rate rise, as Figure 15 shows, but regressively so. Taxpayers on incomes below £15,500 would be better off overall, but the threshold increases would be worth most to those with the highest incomes.

Figure 15: A 1p rise in Income Tax rates could be somewhat counteracted by existing pledges to raise the Personal Allowance and Higher Rate Threshold

Percentage change in average household disposable income from 1p increase in Income Tax rates by equivalised household disposable income decile, before housing costs, 2022-23



Notes: We include a dividend tax rate increase, and apportion this entirely to the top decile.

Source: RF analysis of DWP, *Family Resources Survey* using the IPPR tax-benefit model

[33] Conservative Party, *Forward Together: Our Plan for a Stronger Britain and a Prosperous Future*, The Conservative and Unionist Manifesto 2017, May 2017

Clearly this approach would significantly eat into the funds raised for the NHS by any Income Tax rise, however.

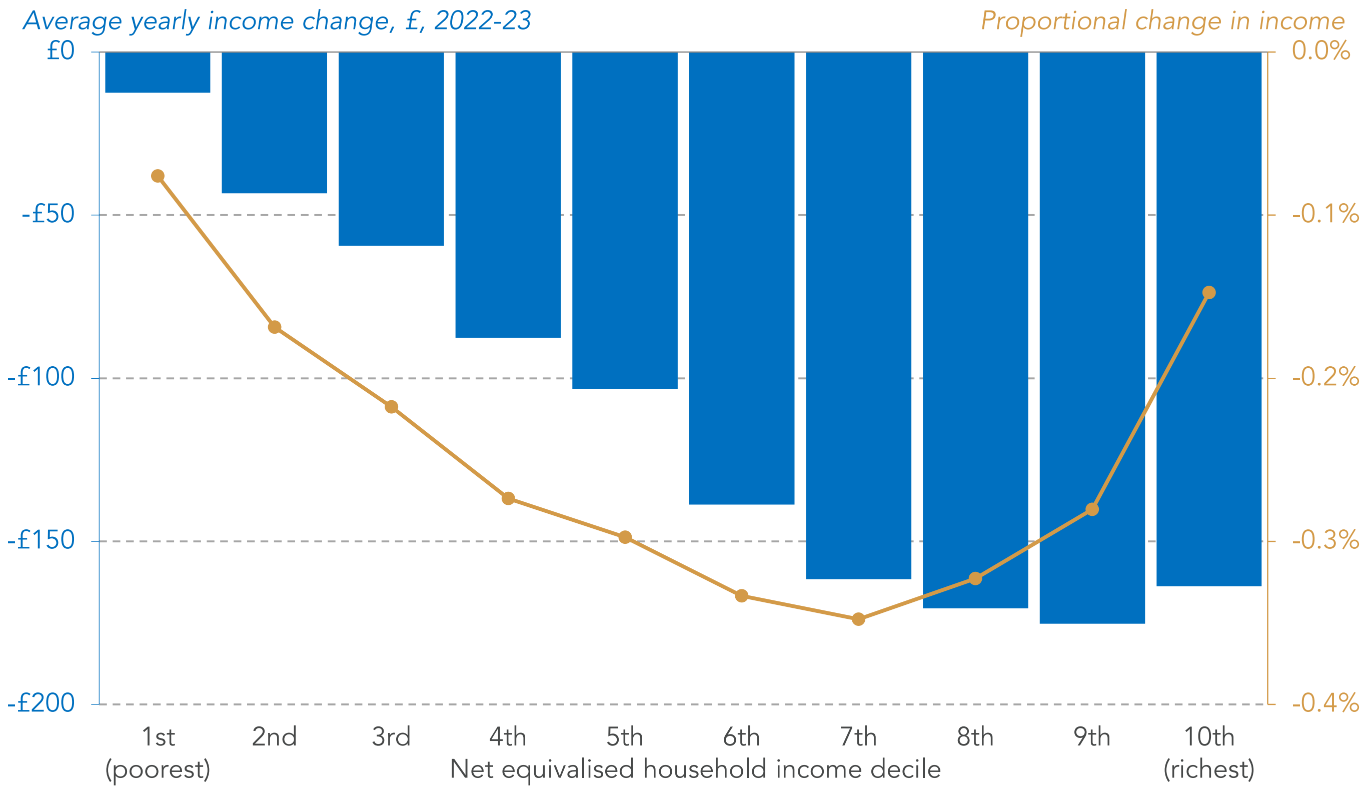
One way in which the government could help fund the NHS would therefore be to not implement these tax cuts. As well as saving money, by effectively cancelling an Income Tax cut this approach would again be more progressive than the default position. The government may be reluctant to abandon a manifesto pledge in this way however – particularly given the furore that surrounded the attempt to row back on the 2015 manifesto at Spring Budget 2017. On that occasion Philip Hammond proposed raising NICs for the self-employed, but fell foul of opposition from Conservative MPs who argued that this move reneged on the manifesto pledge not to increase NICs, Income Tax or VAT.

An alternative approach would be to lift the Income Tax thresholds to those pledged in the manifesto in 2020-21, but to freeze both them and the NICs thresholds in the final two years of the parliament. This would of course cost money in 2020-21, but by 2022-23 it would raise £3.7 billion relative to the default of uprating in line with inflation every year.

Figure 16 sets out the distributional impact of such a move, and shows that the impact of such a freeze would be broadly progressive. This would not be as straightforwardly progressive as in the case of rate rises however: whereas the greatest proportional impact of a rate rise would be for the highest income decile, freezing tax thresholds would have its greatest impact on deciles 7 and 6. The impact would be lowest on the poorest and richest deciles.

Figure 16: Freezing tax thresholds (after hitting the manifesto goals) would be broadly progressive, but less so than a rate rise

Change in average household disposable income from Income Tax and NICs threshold changes, by equivalised household disposable income decile, before housing costs, 2022-23



Source: RF analysis of DWP, *Family Resources Survey* using IPPR tax-benefit model

Like increasing NICs rates, however, freezing NICs thresholds would fall entirely on the earned income of those below state pension age, again making such a tax increase generationally unfair.

Politically, freezing thresholds can be attractive to governments as the change is less obvious to voters than a rate rise. But since 2010 the government has raised the political profile of the Personal Allowance, with multiple parties having promised tax cuts for low earners, perhaps making such a change harder now than in the past.

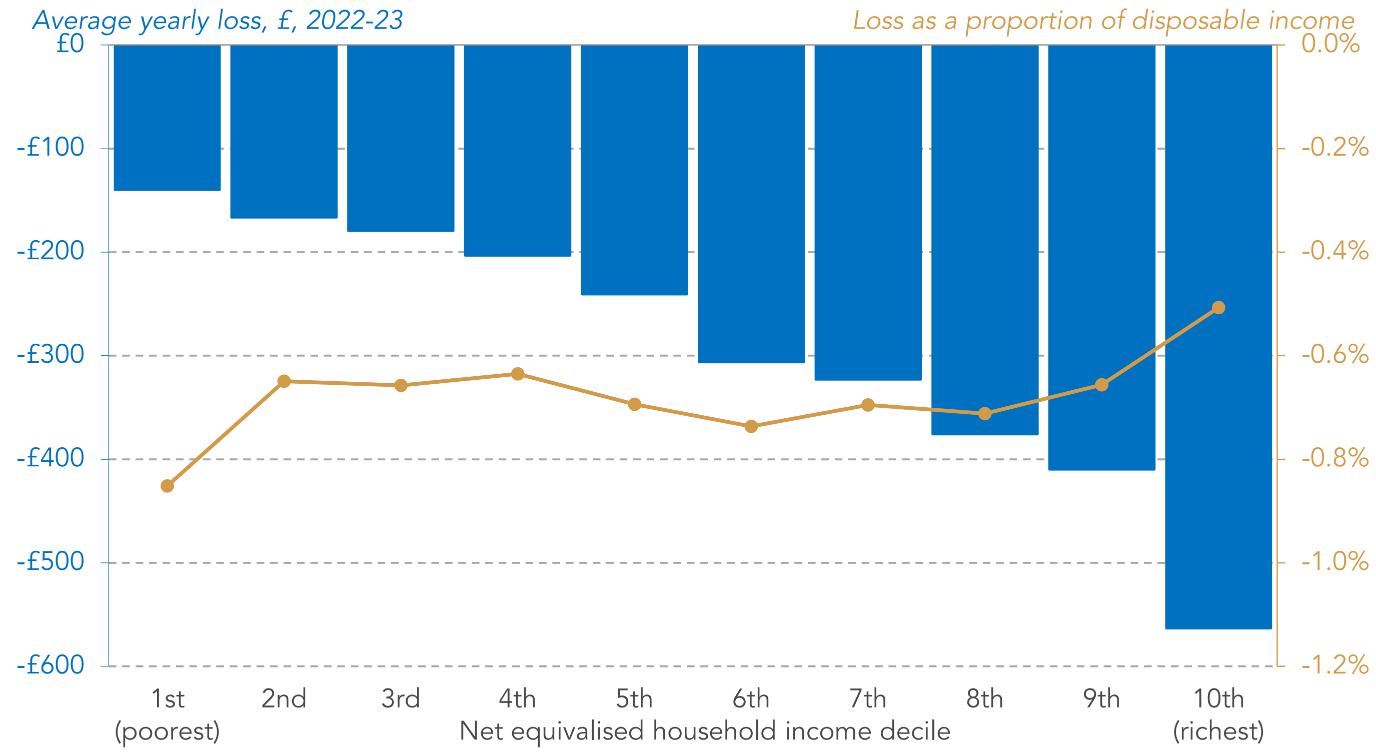
An increase in VAT is undesirable and unlikely

Alongside Income Tax and NICs, the other member of the 'big three' taxes is VAT: together these comprise almost two thirds (64 per cent) of total tax revenue. As with the other two members of the big three then, a rise in VAT has the potential to raise significant sums of money. Each 1 percentage point increase would raise around £6.8 billion in 2022-23.[34]

As tax rises go, however, VAT rises are relatively regressive. At best, increases affect rich and poor roughly in proportion to their expenditure – but this is in contrast to most tax rises, which tend to affect the top half of the income distribution to a greater degree. Figure 17 sets out the potential impact of a 1 percentage point increase in the rate (assuming no behavioural change), with households at the bottom of the income distribution recording the biggest proportional effect and those at the top recording the lowest.

Figure 17: An increase in VAT would be broadly regressive by income

Tax increase due to a 1p increase in VAT by equivalised household disposable income decile, before housing costs, 2022-23



Source: RF analysis of ONS, *Effects of taxes and benefits on household income*, 2015-16

[34] HMRC, *Direct effects of illustrative tax changes*, April 2018; uprated to 2022-23 using OBR, *Economic and Fiscal Outlook*, March 2018

A VAT rise would also increase the tax difference between goods and services taxed at the standard (currently 20 per cent) rate and those taxed at 5 or 0 per cent. This tax difference – while created with good intentions – produces large economic distortions on people's spending that would be exacerbated by another VAT rise. Another option some propose would be to target these VAT 'reliefs' such as on food (costing the exchequer £18 billion a year) or domestic fuel and power (£5 billion), but doing so would (in isolation) be even more regressive and controversial.

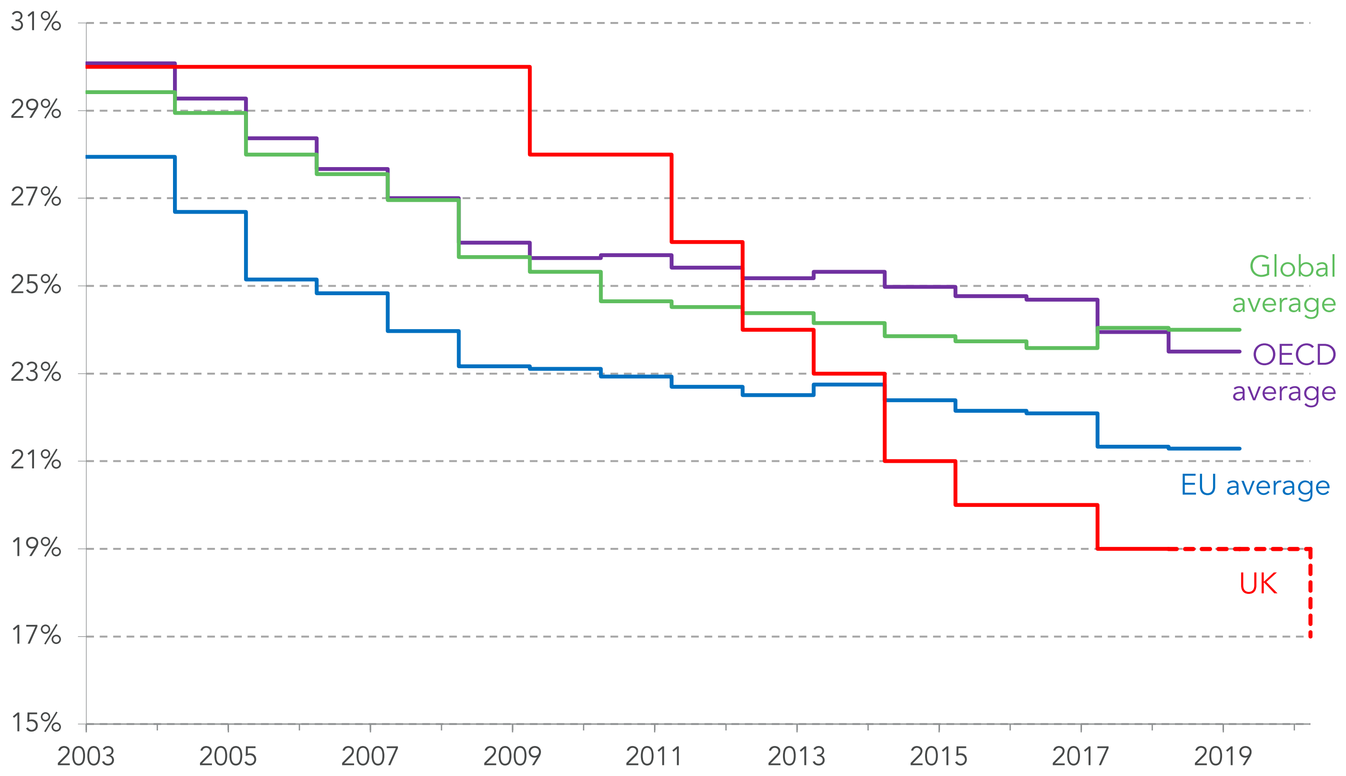
Given that a VAT rise was not in any party's 2017 manifesto, and that the Conservatives' explicitly said "we will not increase the level of Value Added Tax",[35] it appears highly unlikely that the government will seek to go down this route to fund the NHS.

Cancelling the planned cut in the Corporation Tax rate would save in the region of £5.6 billion

Corporation Tax is the country's fourth largest tax. And here it is possible for the government to raise revenue not by increasing rates but simply by not cutting them. Figure 18 shows how the rate has already fallen – from 30 per cent in 2008-09 to 19 per cent today – and how a further cut to 17 per cent is scheduled for 2020.

Figure 18: UK corporation tax rates are now low by international standards and are set to be reduced further in 2020

Headline corporate tax rates



Source: KPMG, with proposed UK rates for 2019 and 2020 added

[35] Conservative Party, *Forward Together: Our Plan for a Stronger Britain and a Prosperous Future*, The Conservative and Unionist Manifesto 2017, May 2017

Crucially, this tax cut has already been legislated for and baked into HM Treasury forecasts. Cancelling it would therefore improve the public finances by £5.2 billion in 2020-21 and around £5.7 billion by 2022-23.

This would of course require primary legislation, but in this instance the government is less likely to face resistance from opposition parties. The Labour manifesto proposed raising the rate to 26 per cent for instance, while the Lib Dems called for a rise to 20 per cent and the SNP said they would not support further reductions. And 77 per cent of the public – including a large majority in every age group and party – said they would support the tax rate staying at 20 per cent (the rate at the time) with the money saved being given to the NHS.[36]

The Chancellor might also feel emboldened to act given the way in which the estimated costings of the move from 19 per cent to 17 per cent have shifted since George Osborne first announced it.

The policy was introduced over two fiscal events – Summer Budget 2015 and Budget 2016. The former announced a move from 20 per cent to 19 per cent in April 2017 and a subsequent further reduction to 18 per cent in April 2020, while the latter took a further percentage point off in April 2020. Together, the HM Treasury costings for the combined reduction from 20 per cent to 17 per cent totalled £3.5 billion by 2020-21[37] (with the OBR rolling this forward into a total of £3.6 billion in 2022-23).[38] However, more recent HM Treasury estimates put the cost of moving from 20 per cent to 18 per cent at £4.9 billion in 2020-21,[39] and the further cost of moving from 18 per cent to 17 per cent at £2.1 billion in 2020-21 (rising to £2.9 billion in 2022-23).[40]

Estimates of the combined costs of moving from 20 per cent to 17 per cent in 2020-21 therefore appear to have doubled: from roughly £3.5 billion to £7 billion. So, on the latest figures, the forthcoming reduction from 19 per cent to 17 per cent will cost the Chancellor in the region of £5.7 billion by 2022-23,[41] compared with an initial estimate roughly half that. The Chancellor would therefore be on strong ground if he were to argue that a previously legislated for tax cut now needs revisiting in the light of new cost estimates.

Cancelling the Corporation Tax cuts may be relatively straightforward from a political perspective then. But, as with all taxes, we shouldn't imagine that it has no distortive effect. All taxes are ultimately borne by individuals, and there is much academic debate about who pays Corporation Tax – whether owners (including pension funds), workers or even customers. There is no clear answer but, while workers will clearly be affected to some degree,[42] it does appear that capital owners may bear a large part of any tax changes.[43] It's also worth noting that the owners of UK companies may be overseas, implying the tax rise would not fall only on British taxpayers (unlike many other tax increases) – but also that Corporation Tax increases may negatively affect inward investment. Overall however, there is no suggestion that an effective Corporation Tax rise

[36] BMG Research, *Independent/BMG poll: NHS & Social Care Funding a Priority for the Public*, 6 March 2017

[37] HM Treasury, *Summer Budget 2015: policy costings*, July 2015, p14; HM Treasury, *Budget 2016*, March 2016, Table 2.1

[38] OBR, *Policy Measures Database*, December 2017

[39] HM Treasury, *Spring Budget 2017*, March 2017, Table 2.2

[40] HM Treasury, *Autumn Budget 2017*, November 2017, Table 2.2

[41] HMRC, *Direct effects of illustrative tax changes*, April 2018; uprated to 2022-23 using OBR, *Economic and Fiscal Outlook*, March 2018

[42] N Moore, T Kasten & C Schmidt, *Do Wages Rise when Corporate Taxes Fall? Evidence from Germany's Tax Reform 2000*, December 2014

[43] A J Auerbach, *'Who Bears the Corporate Tax? A Review of What We Know'*, 2006; K Clausing, *'In Search of Corporate Tax Incidence'*, 2012; J Gravelle, *'Corporate Tax Incidence: Review of General Equilibrium Estimates and Analysis'*, Congressional Budget Office 2013

(a cancellation of the cut) would have an especially regressive or generationally unfair impact. Business might be more open to a cancellation of the cut, however, if it were used for purposes such as technical education – as suggested by the Intergenerational Commission.[44]

Note also that one of the effects of lowering Corporation Tax would be to further tax advantage company owner-managers over regular self-employed workers and employees. This tax difference is a major problem for the Exchequer and would get worse with a 17 per cent rate,[45] providing another reason for reversing the decision.

As part of a long-term settlement designed to put health spending onto a sustainable footing, wealth tax reform offers an important opportunity

Changing the rates or thresholds of National Insurance, Income Tax, VAT or Corporation Tax are perhaps the most straightforward options for a government looking to raise a lot of money quickly. But there is also a need for major reform of the country's approach to taxing wealth.

Personal wealth has grown 2.5 times faster than the economy (and hence incomes) since 1980, and now represents roughly seven times the total value of annual GDP. But wealth-related tax revenues have remained flat over this period (accounting for just 2.5 per cent of GDP). It is unexpected windfalls and valuation effects associated with rising house prices and falling interest rates – rather than active savings behaviour – that explain the majority of families' wealth accumulation in recent decades. Such gains have predominantly accrued to cohorts born in the 1940s, 1950s and 1960s and are very unlikely to be repeated for younger cohorts. As such, while the overall value of household wealth has continued to grow at pace post-financial crisis, we are not seeing substantial progress in wealth accumulation for any cohorts born since 1960.

Given these insights, the Intergenerational Commission concluded that a focus on wealth could help to fund the health and care services that older generations deserve and expect to receive in the coming years in a way that does not ask younger generations to shoulder all of the cost.[46] In particular, the UK's system of property tax should be reviewed.

Council tax is already rising rapidly to support social care provision: average rates in England rose by 4 per cent in 2017-18 and 5.2 per cent in 2018-19, and they are expected to rise by 3.8 per cent in 2019-20.[47] While the tax could be increased further however, doing so would double down on a regressive structure. As it is an entirely local tax it is also particularly ill-suited to raising money for the NHS.

The Intergenerational Commission proposed replacing council tax with a new progressive property tax – related to up-to-date property values – with a tax-free allowance and multiple tax bands. Given that council tax is regressive in relation to property value, a fairer approach could increase tax revenues by £5 billion relative to council tax while leaving nearly three-quarters (72 per cent) of households better off. The Commission stated that this approach could lift social care funding by £2 billion a year, and should be placed alongside an increase in property-based contributions to care costs.[48]

[44] *A new generational contract: The final report of the Intergenerational Commission*, Resolution Foundation, May 2018, Chapter 8

[45] Resolution Foundation, *Work in Brexit Britain: reshaping the nation's labour market*, July 2017

[46] *A new generational contract: The final report of the Intergenerational Commission*, Resolution Foundation, May 2018, Chapter 11

[47] OBR, *Economic and Fiscal Outlook*, March 2018

[48] *A new generational contract: The final report of the Intergenerational Commission*, Resolution Foundation, May 2018, Chapter 9

As for pensions taxation, there remain large, mostly regressive tax breaks for saving: particularly Income Tax relief (£24 billion a year), the lack of National Insurance contributions (NICs) on employer contributions (£17 billion) and the tax-free lump sum. The Intergenerational Commission offered a range of options such as rebalancing Income Tax relief and reducing the maximum tax-free lump sum. However, such potential reforms must be seen in combination with the need to make auto-enrolment a success for lower earners, to further increase pension saving and to ensure balance in tax treatment across generations.[49] So although pension tax reform is needed, it cannot be seen solely as a way to raise revenue.

The Intergenerational Commission also argued for the abolishment of inheritance tax and its replacement by a tax that is better able to command public support and rise to the challenge of growing inheritances.[50] A Lifetime Receipts Tax – covering all lifetime gifts, with fewer exemptions, levied on recipients not givers, and with lower rates – could raise £5 billion extra in its first year, and over £10 billion in later years, particularly if related tax breaks were also curtailed. Again such funds could be used for health spending, but given the nature of inheritances there is a natural case for any extra funds to be focused on younger generations.[51]

Additionally, there are a range of exemptions that could be tightened within existing wealth taxes. These include Business Property Relief (costing £700 million a year), Agricultural Relief within inheritance tax (£500 million), the inheritance tax treatment of 'normal gifts out of income', the forgiveness of CGT upon death (perhaps £1.2 billion a year), and Entrepreneurs' CGT Relief (costing £3 billion a year). The arguments for these tax reliefs entirely delivering value-for-money are unconvincing at best, and changing such policies could raise significant money for the NHS.

With an older population, and private inheritances growing in scale, we believe it is the right time to begin major wealth tax reform – in parallel with rising health and pension costs. In particular, given that council tax valuations in England and Scotland will be 30 years out-of-date by 2021, and that the tax has a particularly regressive structure, the government should include consideration of property tax reform if it consults on the long-term sustainability of health funding.

[49] *A new generational contract: The final report of the Intergenerational Commission*, Resolution Foundation, May 2018, Chapter 10

[50] A Corlett, *Passing on: options for reforming inheritance taxation*, Resolution Foundation, May 2018

[51] G Bangham, *The new wealth of our nation: the case for a citizen's inheritance*, Resolution Foundation, May 2018

Conclusion

It remains as true as ever that you can't have lower taxes, lower borrowing and higher spending. If the NHS is to be given a large 70th birthday present, we must expect the government to set out some hard choices on where the money will come from. With tax rises inevitably forming part of the answer, our recommendation is that the government should consult on the best way forward over the summer, before providing its answers in the Autumn Budget.

By way of helping to inform any such period of assessment, this note has considered the potential sums that might be raised via various approaches, along with details of how each option measures up to three key tests: progressivity, generational fairness and practicality. Table 1 presents a summary of our findings.

Table 1: Summary of short-term, substantial funding options

	Progressive?	Generationally fair?	Politically possible?	Approx. revenue in 2022-23 (£bn)
Increasing personal NICs rates by 1p	Yes	No	V difficult	5.9
Extending NICs to pensioners	Yes	Yes	V difficult	2.5
Increasing Income Tax (IT) rates by 1p	Yes	Yes	Difficult	7.4
Increasing IT rates by 1p & meeting thresholds pledge	Yes	Yes	Difficult	5.7
Freezing IT & NICs thresholds (after meeting pledge)	Partially	Partially	Difficult	3.7
Increasing VAT by 1p	No	Yes	No	6.8
Cancelling planned cuts in Corporation Tax	Yes	Yes	Yes	5.7

It shows that significant sums can be raised in a variety of ways, but it cautions against the government following the example of the 2000s by raising NICs to support health. That approach has public support and is broadly progressive, but it places all of the cost of the shoulders of the working-age and is therefore generationally unfair. Much better to raise some funds by extending NICs to pensioners, and looking to wider tax options such as property tax reform. Cancelling planned cuts in Corporation Tax also appears to be a sensible move – not least given it is likely to be much less politically controversial than some of the other tax rises considered.

Raising taxes is hard for any government – particularly one with only a narrow majority. But the needs of the NHS have been clearly set out, the public appear supportive of funding increases, and pressures on all other areas of spending leave few other options.

Resolution Foundation

Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged. We do this by:

- *undertaking research and economic analysis to understand the challenges facing people on a low to middle income;*
- *developing practical and effective policy proposals; and*
- *engaging with policy makers and stakeholders to influence decision-making and bring about change.*

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