Resolution Foundation
BRIEFING

Nationally insured?

New taxes and new spending to address key Department for Health and Social Care priorities

Torsten Bell, Mike Brewer, Nye Cominetti, Lindsay Judge, Krishan Shah, Daniel Tomlinson & Lalitha Try

Introduction

The Prime Minister yesterday announced a huge package of policy decisions. Indeed, there have been lots of smaller Budgets.

The big picture decision that he, and the Chancellor, have taken is to abandon low tax Conservatism to fund a big rise in NHS spending and to protect those with assets from some of the costs of social care. They have chosen to do so via National Insurance-based tax rises that are progressive and total £14 billion.[1] Despite welcome moves to address some of the fairness problems that come with National Insurance, including raising dividend taxation and applying the new Health and Care Levy to the earnings of working pensioners from April 2023, several issues remain:

- Tax rises fall disproportionately on the working age population: a typical 25-year-old today will pay an extra £12,600 over their working lives from the employee part of the tax rise alone, compared to nothing for most pensioners. The extension of the Levy to the earnings of working pensioners is welcome, but only one-in-six pensioner households have earnings. In contrast two-thirds have private pension income that is exempted from the Levy.
- A Levy focused on earnings leaves several other sources of income undertaxed – including lots of rental income. Of Britain's 1.9 million buy-to-let landlords, two-third are in the richest fifth of households.
- The package increases the tax gap between the self-employed and employees, raising the incentive for firms to use self-employed labour rather than employees. This is something the Chancellor promised to tackle, not exacerbate.

Combined with the Corporation and Income Tax rises announced in the March Budget, the Chancellor has now announced bigger tax rises over the past six months than seen in any Budget since at least the mid-1970s. These total over 1.6 per cent of national income, with the government showing itself to be more than prepared to face up to the tax consequences of announcing big permanent increases in the size of the state.

Despite the pre-announcement focus on social care, much of the increase in spending is focused on other Department of Health and Social Care priorities, mainly the NHS. Only 20 per cent (£5.4 billion) of the new spending in England over the next three years will go on social care, although that share will rise over time. Instead, the social care changes focus on improving the means test through which people are asked to contribute to (or pay all of) the costs of their social care. This is a welcome and overdue socialisation of the risk we all face of high care costs. But dangers remain:

1 The Treasury estimates the gross revenue raised will be around £17 billion, with the indirect effects of the changes reducing that gross figure by £3.2 billion

- The policy may not live up to its marketing, with those in modest homes with few financial assets still needing to put a charge on their homes if they need significant residential care.
- The cap will offer more support to families in the South, who will see a greater share of their assets protected if they hit the cap, but are also more likely to benefit from doing so given higher care costs. In contrast, it is the increased generosity of the means-test that will have relatively more impact in lower wealth regions. In the North East, only 29 per cent of individuals aged 70-plus have sufficient assets that they would receive no state support, compared to almost half in the South West.
- The relative focus on the NHS over social care means the focus of what has been announced is on changing who pays for care, rather than directly addressing the growing problem that far too few people are getting the care they need in the first place.

The Chancellor also confirmed the overall spending totals for the forthcoming Spending Review. These totals make clear the Chancellor's intention to fund any further Covid-19 related costs (for example, education catch-up funding or continued additional subsidy of train operating companies) from within the existing spending envelopes rather than from extra borrowing: a clear change in fiscal approach from the pandemic. More broadly, while health and care spending will rise, these totals also confirm that the day-to-day spending power of unprotected departments, such as local government and prisons, will be cut further in 2022-23 and will not rise significantly in the coming years remaining well below 2009-10 levels (in real terms per capita). This continues the pattern of decision making of recent decades, leaving Britain set for an NHS-dominated state: by 2024-25, the Department of Health and Social Care will account for around 40 per cent of all day-to-day government spending, up from 28 per cent two decades earlier.

Finally, the much-heralded suspension of the Triple Lock was announced, saving the Treasury £5 billion that has been banked not spent. The same looks set to be true of the further fiscal wriggle room that is likely to be provided by the Office for Budget Responsibility, which could deliver a £25 billion-a-year improvement to the public finances in their new October forecasts.

While low tax conservatism may be dead, fiscal conservatism in the Treasury is alive, well and back calling the shots after the big borrowing of the pandemic.

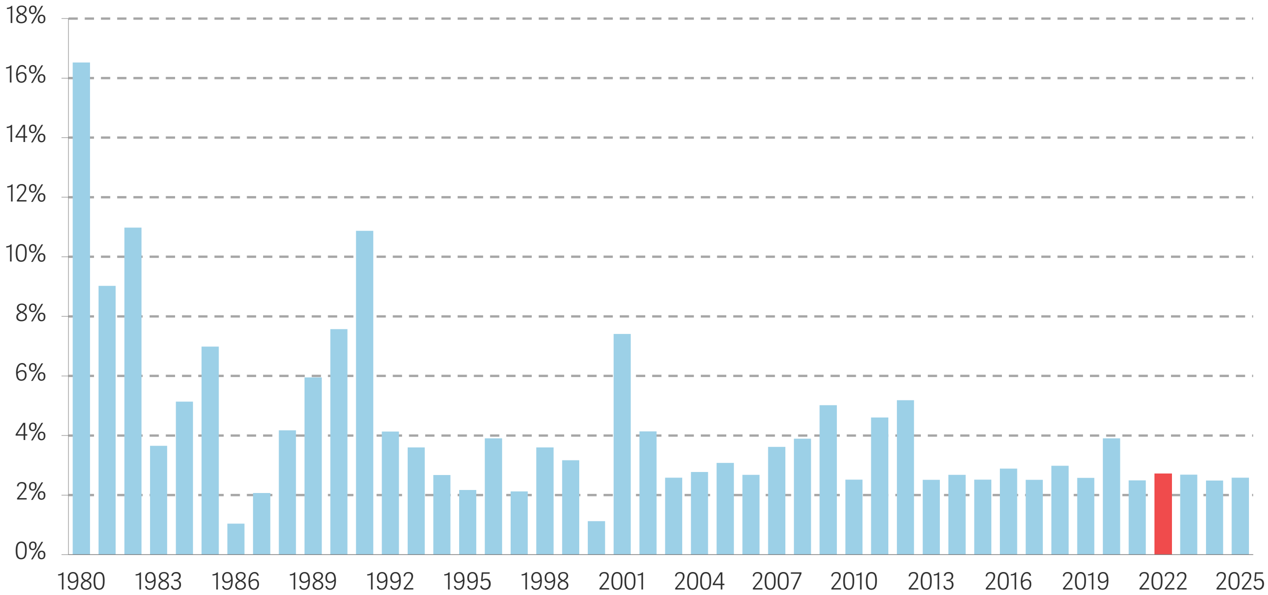
The Triple Lock is replaced temporarily with a Double Lock

The simplest announcement made yesterday was the Government's sensible decision to temporarily scrap the Triple Lock system for uprating the state pension to avoid an 8 per cent rise based on what are currently highly-distorted average earnings statistics. The Government will instead proceed with a Double Lock, raising the state pension in line with the higher of inflation or 2.5 per cent. This means that the state pension is likely to see an inflation-based uprating of around 2.7 per cent in April 2022, compared to an 8 per cent rise if average earnings had prevailed. This looks set to save the Treasury around £5 billion (but only £1.7 billion compared to the most Recent Office for Budget Responsibility (OBR) forecasts, who did not anticipate the recent surge in average earnings).

The change will need to be legislated for in the imminent future given that the current legal requirement to increase pensions by at least average earnings. But Figure 1 shows the wisdom of the move: a 2.7 per cent nominal rise would be bigger than five out of the last ten increases. The impact on recipients of the New State Pension is that they will receive an increase of £4.85 a week to £184.45 (rather than to £194 had an average earnings uprating gone ahead).

FIGURE 1: **Even a double lock will lead to a rise in the state pension larger than those seen in five of the previous ten years**

Nominal percentage change in the State Pension, actual and forecast



SOURCE: RF analysis

Using National Insurance to pay for health and social care has been finessed, but problems remain with the approach

If the suspension of the Triple Lock is relatively straightforward, the package of tax rises announced is anything but. This reflects the Treasury's attempt to overcome some of the downsides to the political choice of a National Insurance-based approach.

Next April, the employee, employer and self-employed rates of National Insurance (NI) will rise by 1.25 per cent, before being cosmetically rebranded as a Health and Care Levy in April 2023. These are progressive tax rises, as we have pointed out before and the Treasury has reminded everyone with its own distributional analysis.[2] But they are also ones that too-narrowly fall on the earnings of the working-age population (rather than wider sources of income, or those aged 66-plus). This creates significant horizontal inequalities (where people who should be treated in a similar way very much are not) that are hidden within the broad focus on the progressive impact across the income distribution. To partially address this problem, the tax rates applying to dividend income are also being increased, and, from April 2023, the new Health and Care Levy will also be applied to the earnings of working pensioners.

Overall, it is good to see the Government recognise the trade-offs involved with a permanent increase in the size of the state, with this package of tax measures raising around £14 billion a year. The very welcome improvements to what people had feared would be a straightforward increase in NI should also be commended, but very large problems with this approach remain: problems that could have easily been overcome with an increase in Income Tax instead.

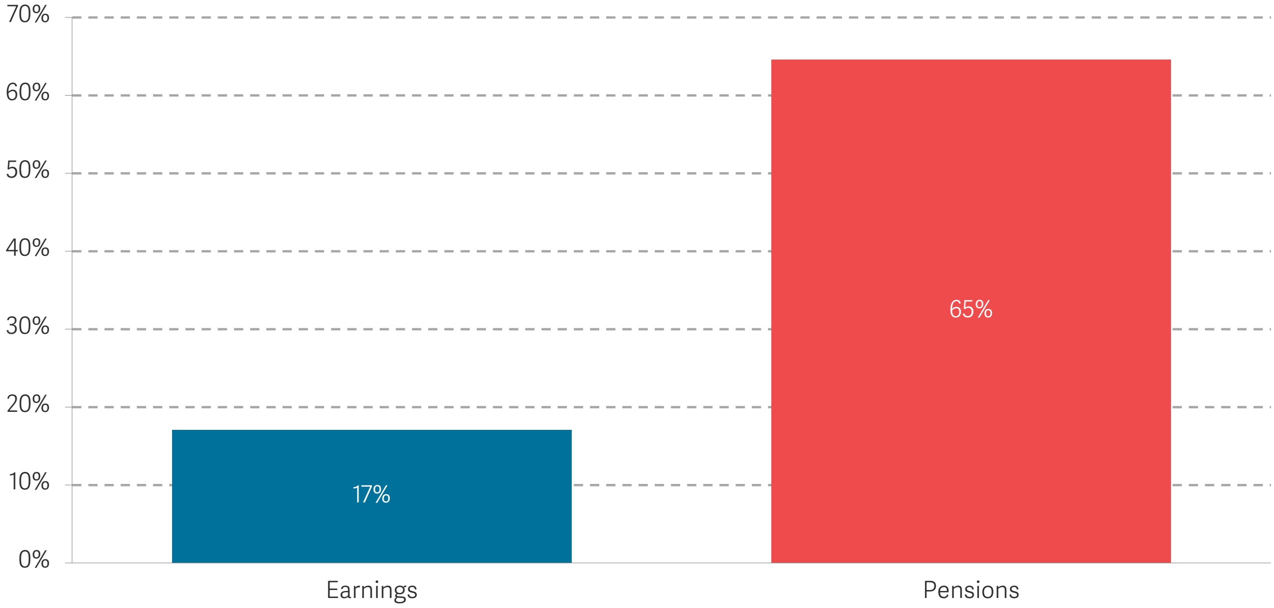
First, the Government has chosen tax rises overwhelmingly focused on the working-age population, with a clear generational impact. A typical 25-year-old today will pay an extra £12,600 over their working lives from the employee part of the tax rise alone, compared to nothing for a pensioner relying on pension income. Pensioners with earnings will have to contribute something, but only 17 per cent of pensioner families are in that position (compared with 65 per cent of pensioner families who receive some private pension income, which is exempt from NI and will not attract the dividend tax either: see Figure 2). Pensioners are more likely to hold shares, but many will be unaffected by the change in dividend taxation given that there is a dividend allowance exempting the first £2,000 a year of income, and the fact that dividends on shares held in ISAs are tax exempt.

Second, some other sources of income are also unjustifiably exempt. Rental income stands out in this regard. And that income is heavily concentrated amongst higher income households: as Figure 3 shows, 67 per cent of the 1.9 million adults who own buy-to-let properties are in the top fifth of the income distribution.[3]

2 Our work is: T Bell & A Corlett, A Caring Tax Rise?, Resolution Foundation, July 2021. The Treasury's analysis is: HM Treasury, Illustrative analysis of the impact of "Building Back Better: Our Plan for Health and Social Care" on households, September 2021.
3 See: G Bangham, Game of Homes The rise of multiple property ownership in Great Britain, Resolution Foundation, June 2019 for more details.

FIGURE 2: **Far more pensioner families get income from unearned sources than from earnings**

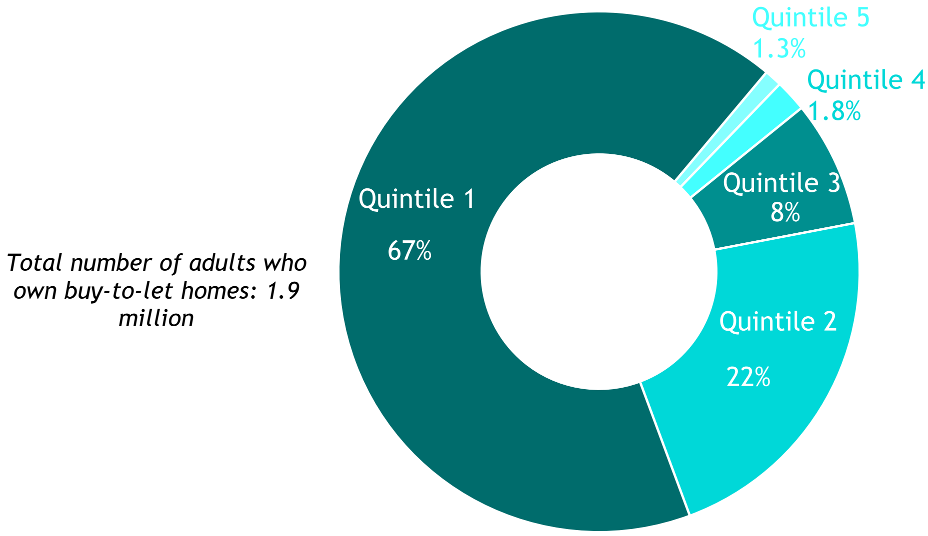
Proportion of pensioner families with income from each source: UK, 2019-20



SOURCE: RF analysis of DWP, Household Below Average Income.

FIGURE 3: **More than two-thirds of buy-to-lets are owned by the richest fifth of individuals**

Proportion of individuals owning a buy-to-let property, by income quintile: GB, 2014-16

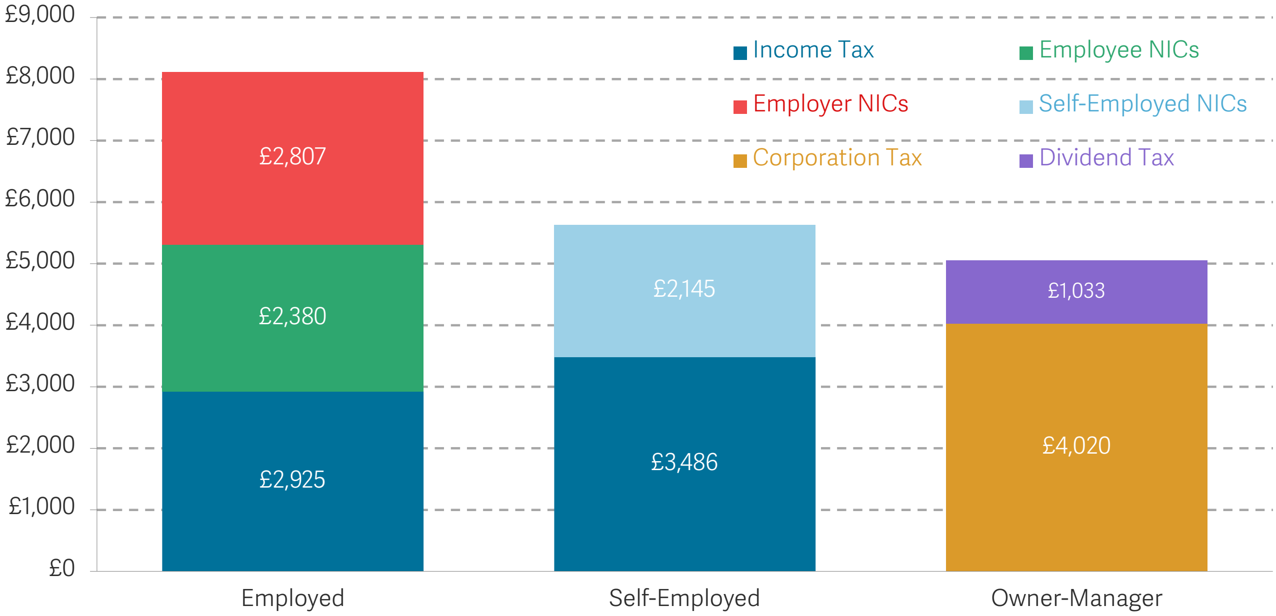


NOTES: This figure originally appeared in G Bangham, Game of Homes: The rise of multiple property ownership in Great Britain, Resolution Foundation, June 2019.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

Third, this policy package deepens the tax incentive for firms to use self-employed labour – something the Chancellor promised during the pandemic to address, rather than exacerbate. This is because, although the self-employed rate of NI has increased in line with the employee rate (albeit with the former still remaining unjustifiably below the later), there is no equivalent to the employer rate of NI for self-employed labour, as Figure 4 shows. By increasing that employer rate as well, the tax gap between the two kinds of employment has risen from what was originally a £2,358 tax difference in favour of self-employment to a £2,480 difference (and from a £2,882 tax break in favour of incorporation to a £3,059 difference) .[4] The result will be to encourage more self-employment at the expense of employment, which is bad for the public finances and for ensuring workers receive proper employment rights.

FIGURE 4: **The National Insurance rise has worsened, not reduced, the tax break in favour of self-employment**

Tax due on £30,000 of economic activity by employment type after the September 2021 increases to National Insurance and dividend tax



NOTES: Owner-Manager category assumes owner takes out a wage equal to the secondary limit (£8,840): the largest wage that can be paid without generating national insurance or income tax liabilities. Uses allowances from 2021-22 tax year and rates that will apply from April 2022.
SOURCE: RF analysis of HMRC rates and allowances.

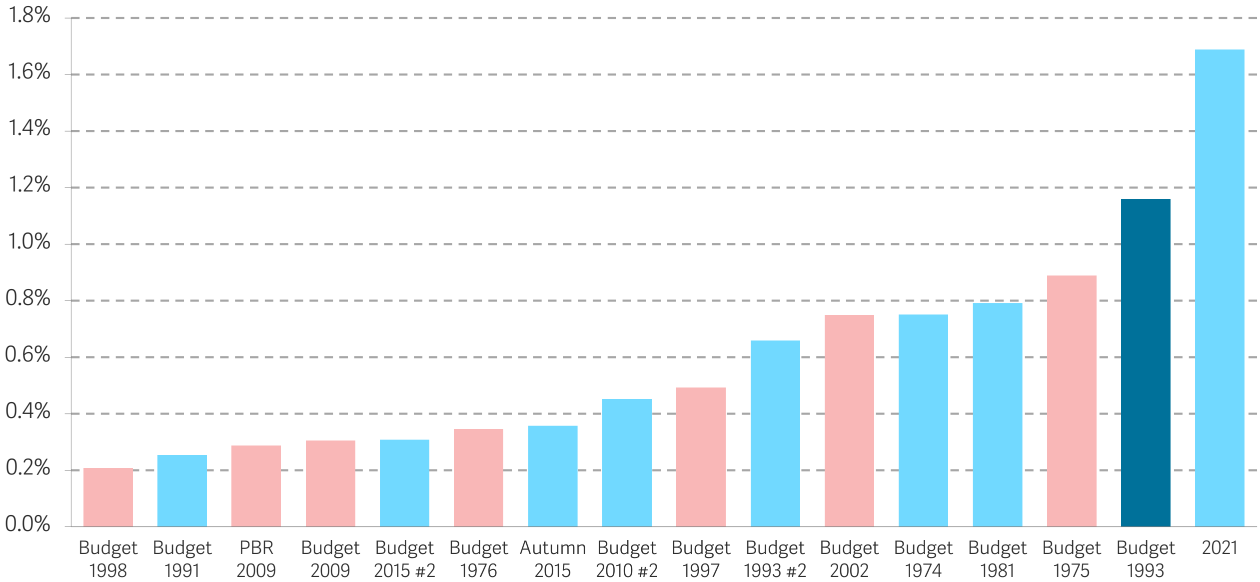
4 See: M Brewer, K Handscomb and K Shah, In need of support? Lessons from the Covid-19 crisis for our social security system, Resolution Foundation, April 2021 for original figures.

Health spending is set to rise significantly, with social care some way behind

These announcements mean that a very significant set of tax rises have been announced over the past six months. Combined with the Corporation and Income Tax rises announced in the March Budget, a total of £36 billion a year of increases are planned by the middle of the decade. This is equivalent to over 1.6 per cent of national income – a bigger rise than in any Budget since at least the mid-1970s, as Figure 5 shows. The timing of tax rises, with some kicking in as early as next April, is also noteworthy. This is far earlier in the recovery than is happening in almost all other developed economies and is only sensible if the recovery through the autumn and winter continues to outperform expectations.

FIGURE 5: **Taxes have risen by more in the past six months than in any fiscal event since 1975**

Change in medium-term forecast tax revenue resulting from the policy measures at selected fiscal events, as share of contemporaneous GDP: UK, 1975 to 2021



NOTES: Medium-term is defined as the final year of the fiscal forecast for forecasts made by the OBR (i.e. since 2010) or the implied-fifth year forecast for fiscal events prior to the OBR's creation. GDP is defined as the outturn GDP in the corresponding calendar year of the forecast, or the most recent OBR forecast for the GDP level for those fiscal events where the outturn is not yet known. Red bars indicate Labour governments and blue bars represent Conservative governments (and the Conservative-Lib Dem coalition Government in 2010).
SOURCE: RF analysis of OBR, Policy measure database and Economic and Fiscal Outlook, March 2021.

These tax rises are for a purpose: extra spending. The £14 billion of tax rises buys the Prime Minister around £10 billion for health and social care priorities; £2 billion in Barnett consequentials for the devolved administrations; and £2 billion in spending associated with managing the direct effects of the tax rises (in the form of higher public sector employer NI/Levy bills and higher Universal Credit payments because the benefit is means-tested on post-tax income).

While the pre-announcement focus has been on social care, this package should really be seen as principally about raising funds for NHS spending. Over 80 per cent (around £25 billion over the next three years) of the additional English spending is going on health priorities outside social care: the NHS (which will see substantial real terms increase over the coming years), some other Department of Health and Social Care (DHSC) areas (for example, medical training) and the ongoing costs of the pandemic (such as testing). Over the three years of the coming Spending Review just £5.4 billion of the additional funds will be spent on social care, although this spend will be rising to around £3 billion a year by 2024-25.

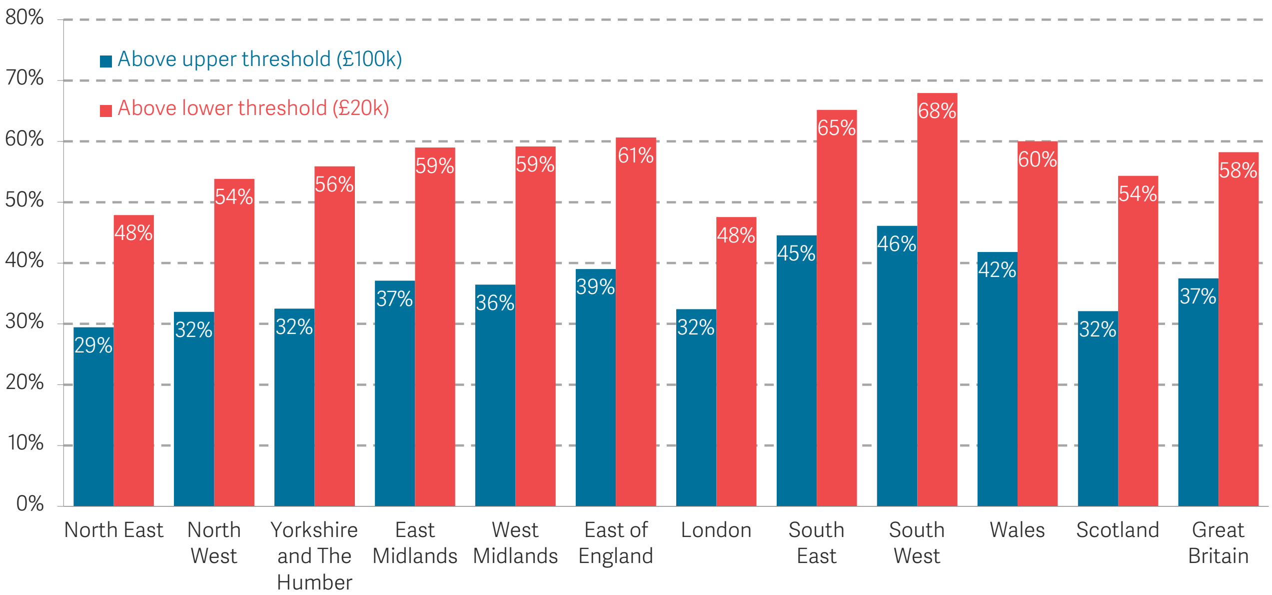
The result of the relative prioritisation of the NHS is that progress on social care is largely limited to significantly improving the way in which individuals who access care are asked to contribute towards its cost. The long-awaited cap on personal care costs recommended by Sir Andrew Dilnot in 2011, and legislated for back in 2014, will be introduced in October 2023 at the level of £86,000. Additionally, the means-test for those who have not spent up to that cap will also be made more generous, reducing the amount that those with modest resources have to contribute towards their care costs: the asset floor under which no-one will not be expected to make any contribution towards care costs has been increased to £20,000 (from £14,250), while the upper limit on the value of assets that can be held while receiving some state support has been more than quadrupled from £23,250 to £100,000. Anyone with capital in between £20,000 and £100,000 will contribute no more than one fifth of the amount by which their capital exceeds £20,000 each year (so someone with exactly £100,000 in capital would have to spend no more than £16,000 of that in the first year of receiving residential care; at present, someone with £100,000 would have to meet the full cost of care themselves, and average residential care costs are just over £26,000 a year).

These changes are a welcome partial socialisation of the risk we all face of very high care costs. With Sir Andrew's report being ten years old, they are long overdue. The reforms will mean the most for those with expensive houses who are unlucky enough to need to spend a long time in residential care, but the expansion of means-tested support to those with assets of up to £100,000 will help those with more modest assets who previously had to meet the full cost of fees.

Two dangers stand out for the Government. First, the limited resources going into social care indicate that the priority has clearly been to protect the assets of those needing long periods of care by reducing their contributions, rather than to address directly what is arguably a bigger problem in the current system: the huge amount of need for care that is currently going unmet. Second, the increased protection for assets may struggle to live up to the billing it has been given. It is simply not true, for example, that no-one will need to give the local authority a significant stake in their home to pay for social care. Someone needing extensive residential care, with a modest house and no other assets with which to meet an £86,000 care bill, will certainly need to do so. Moreover, the plans are also significantly less generous than those first proposed by the Dilnot Commission: those envisaged no-one losing more than 30 per cent of their capital, but as others have shown, the new plan would see someone with £150,000 of assets, who spends several years in care, losing about half of that in care fees.[5]

FIGURE 6: **The more generous means-test will be of relatively more help in areas like the North East, where 7-in-10 households will now benefit**

Proportion of those aged 70+ with eligible assets above the upper and lower thresholds for social care support, by region: GB, 2016-18



NOTES: Total wealth consists of financial assets and property wealth adjusted to account for whether an individual's benefit unit includes another adult or a dependent child – in which case property wealth is discounted from the means test. All wealth is adjusted to 2021 cash terms using CPIH.
SOURCE: ONS, Wealth and Asset Survey.

This new approach will also have very different impacts in different parts of the country. While the cap and asset test thresholds are set at single national levels, household wealth varies significantly across the nation. This means that the cap, which does not benefit households with less than £100,000 in capital, will be of relatively more help in the more affluent areas, while the more generous means-testing of support will be of

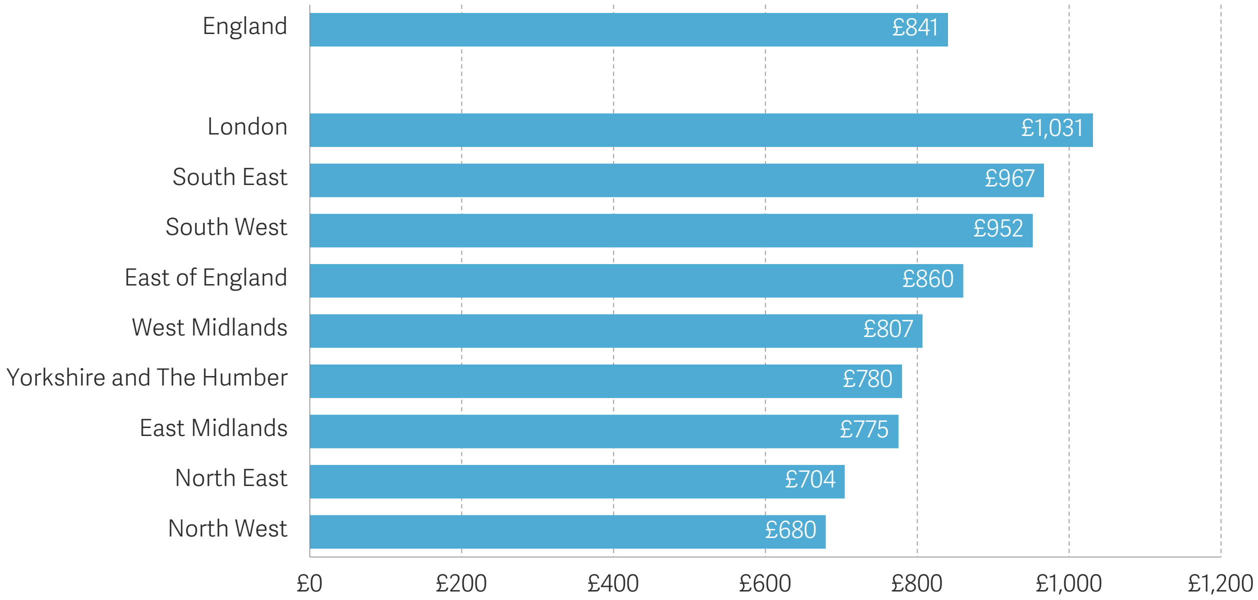
5 See, for example, the tweet by J Browne on 6 September 2021, which updates the analysis in J Browne, Fair social care: Priorities and funding options, Tony Blair Institute September 2021.

relatively more help in lower wealth areas. As Figure 6 shows clearly, only 29 per cent of individuals aged 70 and above living in the North East have sufficient eligible assets that they might receive no state support with their social care costs, compared to almost half (46 per cent) in the South West.

The cap, meanwhile, will offer most protection to those living in high wealth parts of England. This is not just because of the obvious reason that a cap set in cash terms offers far more protection to those with higher-value assets to lose. The way in which care costs are likely to be calculated will also mean that those in more expensive areas will hit the cap more often (and therefore benefit more from the policy existing versus the status quo of no cap). Whether or not you have reached the cap will be calculated based on the normal spend required to receive the care you are assessed as needing in your local authority, not what you actually spend (another risk to the policy living up to its billing). But the costs of delivering care are significantly higher in some areas than others, as Figure 7 shows. The result is that those in the South are not only likely to have more assets that will be protected by the cap, but they are much more likely to hit it too, than those in the North or Midlands (assuming an equal distribution of the chance of needing care).

FIGURE 7: **The weekly costs of care vary widely across England, with implications for where residents are most likely to hit the cap**

Unit cost per week for all adult clients accessing long- term support in residential care, by region: England, 2019-20



SOURCE: Table 52, Adult Social Care Activity and Finance: England 2019-20, NHS Digital.

The outline of the Spending Review is now clear, with implications for the future size and shape of the state

It is not just in the area of health and social care that we got big spending news yesterday. The date for the first full three-year spending review since 2015 has been set for 27 October, alongside an Autumn Budget and updated forecasts from the OBR. The Spending Review will set out departmental spending totals for the years from 2022-23 to 2024-25. But we already now know the big shape of what will be announced, because the Chancellor has now confirmed the total amounts of resource (day-to-day) and capital (investment) departmental spending in each of those years.

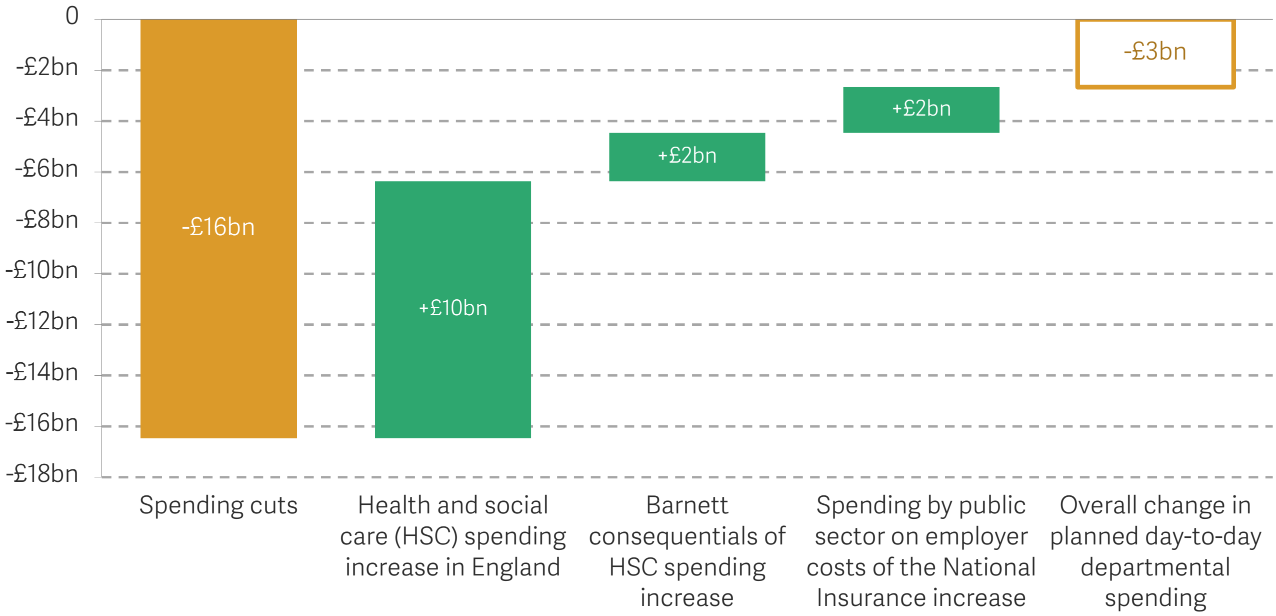
On capital, there is no change: the Government has re-committed for the third time that it will deliver "invest over £600 billion over five years" (this was first announced at Budget 2020). This is very substantial, and will take capital spending to its highest sustained level since the 1970s. What remains to be seen is how the Chancellor will prioritise between traditional calls on such spending and the need to refocus on new demands such as supporting the transition to net zero carbon emissions.

On resource spending, there is only one change to the envelope: it has increased by almost £14 billion in 2024-25 relative to March 2021 plans in order to cover the additional (largely health and care) spending set out above. This means that the Chancellor now intends to fund any further Covid-19 related costs (for example education catch-up funding or continued additional subsidy of train operating companies) from within the existing spending envelopes rather than from extra borrowing: a clear change in fiscal approach from the pandemic.

The component parts of the £14 billion spending increase is shown in the green bars in Figure 8 below. But, crucially, when seen in the context of the sizeable reduction in resource spending relative to pre-pandemic plans from 2022-23 onwards that the Chancellor has budgeted for at the last two fiscal events, this spending cut climbs to above £16 billion by 2024-25. Overall, day-to-day spending is still forecast to be £3 billion lower by the end of the Spending Review period than was planned pre-pandemic. The impact of this will still need to be borne by unprotected departments such as the Ministry of Justice and local government.

FIGURE 8: **Despite the big increase in spending on health and social care, overall day-to-day spending is set to be lower in 2024-25 than was planned before the pandemic**

Changes to day-to-day departmental spending announced since March 2020: 2024-25



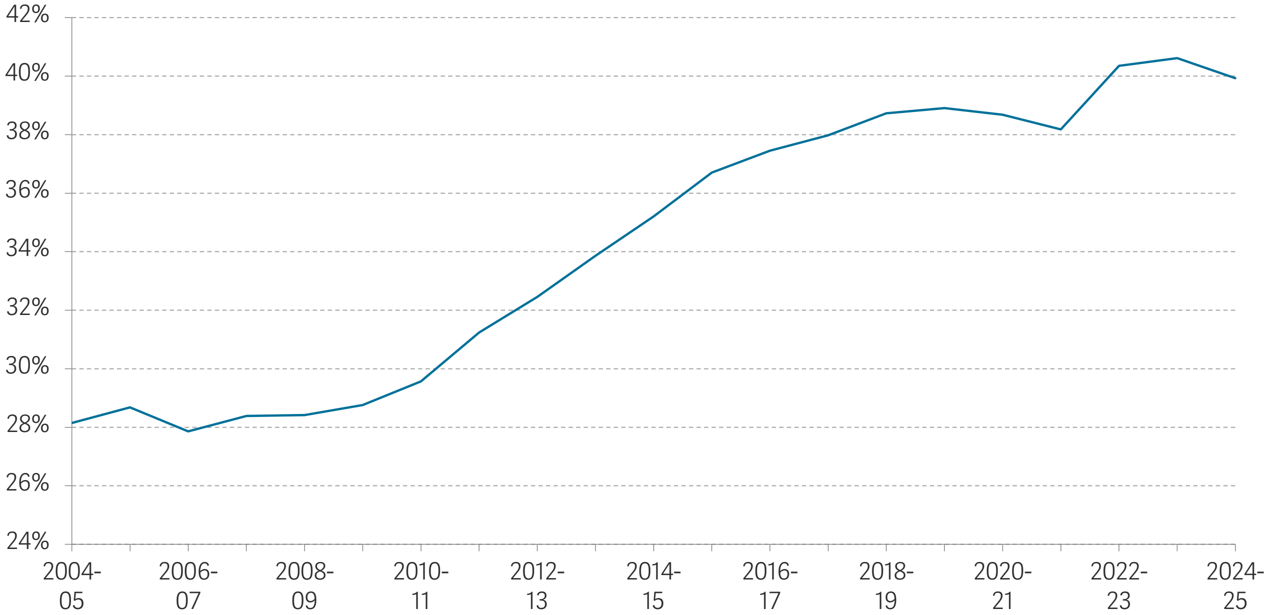
SOURCE: OBR, Economic and Fiscal Outlook, March 2021; Department for Health and Social Care, Build Back Better: Our Plan for Health and Social Care, September 2021.

The two sets of changes depicted in Figure 8 combine to tell us that although the Government is planning for public spending to grow (overall spending is not being held down as it was during the austerity years of the 2010s), we are on course for an ever-more NHS-dominated state. Figure 9 proves the point, showing the share of all day-to-day government spending taken up by DHSC will have increased from 28 per cent in 2004-05 to around 40 per cent in 2024-25 – thanks to its spending growing twice as fast as overall spending.

The good news for other departments is that tax rises, rather than cuts to their spending, are paying for this further rise in health and care spending. The less good news is that the government wants to spend less on them than it did before the pandemic, reflecting a smaller economy. The result will be no significant increase in the spending power of unprotected departments over the course of the Spending Review, with unprotected departmental spending remaining well below pre-austerity levels (in real terms per capita). And acute spending pressures in 2022-23; the spending envelope provided by the Chancellor implies cuts for unprotected departments if he wishes to deliver on pre-existing commitments to protected areas of public spending, such as the Schools budget.[6]

FIGURE 9: **Public spending is increasingly dominated by spending on health and social care**

Day-to-day core Department of Health and Social Care spending, as a share of all core day-to-day spending: 2004-05 to 2024-25



NOTES: Core day-to-day spending refers to Resource Departmental Expenditure Limits (RDEL) excluding depreciation, and excluding spending related to the immediate costs of the pandemic during 2020-21 and 2021-22.
SOURCE: RF analysis of HM Treasury, PESA tables, various; HM Treasury, Chancellor launches vision for future public spending, 7 September 2021.

The full details of departmental spending plans will have to await the Spending Review in a few weeks' time, but the big picture is now clear: the Government is continuing the long-term trend of health-related spending increasingly dominating the shape of the state. At the same time, less high-profile areas of spending will not see a return to the large cuts of the 2010s – but equally will make very little progress in putting the impact of the cuts of the last decade behind them.

6 The table provided in the Chancellor's announcement (see: HM Treasury, Chancellor launches vision for future public spending, 7 September 2021) details how 'core' spending in areas outside health and social care is set to increase by just £1.7 billion between 2021-22 and 2022-23. This is insufficient to fund the Government's existing commitment to increase spending (excluding Covid-19 related catch-up funds) on Schools in England to £52.2 billion by 2022-23, let alone increases in Overseas Development Assistance or other priority areas of spending that may be set out. This means the return of spending cuts for unprotected day-to-day spending budgets in 2022-23.

Conclusion

The Government made some very big decisions yesterday, and ones that are likely to shape the rest of this Parliament. Manifesto promises not to raise taxes and abstractions about low tax conservatism have proven less important than the need to significantly increase spending on the NHS, and to protect some of the assets of those unlucky enough to need significant social care. These are worthy priorities, even if the specific approach to raising taxes remains deeply suboptimal, and the balance of additional spending is skewed heavily towards the NHS rather than social care. The timing of tax rises – so early in the recovery – is also very different to the approaches being taken in other developed economies.

Stepping back, the Treasury has answered the question about whether their wish to reduce borrowing, or the Prime Minister's more relaxed attitude, would be the story of the autumn. Not only have tax rises paid for all additional spending, they have banked the savings from suspending the Triple Lock, and might also receive a £25 billion a year improvement to the public finances in their new forecasts come October. And the spending envelope announced by the Chancellor confirms his intention to stop funding Covid-19 related spending from borrowing, but from within existing planned spending totals instead.

Low tax conservatism has been dumped, but the Treasury's fiscal conservatism is alive and well. Whether that survives the deep uncertainty about what comes next in terms of the pandemic or economic recovery, or more traditional pressure for pre-election tax cuts, remains to be seen.

Resolution Foundation

The Resolution Foundation is an independent think-tank focused on improving living standards for those on low to middle incomes. We work across a wide range of economic and social policy areas, combining our core purpose with a commitment to analytical rigour. These twin pillars of rigour and purpose underpin everything we do and make us the leading UK authority on securing widely-shared economic growth.

The Foundation's established work programme focuses on incomes, inequality and poverty; jobs, skills and pay; housing; wealth and assets; tax and welfare; public spending and the shape of the state, and economic growth.

For more information on this report, contact:

Mike Brewer
Deputy Chief Executive and Chief Economist
Mike.brewer@resolutionfoundation.org

Resolution Foundation, 2 Queen Anne's Gate , London, SW1H 9AA

Charity Number: 1114839 | resolutionfoundation.org/publications