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Head-to-head: is it time for a dedicated tax to fund the NHS?

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HEAD TO HEAD

Is it time for a dedicated tax to fund the NHS?

A dedicated tax is the only way that we can be sure the government is reflecting public wishes, says **Richard Layard**, but **John Appleby** argues it would not protect funding from economic uncertainty

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Yes—Richard Layard

Taxpayers finance the National Health Service. But how much are they willing to pay for it? No one has any idea. The service is financed from general taxation and there is thus no real way in which the public can express its wish for a better (or worse) funded service. If instead there were a specific funding stream dedicated to health, there could be a real public debate about how much people were willing to pay. And this debate would be particularly intense at the time of general elections, ensuring that our healthcare system in some way reflected the wishes of the population.[1]

Moving to a hypothecated tax would involve a major upheaval, but it would be worth it. Britain currently spends less on health as a share of gross domestic product (GDP) than other countries at the same income level.[2] Nearly half of Britons say they are willing to pay for a better service and almost none want it cut.[3] But Whitehall is resistant to the idea that health spending should grow faster than income, even though this has been a worldwide tendency.[4] If, as in Germany, there were a dedicated source of funding for the healthcare sector, it would be much easier for public demand to be translated into action.

Steady funding

The alternative to hypothecation is to continue with alternating periods of famine and plenty. Under the present system the Treasury presses down on expenditure until the position becomes untenable, and there is then a brief period of plenty, as there was 10 years ago, followed by another famine, as now.

However, the Treasury has always objected to hypothecation because it limits its flexibility to determine the overall pattern of public expenditure. But health is different from education, or defence, or law and order. It is a natural candidate for the insurance based approach: everyone needs protection against the major uncertainties of life. People in the UK are willing to pay for insurance against other hazards, and we should enable them to do so for health.

How it could work

So let me outline one possible approach. The key question is what proportion of our national income we want to devote to the NHS. This is what the pre-election debate would revolve around, and at the beginning of each parliament the government would announce its NHS expenditure plan (in real terms) for the next five years.

This expenditure would be directly funded out of a revised system of National Insurance contributions. At present the proceeds of National Insurance go into the general pot with those from other taxes. In the revised system National Insurance would become a designated National Health Insurance, all of which went to health. And the rate of contributions would be sufficient to fund the NHS at the level of expenditure that had been decided. The NHS would continue operating as it does now, free at the point of delivery. But the funding would come from the dedicated (or "hypothecated") tax.

Thus over the parliament there would be a predetermined pattern of real expenditure on the NHS, bringing welcome certainty to the service. And taxpayers would know what they were paying for, with forecast contributions over the five years equalling forecast expenditure.

But, you will rightly say, forecasts are fallible. The answer is to have a fund that receives any excess contributions over health expenditure and also funds any excess of expenditure over contributions. At the end of the parliament the net assets or debt of the fund would be assumed by the Treasury.

There is one other obvious wrinkle. NHS providers need to know their future income for at least three years ahead. So in the middle of a parliament, further commitments should be made for the first two years of the next parliament (even though the next government might change them).

Should the new system include social care, even though it involves a much higher element of private payment? I think it should because the present dichotomy between both health and social care is not working.[5] Unfortunately, current National Insurance contributions are not enough to finance even the

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existing NHS, let alone social care. So we would need to increase contributions, partially offset by cuts in other forms of taxation. Extra contributions could come from requiring contributions from employees over 60, and higher contribution rates, especially from better paid employees.

A reform of this kind would offer real hope to the healthcare sector. It would have its own source of income and the public could judge whether more or less income was justified.

No—John Appleby

In one sense hypothecation is a bit like Brexit: "hypothecation means hypothecation" just as "Brexit means Brexit." But these are just truisms; in practice there are different versions—hard and soft—with differing economic, technical, and political implications depending on the design of the tax.

A hard or strong version of a hypothecated tax would be one where a specific tax funded all the spending on the NHS. A soft or weak version would mean that only part of the NHS budget is funded by a specific NHS tax and the rest funded from other sources, or that surpluses from the specific tax are used for non-NHS spending. Another weak version is the specific linking of a tax increase to a spending commitment for the NHS. This happened in 2002 when the then chancellor, Gordon Brown, raised National Insurance rates with the advertised intention to spend the extra revenue on the NHS.[6]

But hard or soft, a hypothecated tax is not the solution to the NHS's financial problems. Some argue that a hypothecated tax would fix the lack of transparency between the raising of taxes and spending by government and a lack of trust or degree of cynicism on the part of the public with politicians who may say one thing but do another. Hypothecation can close the tax-spend loop. And it could also provide a cynicism bypass, taking tax and spend decisions out of the hands of politicians and governments.

Better solutions exist

But there are many simpler ways to fix the tax-spend transparency problem (through providing information for the public on how taxes are spent, for example) without a major overhaul in the tax system. As for taking the tax-spend decision out of the hands of politicians because we don't trust them to do what they say, the promises and actions of governments would seem to belie that view—from the Blair-Brown governments' pledge and action to raise tax and spend on the NHS to match the prevailing average for our European neighbours, to the coalition and Conservative governments' pledge to increase spending in real terms on the NHS, which was also, by and large, met.[7 8]

You could certainly argue that the latter pledges did not provide the NHS with "enough" money, but nevertheless they were delivered and, while many may not have thought the pledge sufficient, were (at least part of) the basis on which these governments were elected.

Another argument presented for hypothecation is that it overcomes a general resistance to paying tax when it comes to things we like governments to pay for, such as healthcare. However, public opinion on this is somewhat equivocal. For example, the 2015 British Social Attitudes (BSA) survey suggested that while 93% of those surveyed thought there was an NHS funding problem, only a quarter thought the solution was a dedicated NHS tax, with a further quarter supporting the view that the NHS should find ways of coping with its existing budget.[3]

Of course, public views can and do change, and as the BSA survey has shown, general views on increasing taxes to spend more on things like the NHS and education have in recent years increased—though they remain slightly lower than support to keep taxes and spending the same.[7]

Unpredictable revenue

The fundamental problem with hypothecation is that in a way it gets the tax-spend issue back to front.[9] Spending should not be so directly dependent on the revenue raised from a specific tax, especially in the hard version of hypothecation where revenue (and hence spend) will depend on macroeconomic factors unrelated to what we might perhaps like to spend. And in the soft version, where governments might top up spending when the revenue from a hypothecated tax doesn't meet our desired spending level on health, why have any hypothecation at all? The decision about what share of our wealth we would like to devote to healthcare should be (largely) independent of decisions about how we then pay for it, what trade-offs we are prepared to bear given our choice, and decisions about what level of distributional (in)equality we want in terms of who pays and how much.

Current ways of making tax and spend choices are not by any means perfect and could be improved with, for example, more debate (informed by evidence) about what we want to spend on health and the trade-offs involved with other things we also want to spend our limited resources on. But hypothecation only provides the illusion of an escape from such necessary argument and debate.

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