Blog

Tax wealth and profit income to fund social care and healthcare

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The government's new tax package to generate additional funding for health and social care includes 1.25%-point increase in the national insurance rates of employees, employers and self-employed. Tax on dividends will also rise by 1.25%-point from April 2022. This is expected to generate on average £12 billion additional annual funding for health and social care over the next three years[1] with a promise to address the challenges in the NHS as well as social care.
The package falls well below what is required according to the Women's Budget Group's (WBG) research[2], which suggests an initial £28 billion more (in England) on long term care alone and in the longer term an additional £30 billion to broaden the definition of needs and improve quality and working conditions of are workers. For an appropriate investment in the care infrastructure, WBG also proposes an increase of £10.4bn on free childcare hours and childcare tax credits and a further increase of £20.7bn in the longer Term. Adopting a needs-based approach to budget, our research[3] suggests that it is feasible to fund an appropriate and substantial increase in public spending in social care and childcare through taxing capital income and wealth.

In the following, we return to the government's package of £12 billion (a 0.5%-point increase in as a ratio to GDP[4]) additional spending in care, which we label as public purple social infrastructure investment, and compare the effects of alternative taxation strategies on GDP, employment, and public debt/GDP. Our analysis[5] incorporates the positive short and medium-term effects of spending in health and social care on national output, employment, productivity in the rest of the economy as well as gender employment gaps. Crucially, we find that financing public investment in care by increasing taxes on profit income and wealth generate significantly better outcomes on output and employment as opposed to taxes on labour income[6] and decreases income and wealth inequality.

Table 1 below summarizes our estimations. Additional funding for health and social care is expected to increase GDP and generate employment, especially for women due to the occupational segregation in this sector. However, we estimate that the increase in tax on labour by 1.25% to fund this spending as proposed by the government, will significantly offset these positive effects. Our estimations show that a 1.25%-point increase in the tax rate on labour and a 0.5%-point increase in public social infrastructure investment/GDP (equivalent to £12 billion increase in 2022) increase GDP by 0.337% in the short run, but it decreases GDP by 0.273% in the medium run[7] (see Table 1, part A).

Table 1: The effects of £12 billion spending in **public purple social infrastructure** (**0.5%-point of GDP) on GDP, employment and public debt/GDP funded by alternative tax proposals**

	% change in GDP	% change in total employment	% change in female employment	% change in male employment
A. The effects of a 1.25%-point increase in the tax rate on labour income and a 0.5%-point increase in public purpl infrastructure investment/GDP				
Short run	0.337	1.195	1.790	0.719
Medium run	-0.316	-0.273	0.391	-0.806
B. The effects of a 1.25%-point increase in the tax rate on profit income and a 0.5%-point increase in public purple infrastructure investment/GDP				
Short run	1.533	2.454	3.081	1.951
Medium run	1.095	0.678	1.441	0.067
C. The effects of a 0.1%-point increase in the tax rate on wealth and a 0.5%-point increase in public purple social i investment/GDP				
Short run	1.883	2.822	3.458	2.312
Medium run	1.782	1.251	2.048	0.611

In contrast, a fiscal policy package of a 1.25%-point increase in the average tax rate on profit income (e.g., via corporation or capital gains tax) and a 0.5%-point increase in public social infrastructure investment/GDP has significantly higher positive effects on output, employment of both women and men and the budget balance and will lead to 1.095%- point increase in GDP in the medium run.

Finally, the effects are strongest, if the additional £12 billion funding for health and social care is funded by an increase in tax on wealth. A fiscal policy package of a 0.1%-point increase in the average tax rate on wealth (e.g., inheritance tax) and a 0.5%-point increase in public social infrastructure investment/GDP has the highest positive effect on GDP and employment. We estimate a 1.782% increase in GDP in the medium run

There are two reasons why taxes on profit income and wealth are more effective. Firstly, as estimated in various studies, UK is a wage-led economy, i.e., an economy in which higher wages have positive effects on aggregate demand[8]. Therefore, financing additional health and social care spending with higher taxes on labour does not lead to positive effects on output, because higher taxes on labour suppresses household consumption, which in turn leads to lower demand and GDP. The negative impact of taxes on profits and wealth on household consumption are significantly smaller than the negative impact of tax on labour. The increase in aggregate demand due to health and social care spending financed by taxes on profit and wealth simulates also private investment and labour productivity[9]. Secondly, we estimate that a higher tax rate on wealth leads to a decline in wealth inequality (a lower concentration of wealth in the top 1%). We estimate that lower concentration of wealth leads to higher private investment, which might reflect the positive effects of lower market concentration, reduced barriers to entry on incentives for investment and innovation[10]. Moreover, a decline in wealth concentration may be associated with a lower degree of financialization of non-financial companies, which may also stimulate investment[11].

In all three scenarios in Table 1, increasing health and social care funding creates employment for both women and men, albeit a stronger effect on women. This is because women's employment share in health and social care in the UK is significantly larger than in rest of the economy. However, if this spending (0.5%-point of GDP) is funded solely by an increase on taxes on labour (by 1.25%-point) women's employment increases by only 0.391% and men's employment decreases by 0.806% in the medium run due to the negative effects on output. In contrast, if the increase in health and social care spending is funded by an increase in taxes on profit income, both women's and men's employment increase in the medium run, by 1.441% and 0.067% respectively. Again, an increase in the wealth tax has the highest positive impact on women's and men's employment, by 2.048% and 0.611% in the medium run.

Regarding the effects on the public debt-to-GDP ratio, funding health and social care spending with taxes on labour leads to a deterioration in budget balance (an increase} in the medium run due to the negative effect on output. In contrast, funding health and social care by increasing taxes on profit and wealth reduce public debt-to-GDP ratio thanks to the highly positive effects on GDP, which in turn increase tax revenues further.

Based on our estimations, we suggest that funding the increase in health and social care spending by increases in tax rates on profit income and wealth rather than on labour would have been more effective in terms stimulating output, employment and budget balance.

Finally, further increases in the wealth tax beyond our simuations here, in a progressive fashion, aiming at the top 1% of the wealthiest households[12], can generate substantially higher tax revenues to fund public purple social infrastructure including not only the WBG proposal on social care but also childcare, while also generating funds for a green transition with substantial public investment in green renewable energy, public transport and social housing.

[1] Cabinet Office, Department of Health & Social Care and Prime Minister's Office (15 September 2021). Build Back Better: Our Plan for Health and Social Care. Available at https://www.gov.uk/government/publications/build-back-better-our-plan-for-health-and-social-care/build-back-better-our-plan-for-health-and-social-care

[2] WBG (2021) Government's announced plan will not "fix social care once and for all" – we need a free universal social care system (**Government's announced plan will not "fix social care once and for all" – we need a free universal social care system – Womens Budget Group (wbg.org.uk)**) and WBG (2021) Calculating the cost of a high quality, free universal childcare system (**Calculating the cost of a high quality, free universal childcare system – Womens Budget Group (wbg.org.uk)**)

[3] Onaran, Ö., Oyvat, C. and Fotopoulou, E. (2019). The effects of gender inequality, wages, wealth concentration and fiscal policy on macroeconomic performance. Greenwich Papers in Political Economy, No: GPERC71 https://gala.gre.ac.uk/id/eprint/24018/19/24018%20ONARAN_The_Effects_of_Gender_Inequality_Wages_Wealth_Concentration_%28V.3%29_2019.pdf

[4] We estimate public social infrastructure investment/GDP for 2022 using HM Treasury (2021)'s GDP forecast for the UK.

HM Treasury (2021). Forecasts for the UK economy: a comparison of independent forecasts.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1013260/Forecast_August_2021.pdf

[5] The simulations are based on the macro-econometric model developed in Onaran, Oyvat and Fotopoulou (2019).

[6] The national insurance increase in the current government package is expected to have a high incidence on labour.

[7] The effect in the medium run refers to the effect in next year and thereafter when productivity gains in the rest of the economy due to care spending materialize.

[8] For a review of estimations of the growth regime in the UK, see Oyvat, Öztunalı and Elgin (2020) Wage-led versus profit-led demand: a comprehensive empirical analysis. Metroeconomica, 71(3), 458-486. Also see Onaran, Oyvat and Fotopoulou (2019).

[9] Onaran, Oyvat and Fotopoulou (2019).

[10] Gutiérrez G. and Philippon T. (2017). Investment-less growth: an empirical investigation, Brookings Papers on Economic Activity, Fall 2017: 89-169.

[11] Tori, D. and Onaran, Ö. 2018. The effects of financialization on investment: evidence from firm-level data for the UK, Cambridge Journal of Economics, vol. 42, no.5, 1393–1416

[12] Tippet, B. Wildauer, R. Onaran, Ö. 2021. T*he case for a progressive annual wealth tax in the UK,* Greenwich Papers in Political Economy, No: GPERC88, *https://gala.gre.ac.uk/id/eprint/33819/*

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