A national insurance hike to boost social care would be built on a misunderstanding

Sky's Ian King explains why the government can expect a backlash from employers, younger workers and the low-paid if it uses national insurance as a vehicle to raise cash for under-funded social care.

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Analysis

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Boris Johnson and Rishi Sunak are under pressure to raise funds to pay for reforms to social care

Boris Johnson and Rishi Sunak have, it is reported, agreed to pay for long term reform of social care by raising national insurance by a penny in the pound for both employers and employees.

The move would raise an estimated £10bn annually.

The government is braced for unease among its backbenchers because the Conservatives promised not to raise income tax or national insurance in their election-winning 2019 manifesto.

It perhaps ought not to be too worried about that. The prime minister can always point to the crisis in social care and the need, more broadly, to repair the public finances after the **COVID-19** pandemic.

The chancellor, meanwhile, can point out that one of his predecessors, Gordon Brown, did something similar in his April 2002 budget. Having pledged not to raise income taxes in Labour's election-winning 2001 manifesto, Mr Brown broke the spirit of that promise, slapping more than 4 million workers with a 1% increase in national insurance.

The risk of breaking an election promise is the least of the problems with **this proposal**.

For a start, the move will perpetuate the myth that national insurance is some kind of special safety net, hypothecated to pay for pensions, unemployment benefits and other elements of the welfare state such as the NHS.

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It is remarkable how many people still believe this when, for many years, national insurance has simply been income tax by another name.

Yes, there is something called the National Insurance Fund, but essentially it is a **government accounting wheeze**.

The money raised in national insurance contributions is insufficient to pay for the benefits and public services that many people think they do. It just disappears, effectively, into the government's coffers and is spent in the same way that revenues from income tax, VAT and corporation tax are spent.

Because the UK state pension system is a so-called 'pay as you go' system, the national insurance paid by today's workers pays the pensions of today's pensioners, not their own.

This misunderstanding of national insurance may be precisely why the government is proposing going to go down this route.

The Treasury risks hurting those worst affected financially by the COVID crisis through any rise in NI contributions

Polling suggests people are happier paying national insurance rather than income tax because they genuinely appear to believe they are getting something, a benefit, for doing so.

It is why chancellors down the years have reached for national insurance as their favoured stealth tax. In 1979, national insurance receipts were equal to half of income tax receipts. This year, according to the Treasury, they will be equal to roughly three-quarters of income tax receipts.

There are also other problems with this proposal.

One is that it exacerbates intergenerational unfairness. Unlike income tax, workers of state pension age do not pay national insurance on their earnings, so the hike will fall entirely on younger workers.

Moreover, because national insurance - unlike income tax - is levied only on earnings, rather than other sources of income, such as interest on savings, the cost of this measure will fall disproportionately on younger people rather than older ones.

In other words, having made sacrifices throughout the pandemic to protect older people, younger people will again be paying through their earnings for a benefit that will benefit older people rather than themselves.

This move, then, may deepen the problems the Conservatives have with younger voters.

An explicit aim of reforming social care is to prevent people having to sell their homes to pay for such care. Younger people, unable to buy a home in the first place, may wonder why they are being asked to pay higher national insurance contributions so that others may keep theirs.

Others will criticise the lack of progressivity in this proposal.

All workers (other than those earning more than £100,000 annually and who do not benefit from the personal allowance) can earn up to £12,570 before they have to start paying income tax. By contrast, national insurance kicks in as soon as a worker has earned £9,568.

Accordingly, a wealthy pensioner living off a generous final salary pension or on income from their savings and dividends will not be paying this proposed hike, but a low-paid worker earning just £184 per week will be.

Another major problem with this proposal is the unwanted consequences it will have. Taxes, by their nature, reduce the activity on which they are levied. It is why chancellors tax smoking heavily.

Because this proposed national insurance will fall on employers, as well as employees, it will make the cost of hiring someone more expensive.

Higher payroll taxes mean fewer people in work and, potentially, lower growth. It is why, in response to Mr Brown's national insurance hike in 2002, the then-Conservative leader, Iain Duncan-Smith, called the move a "tax on jobs".

Gordon Brown introduced an extra tier of National Insurance in 2002

So, too, did David Cameron and George Osborne when Mr Brown ordered his chancellor, Alistair Darling, to announce a 1% rise in national insurance in March 2010 to pay for the financial crisis. Mr Darling had wanted to increase VAT instead. Mr Brown's decision ensured Labour had barely any support from business in that year's general election.

So, to conclude, what the PM is proposing is a tax increase that will disproportionately hit younger and low-paid workers while making it harder for employers to hire people.

Or, as Nick Macpherson, the former permanent secretary at the Treasury, put it on Twitter: "Rentiers and trustafarians won't have to pay a penny. And the low paid young will subsidise the wealthy old. Higher spending does require higher taxes. But national insurance is a regressive tax on jobs."

Quite.