Packhorse Generation:

The new tax burdens forced onto young people by inflation

John Hobby

Intergenerational Foundation

The Intergenerational Foundation (www.if.org.uk) is an independent, non-party-political charity that exists to protect the rights of younger and future generations in British policy-making. While increasing longevity is to be welcomed, our changing national demographic and expectations of entitlement are placing increasingly heavy burdens on younger and future generations. From housing, health and education, to employment, taxation, pensions, voting, spending and environmental degradation, younger generations are under increasing pressure to maintain the intergenerational compact while losing out disproportionately to older, wealthier cohorts. IF questions this status quo, calling instead for sustainable long-term policies that are fair to all – the old, the young, and those to come.

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1. Introduction

The economic fallout of COVID-19 combined with contradictory manifesto pledges have placed the government in a bind. On the one hand, Her Majesty's Treasury (HM Treasury) is promising to get government finances back on a sustainable footing after two years of record peacetime spending to fight COVID, which the National Audit Office estimates to be £370 billion as of September 2021.[1] The government has also promised to eliminate the NHS backlog and reform social care. However, they are theoretically bound by a 2019 General Election manifesto promise not to raise taxes.

The government needed to find Theresa May's "Magic Money Tree" and, luckily for them, they have found one in the form of hidden tax rises falling largely on the young. To this end the government has committed to raising National Insurance Contributions (NICs) by 1.25pp, freezing income tax thresholds until 2026 and freezing the student loan repayment threshold until 2023.

This paper investigates the combined effects of these policies in a period where high inflation could persist into the medium term. Student loan repayments are treated as a "graduate tax" as student loans have been repaid through employee payrolls since 1998, much like an income tax.

This paper uses government deductibles as a percentage of pre-tax income, henceforth referred to as average tax rates, to assess the impact of these reforms on young people's living standards. This approach has been used as it provides a measure of how the disposable and discretionary incomes of earners across the income spectrum are affected by these changes to taxation. A progressive tax system is designed to ensure that higher earners pay a higher proportion of their income in taxation. The logic being that necessary spending typically comprises a smaller proportion of the income of higher earners, meaning they can better afford to pay.

Conversely, fiscal drag will force young people to pay a larger proportion of their real incomes on all three of these taxes if the aforementioned reforms go ahead. These three policy decisions will make the UK tax system less progressive, raising average tax rates by a greater magnitude for young people and low earners than for higher earners and people over the State Pension Age.

[1] National Audit Office (2022) *COVID-19 Cost Tracker*: https://www.nao.org.uk/COVID-19/cost-tracker/

2. The scale of the problem

2a) COVID-19 spending

The UK government understandably spent vast sums of money on the COVID-19 response from the furlough scheme, test-and-trace programme, PPE and the vaccine roll-out, to increasing working-age benefit provisions in order to help people through economic hardship. This increased spending coincided with significantly smaller tax receipts due to a 9.7% drop in UK GDP in 2020[2] as the nation went into lockdown and output stalled.

This fiscal imbalance necessitated significant government borrowing, driving the public sector deficit to a peacetime record of £323 billion in the financial year ending March 2021,[3] equivalent to 15.1% of GDP or twice the annual NHS budget.[4] This deficit has significantly added to the stock of public sector debt, increasing the UK general government gross debt to £2,223 billion at the end of the 2020–2021 financial year, equivalent to 103% of GDP.[5] Given the size of the public debt, it is little surprise that Rishi Sunak, Chancellor of the Exchequer, has repeatedly stressed his desire to get government finances back on a sustainable footing.

2b) Health and social care spending

The government also announced a wish to meet its manifesto promise to fund the NHS and reform social care. To this end, the government pledged an additional £12bn per year of extra spending towards working through the backlog of more than 5 million people waiting for NHS treatment in England and better funding social care. This increased spending is to be funded through a 1.25pp increase in NICs for employers, employees and the self-employed. The plan is for the lion's share of the funding to go towards the NHS in 2022–23 and 2023–24, after which a larger proportion of the funds will be given to reforming the social care system.

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[2] World Bank (2022) GDP Growth (Annual %) United Kingdom: https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=GB

[3] ONS (2021) *UK Government Debt And Deficit*: https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicspending/bulletins/ukgovernmentdebtanddeficitforeurostatmaast/june2021#:~:text=UK%20general%20government%20gross%20debt,equivalent%20to%2015.1%25%20of%20GDP

[4] The King's Fund (2021) *The NHS budget and how it has changed*: https://www.kingsfund.org.uk/projects/nhs-in-a-nutshell/nhs-budget

[5] ONS op. cit.

The proposals will make means tested local government support significantly more generous by covering all the social care costs of anyone with under £20,000 in assets, and providing means-tested support for those with assets between £20,000 and £100,000. The increased National Insurance receipts will also fund the introduction of an £86,000 cap on the total amount anyone in England will spend on social care over their lifetime, regardless of income, to ensure people will not be forced to sell their homes to pay for their care. However, doubt exists as to whether local-council contributions will count towards the cap – a seemingly technical distinction that would significantly benefit wealthier pensioners.[6]

2c) The political calculus of the "grey" vote

These difficult-to-reconcile aims of being the political party of high-quality public services whilst also maintaining their longstanding image as the party of fiscal responsibility have placed the Conservative government in a tight spot. It is a matter of simple national accounting that a government cannot increase spending and reduce the deficit without also increasing tax receipts.

The question is then who should the government target for higher tax takes? Raising taxes from the government's largely older, wealthier voter base would be politically challenging. Instead, it makes more sense to increase taxation on those people who are not only less likely to vote Conservative, but are less likely to vote in general.[7]

Furthermore, when a political party has a political philosophy that believes, rightly or wrongly, that older people should not have to sell their homes in order to pay for their social care, this essentially amounts to a wealth transfer from low-earning millennials to retired baby boomers, who thanks to rising house prices are already the wealthiest generation in history.

[6] Intergenerational Foundation (2021) *The Social Care Cap And The Intergenerational Contract*: https://www.if.org.uk/2021/11/23/the-social-care-cap-and-the-intergenerational-contract

[7] British Election Study (2021) *Age And Voting Behaviour At The 2019 General Election*: https://www.britishelectionstudy.com/bes-findings/age-and-voting-behaviour-at-the-2019-general-election/#.YfKopf7P1D8

3. Income tax

If tax brackets are not adjusted accordingly, inflation acts as a hidden regressive tax rise because smaller proportions of people's incomes fall into the lower tax brackets or tax free allowance. Tax brackets usually move in line with inflation to counter this effect, but the government has committed itself to freezing income tax brackets until 2026 in attempt to improve government finances. Recent Treasury estimates suggest this hidden tax increase will raise almost £3bn in 2022–23 and over £13bn per year by 2025–26,[8] figures that could be even larger in nominal terms if inflationary trends continue into the medium term.

Opinion has been heavily divided among economists and central bankers over whether recent inflationary pressures will prove transitory or will persist into the medium term. Most central banks previously argued that this inflationary episode is likely to be a transient phenomenon, a natural result of an overheating economy following the strong COVID recovery. Such explanations pointed to short-run supply side shortages in a time of loose monetary policy and the rapid expenditure of pent-up lockdown savings. The argument follows that global supply chains have simply not had time to adjust to the resurging global demand that has resulted from most of the world undergoing economic recovery simultaneously. Under normal circumstances, this spike in demand would introduce inflationary pressures in the short-term but prices would stabilise as global supply rises to meet demand.

However, the global economy is facing various supply chain distortions and bottlenecks, as well as ongoing shortages of key inputs from semiconductors to natural gas. This increased uncertainty over supply chain stability has led to many firms moving away from zero-inventory practices and hoarding inputs. The UK is especially vulnerable to these pressures due to its high reliance on trade, natural gas for heating and its rapid adoption of sustainable electricity. Inflationary pressures may, therefore, persist into the medium-term in the UK.

If these price rises come to be internalised by consumers, people will revise their inflation expectations to expect higher prices in the future and demand higher nominal wages to compensate. Firms may then raise prices in response to higher wage demands in order to maintain their margins, setting up a wage-price spiral.

[8] Seely, A. (2022) *Spring Budget 2021: Personal Allowance & Higher Rate Threshold*, House of Commons Library: https://researchbriefings.files.parliament.uk/documents/CBP-9186/CBP-9186.pdf

In the case that inflationary pressure becomes incorporated into the expectations of households and firms then inflation could become a long term phenomenon. If this scenario comes to pass, which is beginning to look increasingly realistic, the income tax bracket freeze will have a significant impact on the disposable income of all earners.

Figure 1

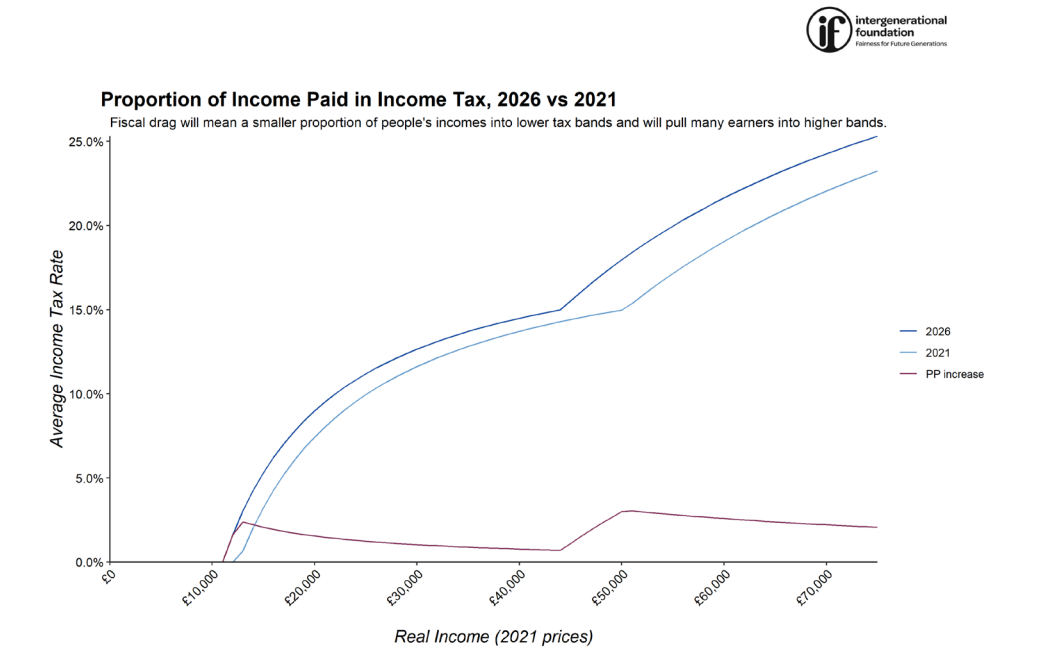


Figure 1 shows the average income tax rate (income tax payments as a proportion of income) faced by workers with a real annual salary of under £75,000 per year in 2021 and 2026. The model assumes that income tax brackets will be frozen until 2026 and an annual inflation rate of 5.4% in 2021, followed by a constant 2% p.a. thereafter.[9] Incomes in 2026 have been adjusted for inflation, converting them back to 2021 prices. The light blue line shows the average income tax rate faced at each level of income in 2021 while the dark blue line shows the average income tax rate for each level of real income in 2026.

[9] The Bank of England inflation target is used as a best-case scenario. It could, however, be a somewhat conservative estimate

The 2026 curve clearly lies to the left of 2021, showing that for a given level of real income a person will pay a higher average income tax rate in 2026. The purple line shows the effective percentage point rise in average income tax rate between 2021–2026 at each level of real income, the vertical gap between the two curves at a given level of real income. One can clearly observe two spikes in effective tax rate rises in the regions £10,000-15,000 and £45,000–50,000. These spikes show that people on the border between tax brackets are most vulnerable to the effects of fiscal drag, as larger portions of their income fall into higher income tax rates.

IF recommends reversing the decision to freeze tax brackets given the likelihood of sustained inflation.

4. National insurance contributions

On 7 September 2021, a 1.25 percentage point (pp) increase in NICs was announced for working age people and older people working after retirement. While the 1.25pp for both groups may appear the same, in reality the NICs increase is on top of the existing 12% NICs rate for working-age employed people, bringing their NICs rate to 13.25%, while over-65s are starting from zero so their new NICs rate would be 1.25% if working. There is an obvious intergenerational inequity in the difference in tax rates for two generations when the funds raised will be used predominantly on older generations.

Fundamentally, this is a tax hike on working-age people smuggled in under the auspices of COVID support, only possible due to the strong connection in the public consciousness between NICs and welfare payments. Previous IF research has shown that this connection is no longer as strong as it once was and that NICs essentially now comprise a part of the normal budget,[10] as the government can use bond purchases to transfer any excesses from National Insurance payments into regular government accounts.[11]

Figure 2 shows NICs as a proportion of real pre-tax income across income levels for working-age employees, henceforth referred to average NICs rate. The pink line shows the average rate under the current NIC system in 2021, with NICS taking up an increasing proportion of pre-tax income between £12,000 and £50,000 in a shape that is familiar to progressive tax regimes. The curve then decreases for income above £50,000, as the marginal tax rate for income above this threshold bracket drops to 2%. Figure 2 shows that a working-age person earning £27,000 pays the same proportion of their income in NICs as someone earning £70,000.

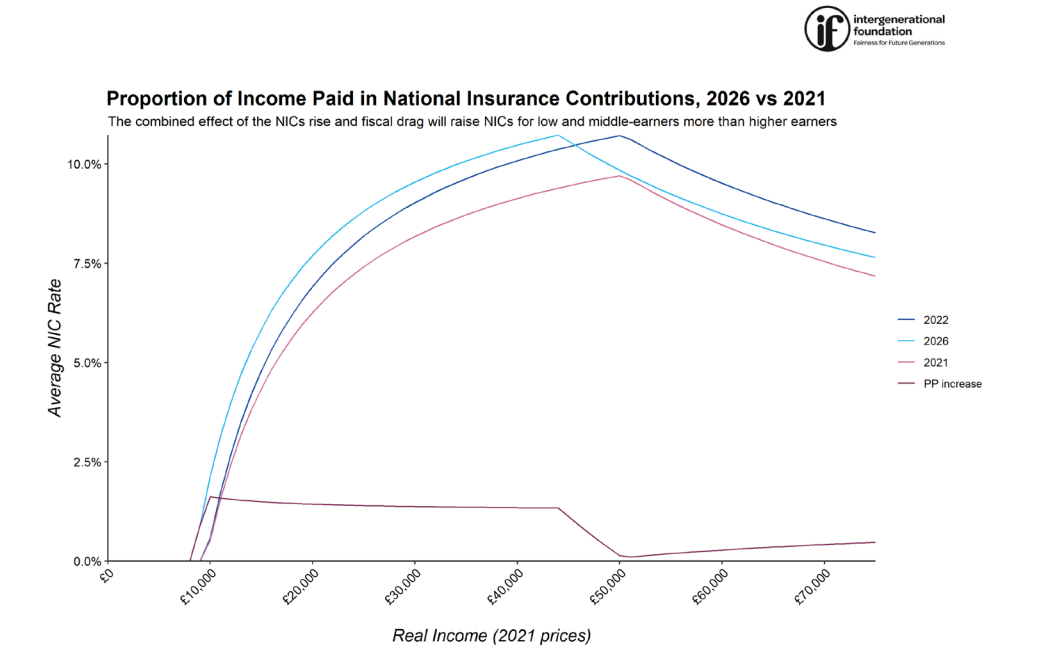
The dark blue line shows the effect of the NICs rise in isolation, showing that NICs will increase as a proportion of income for the entire working-age population by a similar magnitude. However, NICs thresholds are also scheduled to be frozen until 2026, meaning fiscal drag is also relevant to NICs.

[10] Kingman, D. (2013) *All In This Together? Why Over-65s Should Pay National Insurance*, Intergenerational Foundation: https://www.if.org.uk/wp-content/uploads/2014/02/All-in-this-together-Why-over-65s-should-pay-National-Insurance.pdf

[11] Adam, S. and Loutzenhiser, G. (2007) Integrating Income Tax And National Insurance: An interim report, Institute for Fiscal Studies: https://ifs.org.uk/wps/wp2107.pdf.

The light blue line shows the average NIC rate across income levels in real terms in 2026, assuming persistent inflation rates of 2% p.a. across the period. This has the combined effect of moving the curve upwards (NICs hike) as well as to the left (inflation).

Figure 2



Source and notes: IF's calculations using GOV.UK figures on NICs bands and rates. NICs bands and NIC-free allowance are assumed to remain frozen at current levels until 2026. Inflation is assumed to be 5.4% in 2021 and 2% p.a. thereafter. Incomes in 2026 are deflated to 2021 prices using the same inflation rates.

The purple line shows the vertical distance between the dark and light blue lines, the percentage point increase to average NICs rate across real income levels in 2026 compared to 2021. This plot clearly shows that low and middle earners face the largest increase to NICs as a proportion of income, facing an increase between 1.5–2.3pp between £10,000 and £41,000. Their higher-earning counterparts, however, will face an increase of less than 1% for income over £70,000, and earners with a real income between £50,000 and £60,000 will experience a very minimal proportional increase to their NICs by 2026.

Cast in this light, the government's Health and Social Care Levy will prove to be a deeply regressive tax reform if recent inflationary pressure persists into the medium term. Low and middle earners – likely younger generations - may face twice the tax hike than higher earners. As such, low and middle earning people, who are most likely to be young, are being burdened with the vast costs of clearing the NHS backlog and reforming social care.

The injustice of this tax reform has a further intergenerational element, as workers over the age of 65 have not historically paid NICs. The government has announced that from April 2022 pensioners who continue to work after State Pension Age will now contribute 1.25% of income in NICs. While this is a step in the right direction, the 1.25% in NICs will still be ten times lower than the rate paid by the working-age population. This means that pensioners will continue to contribute little towards their own social care costs during a period of increasing longevity and increasing chronic illness in old age.

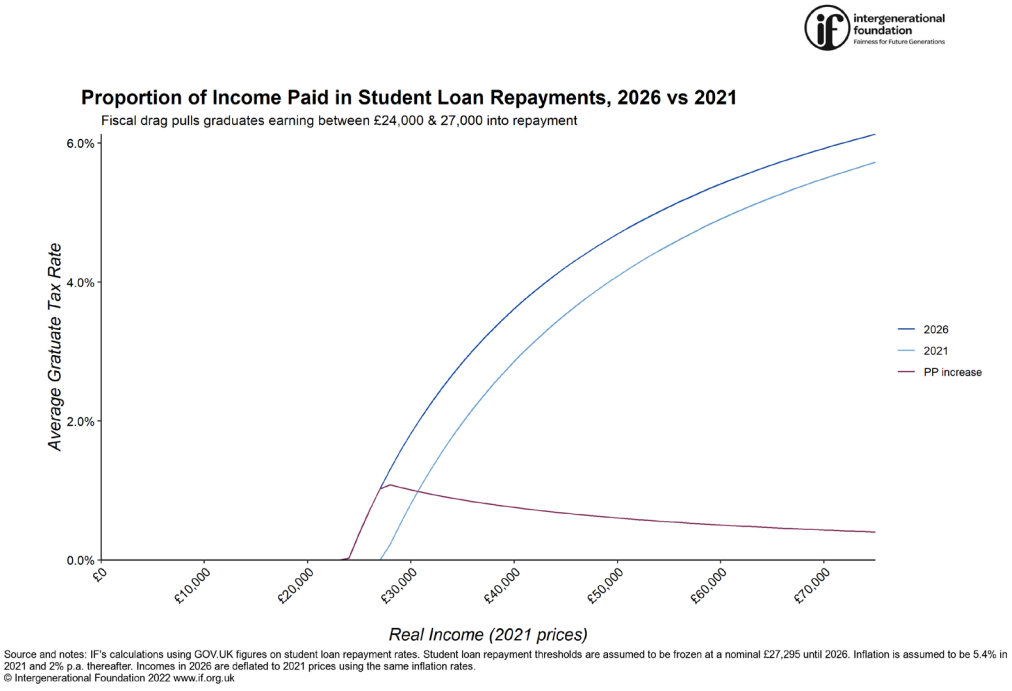
Even if funding such spending had to be financed through NICs, National Insurance could be reformed in a number of intergenerationally fair ways to generate similar sums of money. Primarily, IF recommends reforming the NICs so that those over the state retirement age pay at the same rate as other workers. NICs could also be reformed to be less regressive for higher earners. Analysis from Richard Murphy estimates that charging those earning over £50,000 at the same rate as lower earners would generate an additional £14bn in revenue for the Treasury[12] – slightly more than is expected to be raised by the Health and Social Care Levy.

[12] Murphy, R. (2021) *Charging National Insurance At 12% On All Employees, Including Those Earning Over £50,000 A Year, Could Raise £14 Billion Of Extra Tax A Year*, Blog, Tax Research UK: https://www.taxresearch.org.uk/Blog/2021/09/05/charging-national-insurance-on-all-employees-including-those-earning-over-50000-a-year-who-pay-a-reduced-rate-at-present-could-raise-14-billion-of-extra-tax-a-year

5. Student loan repayment threshold

In January 2022, the Department for Education announced that the student loan repayment threshold will remain at £27,295 for 2022-2023, a move that could generate an additional £600m per year for HM Treasury.[13] The decision only confirms that the threshold will be frozen for the next financial year, but if this freeze were extended it would have a serious impact on graduates earning between £20,000 and £30,000.

Figure 3



The light blue line shows student loan repayments as a proportion of pre-tax real income (henceforth the average graduate tax rate) in 2021 across income levels. The dark blue line shows the average graduate tax rate faced by earners at each level of real income in 2026, assuming the threshold remains frozen. Fiscal drag once again has the effect of shifting the tax curve left, as a smaller proportion of people's income fall into the graduate tax free allowance.

[13] Institute for Fiscal Studies (2022) *IFS Response To The Freeze Of Student Loan Repayment Threshold*: https://ifs.org.uk/publications/15923

The purple line shows the increase in average graduate tax rate faced at every level of real income in 2026 compared to 2021. Graphically this is the vertical distance between the light and dark blue curves. This shows that those earning between £25,000–£30,000 will experience the highest increase in average graduate tax rate, as student loan payments will take up an additional 1% or more of their income. Such a move makes the student finance system less progressive and closer to a flat graduate tax of 9%, with a couple of key exceptions.

Primarily, the student finance repayment system varies greatly depending on when a student graduated, their lifetime income and their family wealth. The vast majority of graduates never pay back their loans in full due to the large lump sum and high interest rates, making the student loan repayment plan a 30-year tax on all income earned over the repayment threshold. However, the top 5% of graduate earners pay their loan back more quickly, as they clear more of their debts early allowing them to accumulate less interest. This means that after 10 to 20 years, the graduate tax no longer applies to the very highest earners, amounting to lost income for Student Finance England that makes fees more expensive for everyone else. This is effectively a dual system where student debt is a somewhat manageable loan for the very highest earners and a 30-year tax for everyone else.

This unfairness is compounded by the fact that that 10% of students, from wealthy families, pay for tuition and maintenance upfront and do not enter the student finance system, letting them off the graduate tax entirely.[14] This is a £30,000 fee for escaping 30 years of taxation.

Previous IF research has shown that the national benefits of higher education far exceed tuition fees. Our 2017 report, based on a BIS research paper, shows that the average student experiences a directly monetised life-cycle benefits of £501,000. That graduate premium accrues 42% to the individual in the form of increased net income, and 58% to the nation in the form of extra tax compared to non-graduates.[15] IF is against education being charged for, not only out of principle but because the increased tax receipts from the average university graduate far exceed the cost of tuition fees, providing a strong economic case to justify a return to block grants.

[14] Ehsan, R. and Kingman, D. (2019) *Escape Of The Wealthy: The Unfairness Of The English Student Finance System*, The Intergenerational Foundation: https://www.if.org.uk/wp-content/uploads/2019/01/Escape-of-the-Wealthy_Jan_2019_final-1.pdf

[15] Albertson, K (2017) T*he Economic Inefficiency Of Student Fees In England: Why Paying Tuition Fees From The Public Purse Makes Financial Sense*, The Intergenerational Foundation: https://www.if.org.uk/wp-content/uploads/2017/04/The-Economic-Inefficiency-of-Student-Fees_Final.pdf

6. Overall impact

Freezing NICs, income and graduate tax brackets while raising the NICs rate will result in the entire taxpaying population seeing a smaller proportion of their pay.

Income tax as a proportion of income will increase the most for those earning a real income close to the thresholds of £12,570 and £50,270 as fiscal drag will cause a smaller portion of their income to fall into the tax-free allowance and 20% bracket respectively.

Changes to NICs will affect working-age people with a real income between £12,500 and £40,000 the worst due to the combined effects of the health and social care levy and inflation.

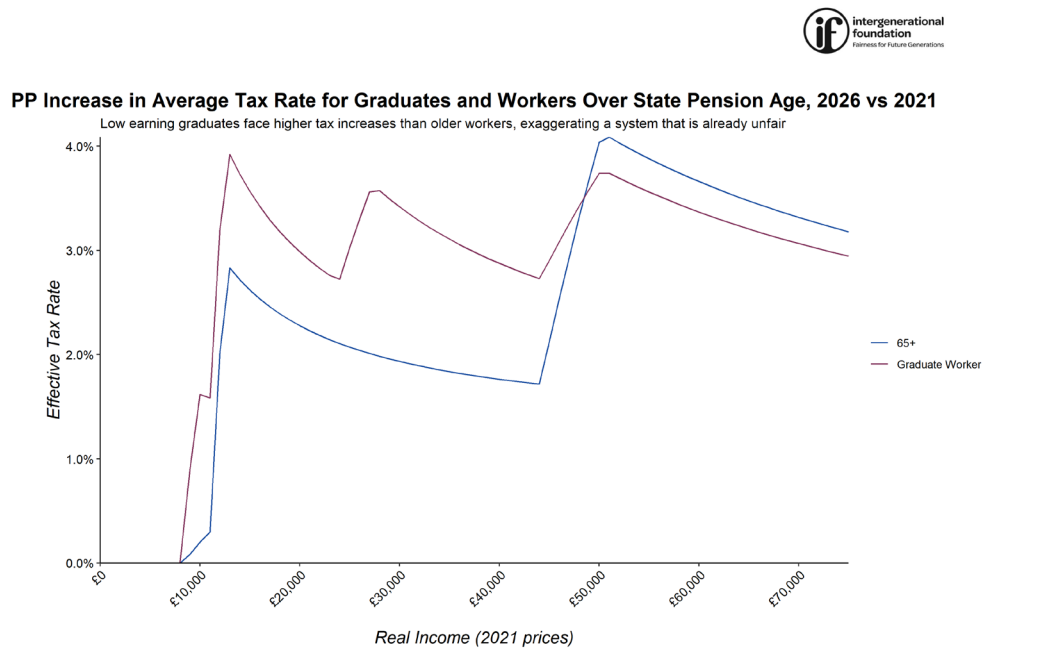
Freezing the student loan repayment threshold during a time of sustained inflation will have a strong impact on graduates earning between £20,000 and £30,000 p.a., as fiscal drag will force almost all employed university graduates into making payments.

However, the structure of the tax system means these effects do not affect all taxpayers equally. Those over the State Pension Age will only feel the effects of higher income tax and the Health and Social Care levy after 2023. Working-age earners with no student loan will feel the combined effects of the NICs hike and fiscal drag to their income tax and NICs. Young graduates will feel the full brunt of all three. Figure 4 shows the percentage point increase to deductibles felt by each type of worker in 2026 compared to 2021, subject to our assumptions.

A graduate earning a real income of £27,000 (in 2021 prices) will see their average tax rate, defined as deductibles as a percentage of income, rise by 3.5pp by 2026. This means their real after-tax income will be 4.37% (£962) lower in real terms than the same worker earning the same real income in 2021. Someone who continues working past state pension age on the same real income will see their after tax real income decrease by only 2%. This means that young graduates will see their after-tax income shrink by 1.75 times more than similarly qualified pensioners on the same income, exaggerating a system that already taxes low earners and young people at higher average rates than their older counterparts.

When considering how much young people are forced to spend on necessities, the impact of these tax rises on young people is staggering. IF has attempted to determine the impact on discretionary income of a representative university graduate. Appendix A details the assumptions and approach used to calculate our estimates.

Figure 4



Source and notes: IF's calculations using GOV.UK data on personal allowances, tax rates and student loan repayment rates. All tax bands and tax-free allowances are assumed to remain frozen until 2026. NICs are assumed to rise by 1.25pp. Inflation is assumed to be 5.4% in 2021 and 2% p.a. thereafter. Incomes in 2026 are converted back to 2021 prices using the same inflation figures.

Accounting for 5.4% inflation for 2021, freezing all thresholds and increased NICs will lead to a £510 (14%) drop in discretionary income for a graduate earning £27,000 in 2022 compared with a year earlier. This figure does not even account for the imminent energy and cost of living crises that will see household energy prices rise by up to 54% in April, meaning a lone occupant of a one-bedroom flat could see their energy bills rise by an additional £395.[16] Higher taxes and energy bills could therefore result in young people seeing their discretionary income drop by up to 25% over the course of 2022 alone.

[16] EDF (2021) *What Is The Average Energy Bill In The UK?*: https://www.edfenergy.com/for-home/energywise/what-is-the-average-energy-bill-in-the-uk

Furthermore, the prices of many other basic goods, such as pasta, are increasing faster than CPI shows,[17] meaning inflation could have an even stronger effect on young people. These three tax bracket tax freezes are clearly hitting low and middle-earning young people the hardest at a time when they can least afford it.

Over the long run, at 2% annual inflation from 2023 to 2026, our graduate could see their real discretionary income fall by 27% by 2026 compared to 2021. These effects will be magnified if recent inflationary pressures turn out to be structural rather than transitory. At 4% annual inflation over the period our graduate will see a 40% drop in real discretionary income by 2026.

These reductions in discretionary income will inhibit the ability of young people to save for housing deposits at a time when the ratio of house prices to wages is at historic levels.[18] It is true that young graduates could respond by cutting costs, by moving to cheaper rented accommodation or lowering their spending. However, young people are already spending proportionally more on housing than any other age group and exhibit lower discretionary spending that older age groups.[19]

Overall, these three policy decisions will make the tax system less progressive, increasing average tax rates for those on low/middle incomes and young university graduates by more than the increases experienced by high earners and older workers. These policies essentially amount to an intergenerational transfer from working-age people to retired baby boomers. IF believes that the government must stop asking low earners and young people to foot the bill for the increasing costs of an ageing population. In the next section we offer some policies that could help rectify the situation.

[17] ONS (2022) *CPI-Consistent Inflation Rate Estimates For UK Household Groups*: https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/cpiconsistentinflationrateestimatesforukhouseholdgroups/2005to2021

[18] Simpson, L. and Bui, M. (2021) *Left Behind: A Decade Of Intergenerational Unfairness*, The Intergenerational Foundation: https://www.if.org.uk/wp-content/uploads/2021/11/Left-Behind-A-Decade-of-Intergenerational-Unfairness_Curtis_Banks.pdf

[19] Kingman, D. (2019) *All Consuming Pressure: The Cost-Of-Living Crisis Facing Younger Generations*, The Intergenerational Foundation: https://www.if.org.uk/wp-content/uploads/2019/10/All-Consuming_pressure_draft_Final.pdf

7. Policy recommendations

The current progressive income tax system is not fundamentally broken, it ensures that people earning higher incomes pay a higher proportion of their earnings in income tax. The problem, however, lies in the decision to freeze tax brackets in a time of high inflation. IF recommends a reversal of the decision to freeze tax brackets and have them rise in line with inflation in order to protect the income of low and middle earners, amongst whom young workers are overrepresented.

National Insurance is essentially a general tax at this point, most of it goes into paying state pensions but any surpluses are transferred to other departments through gilt purchases.[20] This means there is little reason for its regressive structure or exemption for those over the state pension age. IF recommends scrapping the exemption for workers aged 65+ which our previous research has shown to be popular across the political spectrum and would increase tax income by over 1.5bn per year.[21] The £50,000 threshold, over which workers currently pay a marginal 2% (soon to be 3.25%) tax rate, should also be reformed so that the burden of increased healthcare and pension costs are more evenly shared across the income distribution. A more ambitious government could scrap the National Insurance system altogether and fully integrate NICs with income tax.

The current student finance system embodies the worst aspects of graduate debt and a graduate tax and should be reformed. IF has previously recommended a range of policy solutions, ranging from forcing all students into taking a tuition loan, transforming the system into a proper graduate tax to having the state fund tuition fees.[22] Each proposal has its own redistributive implications and political complications but research has shown that all three are economically feasible and could improve economic outcomes and endow the UK with better human capital for future growth. IF also believes that it is vitally important to offer alternatives to university, opportunities for people to improve their prospects with other forms of education.

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[20] Adam, S. and Loutzenhiser, G. (2007) *Integrating Income Tax And National Insurance: An interim report*, Institute for Fiscal Studies: https://ifs.org.uk/wps/wp2107.pdf.

[21] The Intergenerational Foundation (2018) *An Extraordinary Anomaly: Why Workers Over State Pension Age Should Pay National Insurance*: https://www.if.org.uk/wp-content/uploads/2018/06/National-Insurance-Exemptions_an-extraordinary-anomaly_FINAL.pdf

[22] Ehsan, R. and Kingman, D. (2019) *Escape Of The Wealthy: The Unfairness Of The English Student Finance System*, The Intergenerational Foundation: https://www.if.org.uk/wp-content/uploads/2019/01/Escape-of-the-Wealthy_Jan_2019_final-1.pdf

At a more fundamental level, a more robust system of capital taxation could help pay for high-quality public services. ONS data shows that the labour share of national income in the UK is around 60%,[23] and that NICs and income tax comprise around 47% of government revenue.[24] This leaves the remaining capital share of income at 40%, whilst business rates and company, capital and council taxes amount to 19% of government revenue. The government should make more effort to properly tax capital income through reforms to land taxation, inheritance tax and capital gains tax. A truly effective system of capital taxation would not only help narrow the wide intergenerational inequality currently present in the UK but would also improve intragenerational outcomes.

Part of the reason that NICs were reformed rather than income tax is that there would be little alarm about this among the Conservatives' key voter base and the fact that people likely to be affected (young people and low earners) are less likely to vote Conservative and even less likely to vote in general. IF therefore believes in increasing the representation of young people at all levels of politics so that their interests are better fought for in policymaking.[25]

[23] ONS (2021) *Labour Costs And Labour Income*, UK: https://www.ons.gov.uk/economy/economicoutputandproductivity/productivitymeasures/bulletins/labourcostsandlabourincomeuk/2021#:~:text=The%20UK's%20first%20official%20estimate,average%20between%202010%20and%202019

[24] IFS (2021) *Where Does The Government Get Its Money?*: https://ifs.org.uk/taxlab/key-questions/where-does-government-get-its-money

[25] Kingman, D. and Leitch, C. (2020) *Grey Power: Young people missing from politics*, The Intergenerational Foundation: https://www.if.org.uk/wp-content/uploads/2020/11/Grey_Power_Young_People_Missing_FINAL.pdf

8. Conclusion

This paper highlights the cumulative effects of policy decisions to freeze income tax brackets, increase NICs on young workers and freeze the student loan repayment threshold. These changes will hit low-earning young people the hardest and will significantly decrease their take-home pay, disposable income and ability to save for pensions and housing.

Subject to our assumptions, a young graduate earning a real income of £27,000 per year will see their average deductibles rate increase from around 18% in 2021 to 22% by 2026. This may decrease their discretionary income by as much as 27% compared to 2021. This regressive tax reform makes it even less likely that the current generation of young people will be able to reach the same milestones and enjoy the same standards of living as previous cohorts.

While IF believes in the projects that these discreet taxes on young people are funding; reducing the public debt, increased support for poorer pensioners and working through the NHS backlog, many other avenues for raising the required revenue exist. This paper has suggested a few such proposals including:

- Immediately unfreezing tax brackets and having them rise with inflation.
- Making National Insurance a more progressive tax by adjusting the £50k threshold and requiring workers over the state pension age to pay NICs at the full rate.
- Scrapping any plans to freeze the student loan repayment threshold and, more broadly, reforming the student loan system to be less punitive on young earners by nationalising the student finance system.

Underpinning all of these recommendations is the urgent need for policy-makers to assess prospective policies for their impact on younger and future generations using intergenerational impact assessments.

Appendix

Our hypothetical student is earning £27,000 p.a. in 2022, just below the national median annual salary for 22–29 year olds of £27,092. Her salary will rise only in line with inflation for the next five years. We have assumed that the income tax brackets and personal allowance will remain fixed for the next five years and that the student loan repayment threshold will be frozen at £27,295 for the 2022–23 tax year onwards. Finally, we assume that the National Insurance rise will go ahead and that NI thresholds will also remain fixed going forward.

For living costs, ONS data on the average UK weekly expenditure of 1 adult households in 2020 (Family Spending Workbook 2, Table A23) is used , allowing for an additional £1,000 per year for council tax. These costs are assumed to rise in line with inflation over the period.

The spreadsheet used to calculate these estimates is available on request.

Notes

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