collective wellbeing
Carnegie UK

# Financing the Future

## Discussion paper

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# Contents

# Introduction to Carnegie UK

Carnegie UK's purpose is better wellbeing for people in the UK and Ireland. We aim to improve collective wellbeing by influencing public policy and practice. We understand collective wellbeing as everyone having what they need to live well now and in the future. We believe that collective wellbeing happens when social, economic, environmental and democratic wellbeing outcomes are prioritised and given equal weight in decision making. We want decision makers to put collective wellbeing at the heart of policy making, resource allocation and long-term planning.

# Introduction to Collective Wellbeing

We understand collective wellbeing as the progressive realisation of social, economic, environmental and democratic (SEED) outcomes.

- **Social wellbeing:** Everyone can achieve their potential and contribute to society because they have basic needs met. Our basic needs are having access to health and social care, education, housing, transport, digital and childcare.
- **Economic wellbeing:** Everyone has a decent minimum living standard and can absorb financial shocks. This means financial security now and being able to maintain adequate income throughout their lifetime.
- **Environmental wellbeing:** Everyone has access to green and blue spaces and collectively we live within the planet's natural resources. This means we protect the environment for future generations.
- **Democratic wellbeing:** Everyone has a voice in decisions made that affect them. This means having local and national leaders who support participation, foster trust and encourage diversity.


# Introduction to this discussion paper

This paper sets out a summary of relevant tax, spend and fiscal policy issues in the UK today against the backdrop of our current collective wellbeing. The paper seeks opinion on the merit, challenges and opportunities associated with exploring what a new social contract between the citizen and state focussed on collective wellbeing could and should look like.

# UK political and financial context

Some of the biggest challenges all governments across the UK and Ireland need to grapple with, both now and in the future, are how to raise and spend money effectively to deliver the outcomes required to achieve their policy aims.

Public finances are increasingly stretched, and across the UK we are collectively facing challenging economic and demographic transitions which will exacerbate spending challenges and necessitate difficult choices for those in positions of power.

Adding to this challenge, public awareness and engagement in the debate around revenue and spend is often limited, in part because these topics are complex and it can be difficult to understand fully how money is being raised and spent by government. Associated conversations can therefore also be limited and are often lacking in creativity and characterised by political risk mitigation on the part of decision makers.

Frequently, the political debate on what funds to raise and how is heavily influenced by ideology. In addition, our revenue and spend models are rarely considered holistically in the context of investment for shared outcomes across portfolios. Tax, revenue and spend policies are often viewed in isolation of each other in terms of their cumulative policy impact.

An additional factor in our political and public policy landscape is the asymmetric nature, and continuing evolution of, the devolved settlements in the nations and regions of the UK. The growth of empowered mayoralties in England is the latest tier in an increasingly complex map of devolved policy powers over aspects of revenue raising and spending across the UK. As these tiers of devolution grow and evolve, often, little consideration is given to their coherence and interaction in relation to effective and long-term public policy making that cuts across traditional portfolios.

We believe that the prism of collective wellbeing can provide a unique, helpful and important lens through which to better view these issues and their interactions.

# Overview of tax and spending policy in the UK

In spite of the well documented economic challenges facing the UK, the OBR forecasts[1] public spending in 2024-25 to be £1,276.2 billion, equivalent to around £45,000 per household. This places the UK as the 6th largest economy[2] in the world in 2024.

## Trends in UK policy spend

Annex A to this document sets out trends for UK government expenditure in key policy areas since 2011/2. Notable highlights from this include:

- Government spend on education has grown by 26 per cent in real terms since 2001/2.
- Spend on social protection, which includes all state pensions and benefits, has grown by 52 per cent in real terms over the same period.
- Spending on health has grown by 114 per cent in real terms.
- Spending on transport has grown by 137 per cent in real terms.

In spite of these significant uplifts since 2001, many people depending on these services are experiencing real hardship, and increased spending is not always correlated with improved outcomes. For example, in England and Wales, healthy life expectancy at birth in 2020 to 2022 decreased for both males and females compared with 2011 to 2013[3].

The impact of the COVID-19 pandemic on spend is very clear with the sharp increases in spending on health and other public services (which includes support for businesses) in 2020-21 and the corresponding increase in debt interest from 2021-22.

Another way to look at the trend is to consider how public spending has changed in relation to overall economic output. ***Figure 2*** in Annex A shows public spending including debt interest as a percentage of GDP over time. Spending rose from 33.4 per cent of GDP in 2001-02 to 42.1 per cent of GDP in 2009-10, then declined year on year to reach 35.6 per cent of GDP in 2019-20. The impact of the pandemic is evident again in 2020-21 and 2021-22, and by 2023-24 public spending was around 40.3 per cent of GDP.

This level of public spending in the UK is not unusual internationally. The OBR guide shows that UK public spending as a share of national income in 2023 was around the average for industrial countries. Whilst there are definitional challenges, the broad picture shows that there are countries with successful economies which choose to have higher or lower levels of public spending.

Choices about the level of public spending need to be made alongside choices about taxation, an issue where consideration of the social contract feels pertinent. The OBR shows the UK government tax receipts in 2023 were just below the OECD average, and data from the IFS for 2021 shows the UK tax receipts as a share of national income were below the OECD and G7 averages, and significantly lower than France,

1 OBR: a brief guide to the public finances October 2024
2 According to the IMF – see https://www.imf.org/external/datamapper/NGDPD@WEO/OEMDC/ADVEC/WEOWORLD
3 https://www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/healthandlifeexpectancies/bulletins/healthstatelifeexpectanciesuk/between2011to2013and2020to2022

Italy and the Scandinavian countries (see ***Figure 3*** in Annex A). The OBR observes that the UK budget deficit and UK net debt in 2023 were higher as a percentage of national income than the average for industrial countries, which is not sustainable in the long run.

There are significant choices to be made on how tax revenues are raised as well as on the appropriate level of taxation. ***Figure 4*** in Annex A shows the major tax revenues in the UK in 2023-24. Between them, Income Tax and National Insurance brought in half of UK tax receipts, with VAT accounting for another 19 per cent. These taxes account for the majority of revenue in many other countries also. ***Figure 5*** shows an analysis of tax revenue composition in 2019 from the IFS with income tax, social security contributions, payroll taxes, VAT and goods and services taxes making up a substantial majority of tax revenues across the OECD, pre-2004 EU members states and Scandinavia. One significant difference in the UK is the share of revenue raised from recurrent buildings taxes, which is substantially higher than the OECD average. This may be worth bearing in mind in any discussion of housing costs..

Tax can be used to do more than raise revenue. ***Figure 6*** in Annex A shows a breakdown of the receipts labelled as 'smaller taxes and duties' (***Figure 4***). Several of these are intended to change behaviour to achieve outcomes which can be associated with collective wellbeing – for instance, Landfill Tax aims to reduce negative environmental impacts and the Soft Drinks Industry Levy aims to improve population health by reducing the consumption of sugary drinks. These taxes have attracted many criticisms, but they have had an impact. Analysis by the Institute for European Environmental Policy[4] noted that Landfill Tax had significantly reduced the quantity of waste sent to landfill. The Institute of Labor Economics published analysis in 2021[5] which concluded that the Soft Drinks Industry Levy had been responsible for a reduction in intake of just under 6,500 calories from soft drinks per annum per UK resident.

The overall impact of the tax system, benefits systems and public services in the UK is to redistribute income from the highest to lowest earning households. ***Figure 8*** and ***Figure 9*** in Annex A show the impacts of benefits, direct and indirect taxes and benefits in kind (public services) on average household income and the ratio of top to bottom quintile household income. For a household in the bottom quintile, cash benefits have the biggest positive effect and public services also have a very significant positive effect. Indirect taxes like VAT are so regressive that their impact on lower income households more than offsets the benefit of paying lower levels of direct taxes.

This overview barely scratches the surface of a large and complex subject but is intended to provide context to discussion of a principled approach to spending and taxation that supports collective wellbeing.

4 https://ieep.eu/wp-content/uploads/2022/12/UK-Landfill-Tax-final.pdf

5 https://www.iza.org/publications/dp/14528/does-a-spoonful-of-sugar-levy-help-the-calories-go-down-an-analysis-of-the-uk-soft-drinks-industry-levy

# Pressures on Future Generations

A lot has been said and written about rising inequality, the cost of living and wider economic challenges facing people now compared to earlier generations.

*Table 1: Past, current and future comparisons of population and public spending*

| | 1973 | 2023 | 2073 |
|---|---|---|---|
| Percentage of UK population aged 65 or older[6] | 13.6% | 18.9% | 27.2% |
| Percentage of UK population aged 19 or younger[7] | 31.0% | 22.6% | 18.8% |
| Health spending in UK as a percentage of GDP[8] | 3.6% | 7.9% | 14.5% |
| Spending on pensioner benefits (inc state pension) in UK as a percentage of GDP[9] | -[10] | 5.6% | 8.9% |
| UK Debt interest as a percentage of GDP[11] | 4.1% | 4.5% | 12.5% |

The age composition of our society has already shifted dramatically. Increasing life expectancy and falling birth rates mean that the proportion of the population aged 65 or older has been growing while the proportion of the population aged 19 or younger has been falling. The Office for National Statistics population projections for 2073 see these trends continuing. By 2073, on ONS projections, the percentage of the adult population aged between 20 and 64, who generate a high proportion of income tax and national insurance revenue will fall from 58.5 per cent of the population to 54 per cent of the population.

One of the key assumptions in the ONS population projections is about net long-term international migration, which they have assumed is around 315,000 people per year from mid-2028 onwards – much lower than the estimated net 728,000 additional people[12] estimated to have taken up residence in the UK in the year to June 2024, but similar to the trend between 2012 and 2018. ONS projects that by mid-2035 there will be more deaths than births, so net migration of people of working age may be even more important to the economy over the coming decades.

6 ONS mid-year population estimates and 2021-based interim national population projections projections as at January 2024
7 ONS mid-year population estimates and 2021-based interim national population projections projections as at January 2024
8 1973 figure from IFS spending composition sheet for 1973-74; 2023 and 2073 figures from OBR Fiscal Risks and Sustainability September 2024 chapter 4, forecast for 2023-24 and projection for 2073-74.
9 2023 and 2073 figures from OBR Fiscal Risks and Sustainability September 2024 chapter 4, forecast for 2023-24 and projection for 2073-74. Includes pension credit, winter fuel payments and the Christmas bonus.
10 Separate figures for social security spending on pensioners are only provided in the IFS spending composition sheet from 1978-79 onwards. The figure for 1978-79 was 5.0%.
11 Gross debt interest figures. 1973 figure from IFS spending composition sheet for 1973-74; 2023 and 2073 figures from OBR Fiscal Risks and Sustainability September 2024 chapter 4, forecast for 2023-24 and projection for 2073-74.
12 ONS Long term international migration, provisional: year ending June 2024

Looking over the same 50-year period, all the current evidence suggests that the demand for public spending will increase. Table 1 also shows figures from the OBR Fiscal Risks and Sustainability report in September 2024 for projected spending in 2073 on health and pensioner benefits (including state pension) as a share of national income. These figures are based on current policies and the population projections, but also critically on assumptions about population health.

OBR projects tax revenues as declining slightly from a forecast 40.4 per cent of GDP in 2023-24 to around 39.6 per cent of GDP in 2073-74 based on current taxes. This is not a scenario which governments could tolerate in the long term, as it would lead to a rising deficit and growth in public sector debt which would see debt interest payments increase to an unsustainable 12.5 per cent of GDP by 2073-74. Looking at changes to taxation is therefore essential over the coming years.

Another key factor is the level of government investment. A full analysis of capital vs revenue spending is beyond the scope of this paper, but it is worth noting that public sector net investment in the UK fell as low as 0.1 per cent of GDP in the late 1980s and stayed below 1.5 per cent of GDP until 2003-04. Since then, it has not gone below 1.5 per cent of GDP and has reached peaks of 3 and 3.5 per cent in 2008-10 and 2020-21 respectively (***Figure 12***, public sector net investment). OBR analysis[13] showed that the UK ranked between 23rd and 27th out of 30 OECD countries for level of government investment as a percentage of GDP between 2007 and 2017 – South Korea, Estonia and Latvia were averaging government investment of 5 per cent of GDP over that period.

Alongside the wider fiscal impacts on future generations, we need to consider the living cost reality. Figure 10 in Annex A shows how median house prices have changed relative to median income between 1999 and 2022 in each of the four countries of the UK. There are clearly differences between the countries, but overall affordability has worsened, and especially so in England, where the median house price in 2022 was 8.4 times median income, compared to 4.4 times median income in 1999. The position in London and some other towns and cities around the UK is significantly worse than these averages. It is not surprising that in 2023, the Halifax[14] reported that the average age of a first-time buyer had risen from 30 to 32 over the previous decade. Figures from the ONS[15] amongst others suggest that the position is not much better for renters.

The problem is not only rising housing costs, but stagnation in earnings. The Resolution Foundation published a report in 2017[16] on pay progression across age cohorts which showed that most five-year birth cohorts were at that time earning similar wages to those born around 10 years before them. This reversed a trend that successive cohorts could expect to earn significantly more.

13 OBR Economic and Fiscal Outlook – March 2020
14 https://www.lloydsbankinggroup.com/media/press-releases/2023/halifax-2023/number-of-first-time-buyers-falls.html
15 ONS Private rental affordability, England and Wales: 2023
16 https://www.resolutionfoundation.org/app/uploads/2017/02/IC-labour-market.pdf

The House of Commons Library produced a summary of average earnings by age and region in November 2024[17] which showed that only 18-21 year olds were on average earning more in real terms in 2024 than in 2008 – all other age groups had lower median pay in 2024 than 2008, with 30-39 year olds particularly badly affected.

Another important inter-generational factor in the UK is wealth. Recent analysis published by the Resolution Foundation[18] highlighted that in the UK, unlike in the US, headline wealth inequality has not risen significantly in recent decades – but this is largely because increasing wealth inequality between younger and older adults has been offset by reductions in wealth inequality between older adults. Large inheritances and gifts have a significant impact, and this needs to be taken into account in considering how to use tax and spending to ensure we can all live together well in the future.

17 https://commonslibrary.parliament.uk/research-briefings/cbp-8456/
18 https://www.resolutionfoundation.org/events/an-uneven-inheritance/

# Life in the UK index and what we know about collective wellbeing

The limits of GDP as an accurate indicator of quality of life within a country are widely recognised, however in spite of this GDP is often used to measure social policy success in the UK. To provide an alternative measure, Carnegie UK developed our 'Life in the UK' index, to measure the collective wellbeing of people across the four nations of the UK annually.

The results for 2024 paint a bleak picture. They reveal consistently low democratic wellbeing and widespread lack of trust across all age groups in the UK's political systems and institutions, with only a minority of people feeling that they had influence over local or national decision-making.

Carnegie UK promote and facilitate certain conditions, known as our 'wellbeing tests' that advance collective wellbeing when they are in place and applied to policy and decision making. We have highlighted the following tests for the purpose of this conversation:

- **Give people voice and choice**: recognising that wellbeing cannot be 'done to' people, it has to be done by and with them, encouraging conversations and interactions between diverse communities, sectors and professions.
- **Recognise relationships:** understanding the importance of human relationships and social connectedness in relation to effective policy making.
- **Support subsidiarity**: advocating local decision-making which reflects the needs and priorities of people living in that place.
- **Enhance transparency:** opening up access to knowledge, data and evidence to support people themselves taking action on wellbeing.
- **Focus on long-termism**: safeguarding the collective wellbeing of future generations.


What the state chooses to do or not to do has a major impact on Collective Wellbeing: how we can all live together well now and in the future. Almost all things that the state does costs money, and the way that money is raised has a significant impact on communities. Decisions about tax, revenue more broadly and public spending are therefore essential to our collective wellbeing.

# What do we mean by a Social Contract for Collective Wellbeing?

At the heart of any debate about how governments make decisions concerning how revenue is raised and spent is the issue of a social contract.

The Oxford Language Dictionary defines a social contract as:

*'An implicit agreement among the members of a society to cooperate for social benefits, for example by sacrificing some individual freedom for state protection'.*

The notion of a social contract goes back at least as far as the 1600s[19]. And as our own Carnegie UK Life in the UK index and Engaging Democracy work highlights, trust in governments and faith in democratic systems is currently worryingly low.

We can understand this growing crisis of trust in democracy in part as a breaking down or undermining of our current social contract between the people in the UK and the role of the state in its various forms and functions.

It is worth noting that there is no formal, codified or consistent version of any social contract that is applied or assumed in UK policy making. Where references to a social contract in UK political discourse are made, they are largely with vague and non-specific reference to the post-war establishment of the Welfare State.

Some interpretations of a social contract, also include distinct generational aspects, whereby different generations receive what they need at different times of life. However, currently, things do not look brighter for future generations, with demographic changes, the climate crisis, technological change and the rising costs of living all posing a threat to future wellbeing.

There is an opportunity now to look at resetting the contract between the citizen and state to ensure it is fit for purpose for the political and democratic challenges we face today, and those coming over the horizon.

This document considers the public finance aspects of the social contract – how money is raised through taxation and how it is spent via public policy. We want to consider this alongside social, economic, environmental and democratic wellbeing and how people can have a meaningful voice in these choices on spending and tax.

19 https://www.idea.int/blog/explainer-social-contracts#:~:text=What%20is%20a%20social%20contract%3F,the%20agreement%20can%20vary%20widely.

## Provocations and questions for discussion

This paper has provided a deliberately limited overview of several significant and complex areas of UK public policy. We have sought to provide additional impartial information on these issues in the various appendices to this document.

With this information in mind, Carnegie UK is interested in understanding more about different aspects, options and opinions on issues relating to a new social contract for wellbeing between citizens and the state.

In particular, we welcome stakeholder opinions and insight on the following five questions:

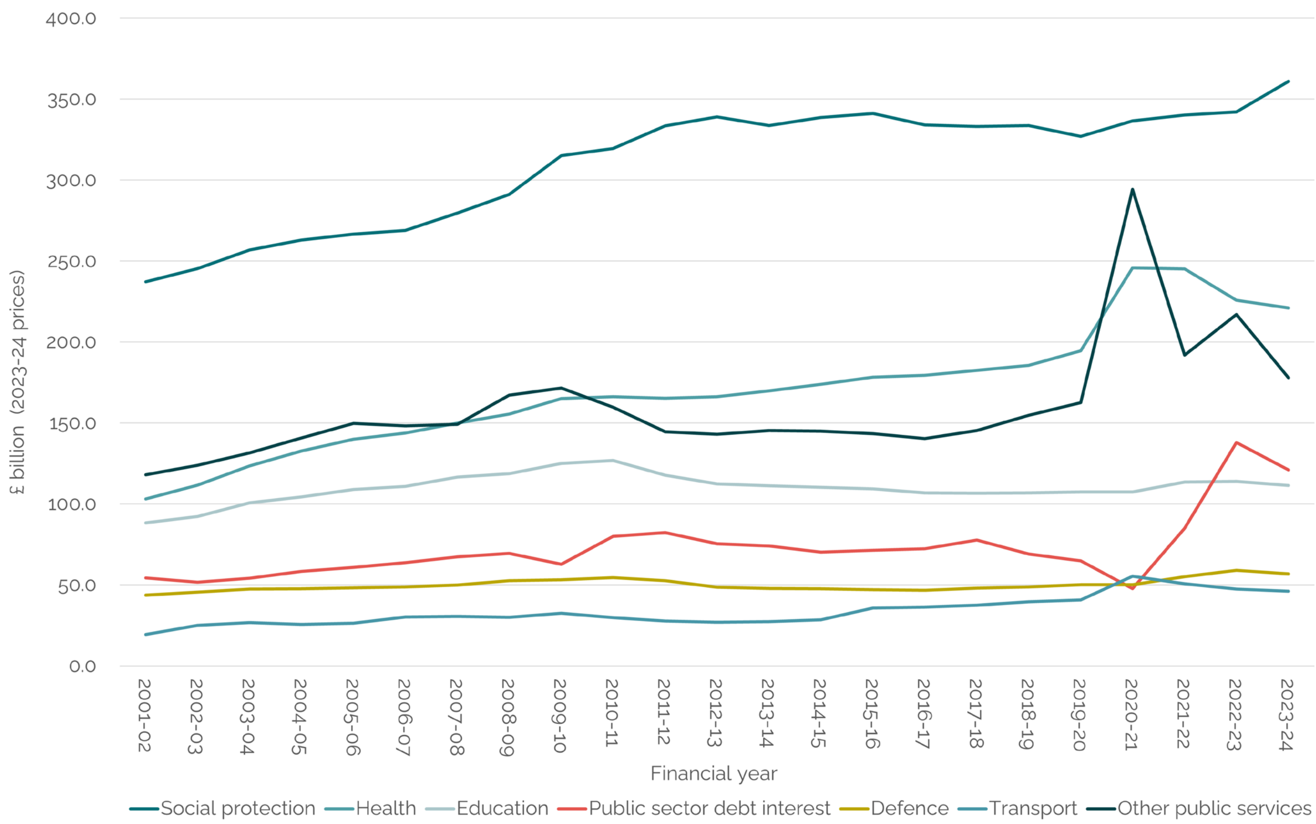
1. Is there merit and value in developing a new social contract for collective wellbeing in the UK between the citizen and the state at this time?
2. What would be the essential features of a new social contract for collective wellbeing to ensure it is successful?
3. What are the main barriers or obstacles to developing and adopting a new social contract for collective wellbeing in the UK?
4. How can we strike the balance between responding to present needs and pressures and those of future generations?
5. What principles or approaches to both taxation and public spending must be considered in relation to a new social contract for collective wellbeing in the UK?

# Appendices

# Contents

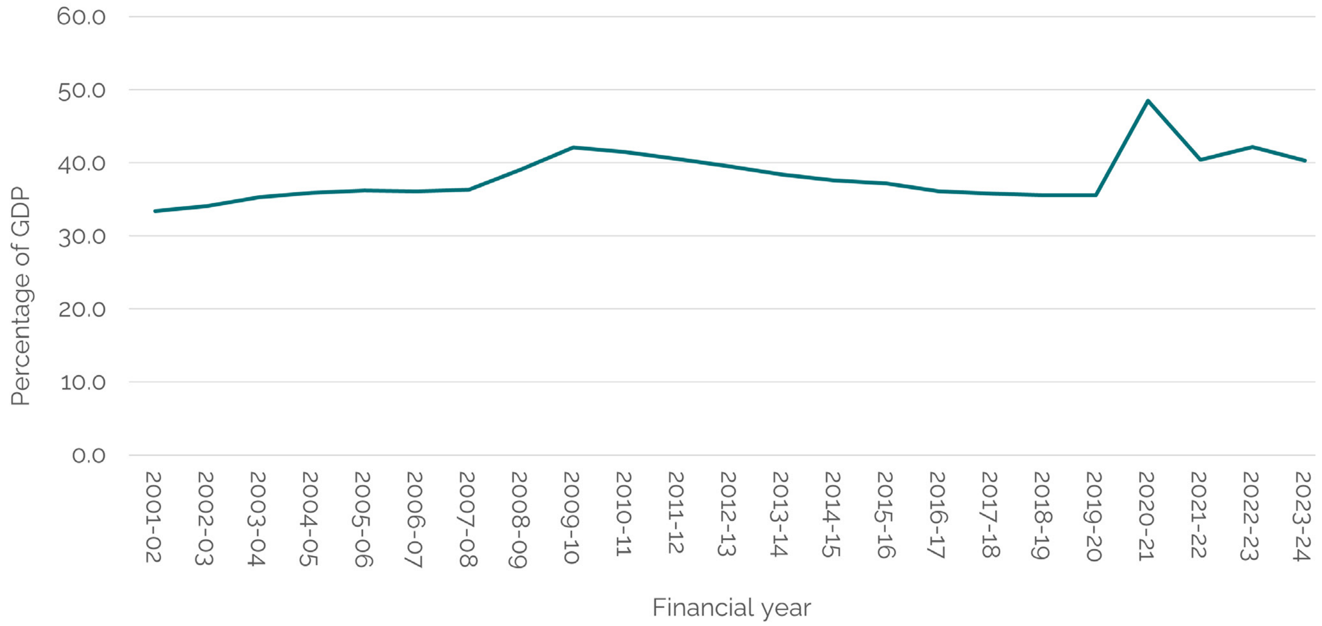
## Annex A: Tables and Charts

## Figure 1: Public spending in the UK in real terms, 2001-02 to 2023-24



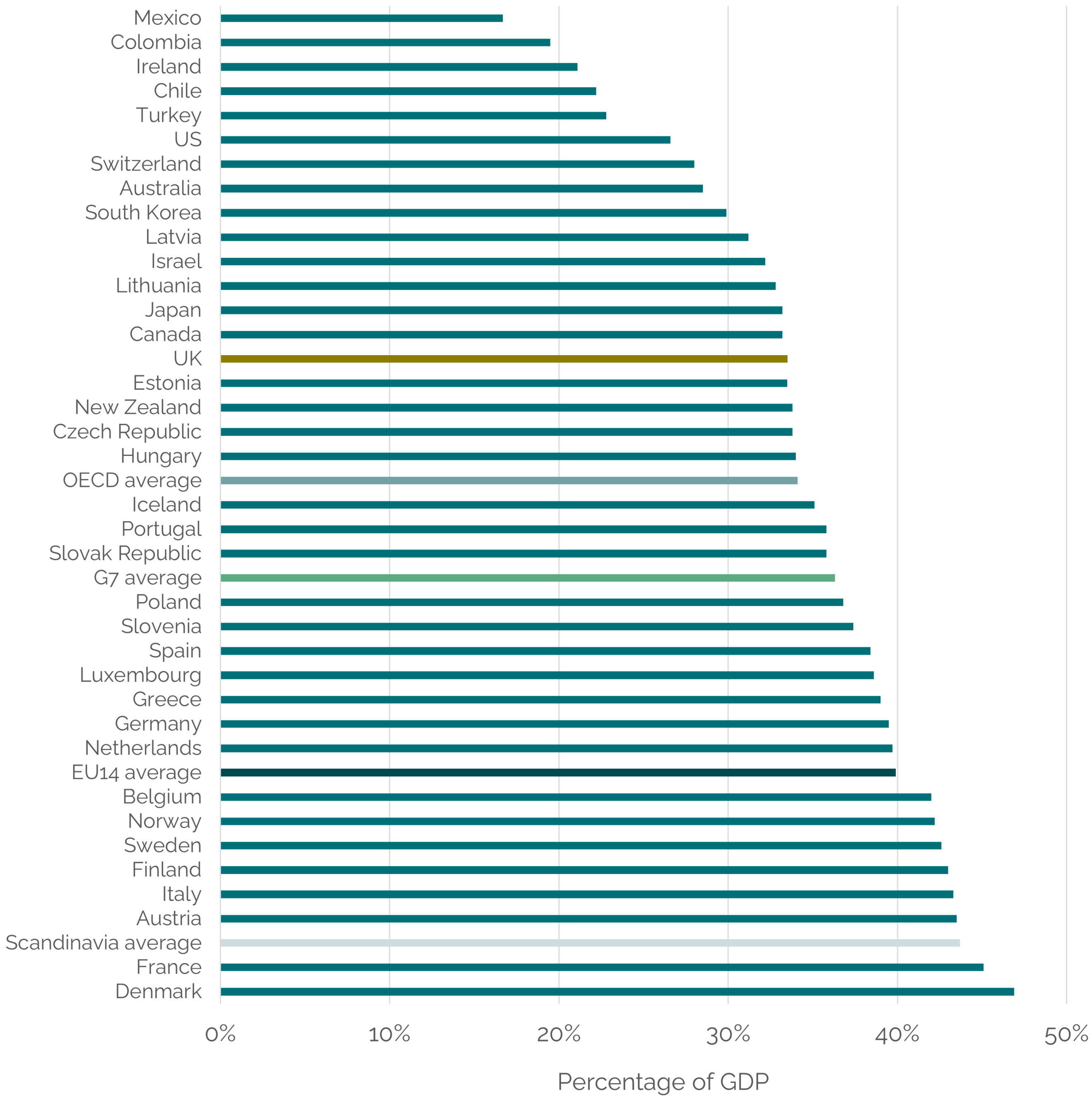

*Source: HM Treasury Public Expenditure Statistical Analyses 2023-24*

## Figure 2: Public spending in the UK as a percentage of GDP, 2001-02 to 2023-24



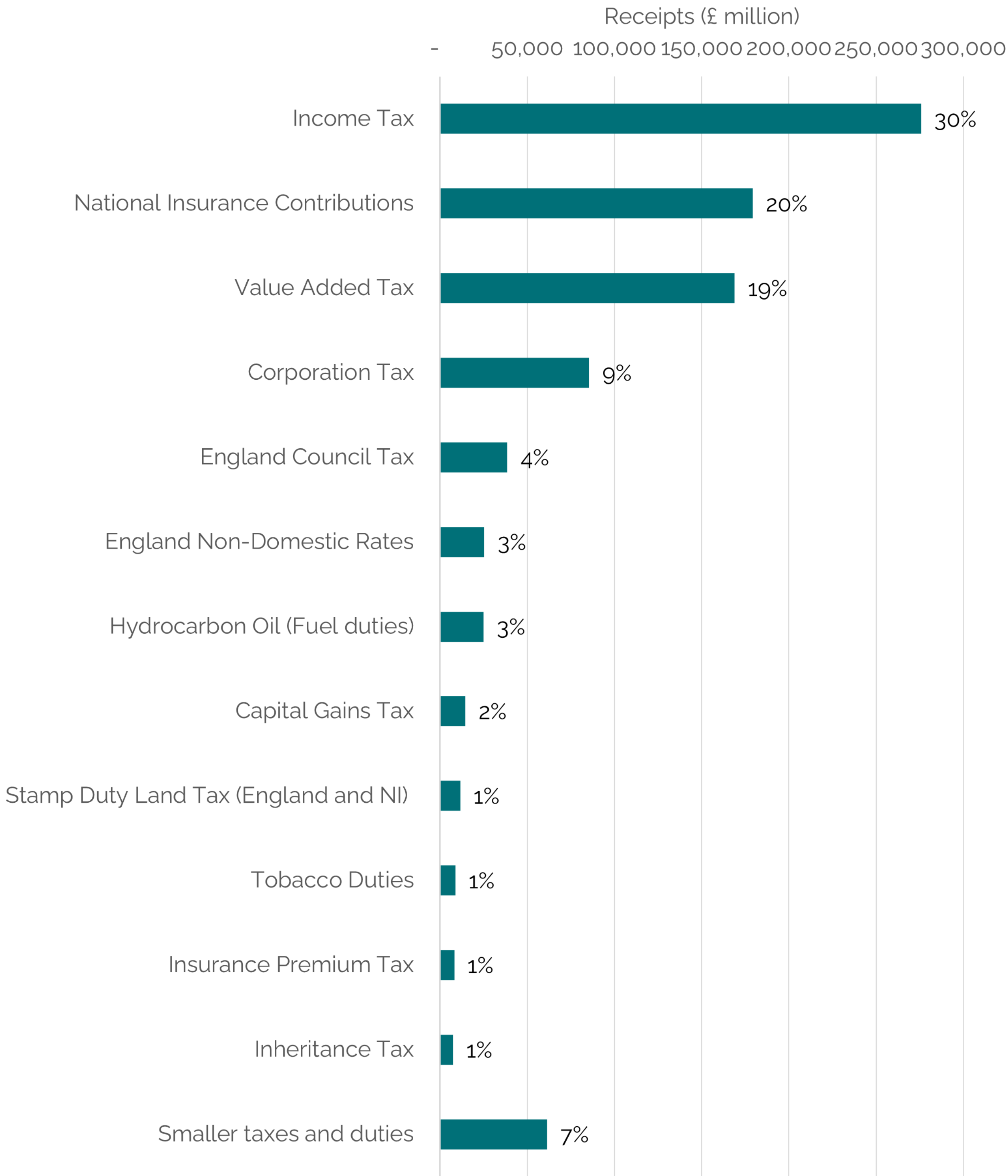

*Source: HM Treasury Public Expenditure Statistical Analyses 2023-24*

## Figure 3: Total tax revenue as a share of GDP in OECD countries 2021



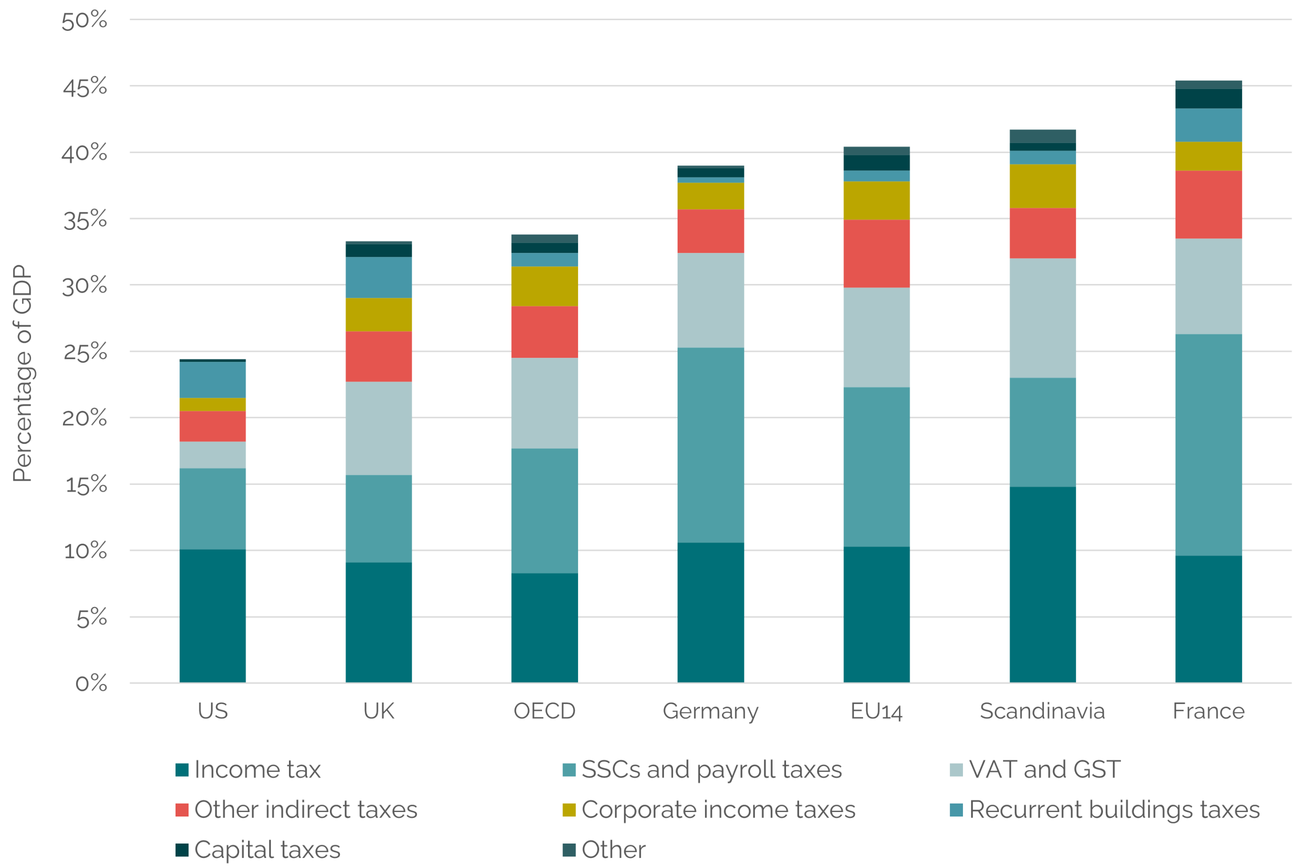

*Source: IFS TaxLab: How do UK tax revenues compare internationally?*

## Figure 4: Overview of tax receipts 2023-24



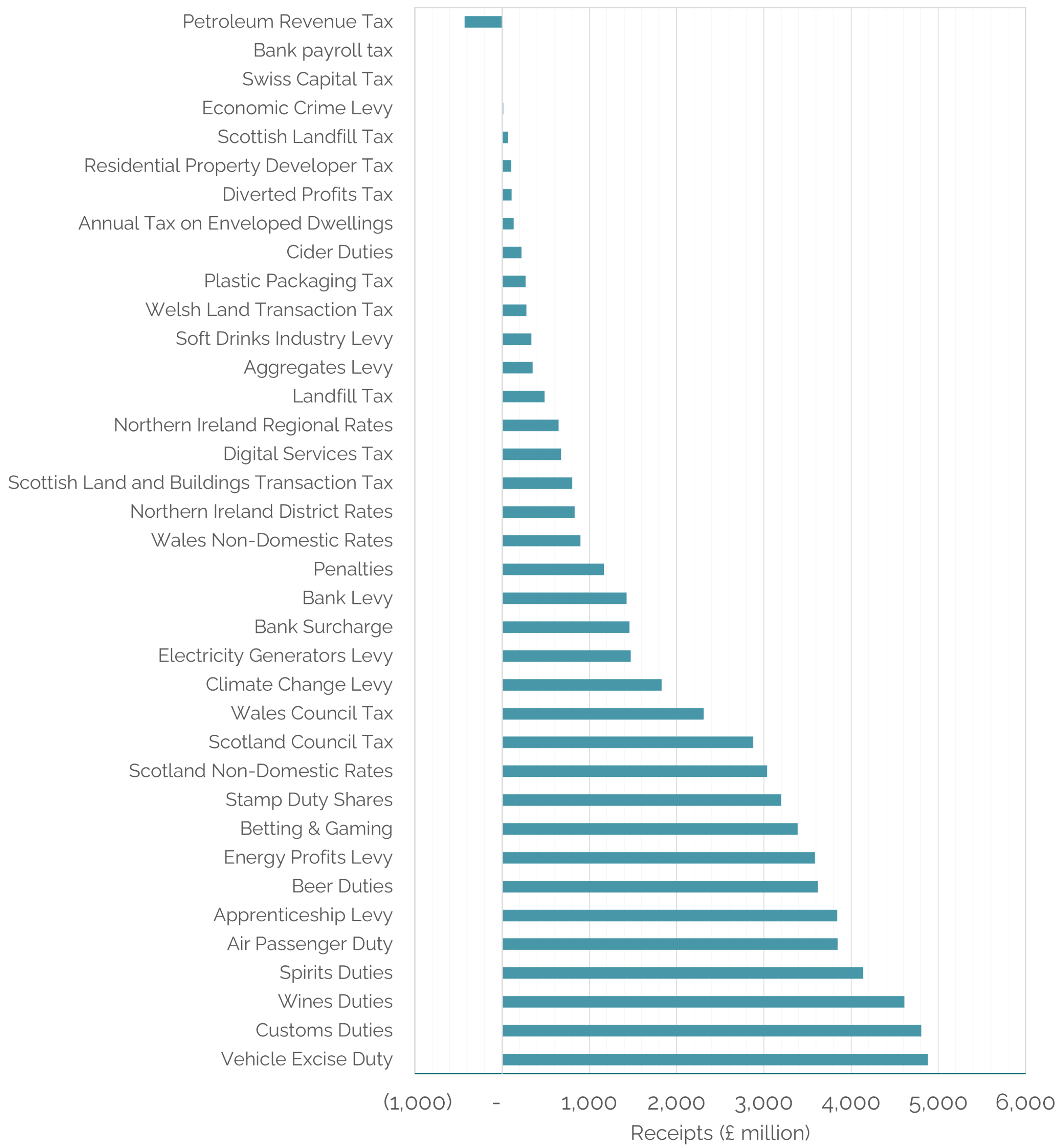

*Source: HMRC, MHCLG, ONS, Scottish Government, Revenue Scotland, Welsh Government, Welsh Revenue Authority, Northern Ireland Executive*

## Figure 5: International comparison of tax revenue composition 2019



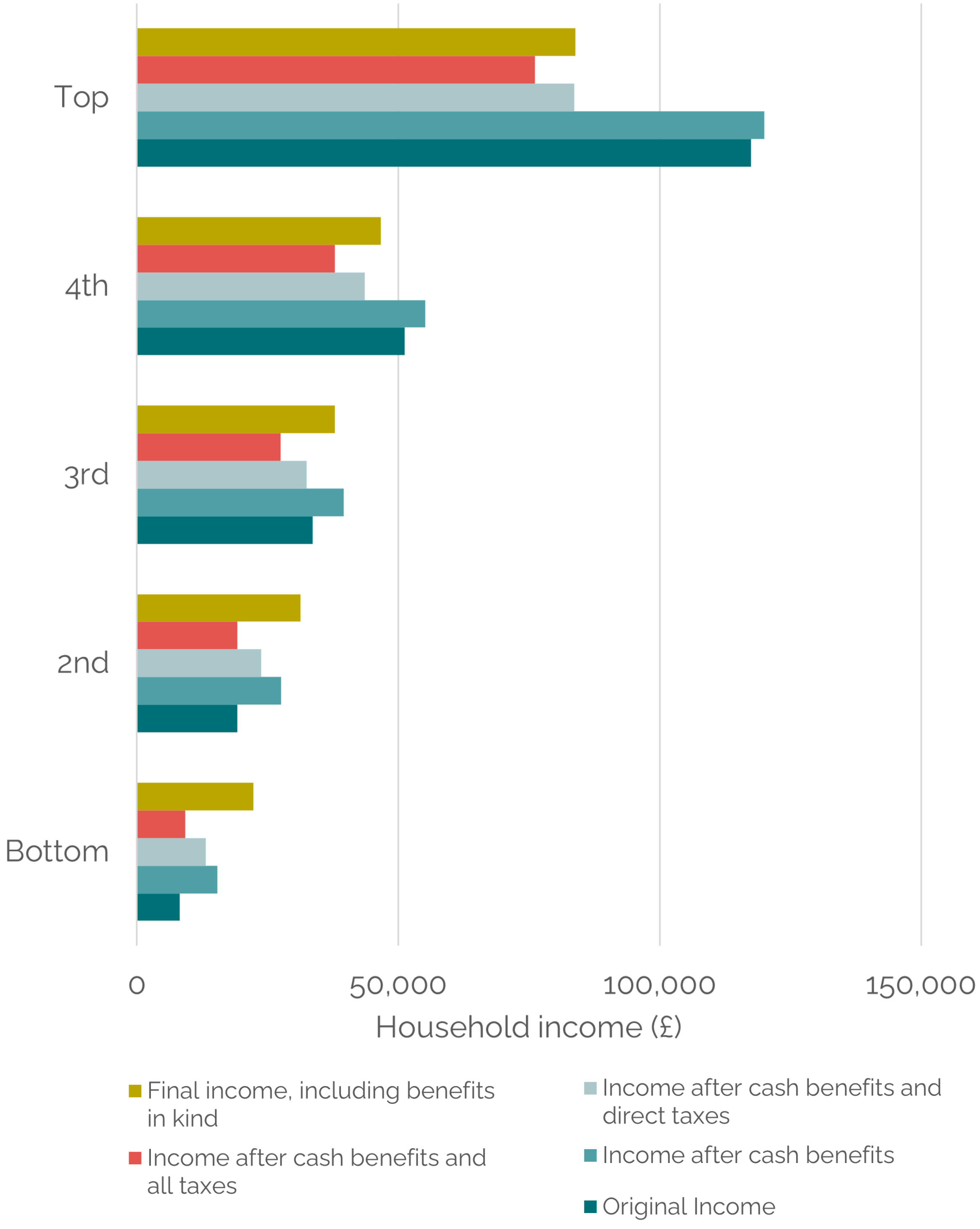

*Source: IFS TaxLab: How do UK tax revenues compare internationally?*

## Figure 6: Receipts from smaller taxes and duties 2023-24



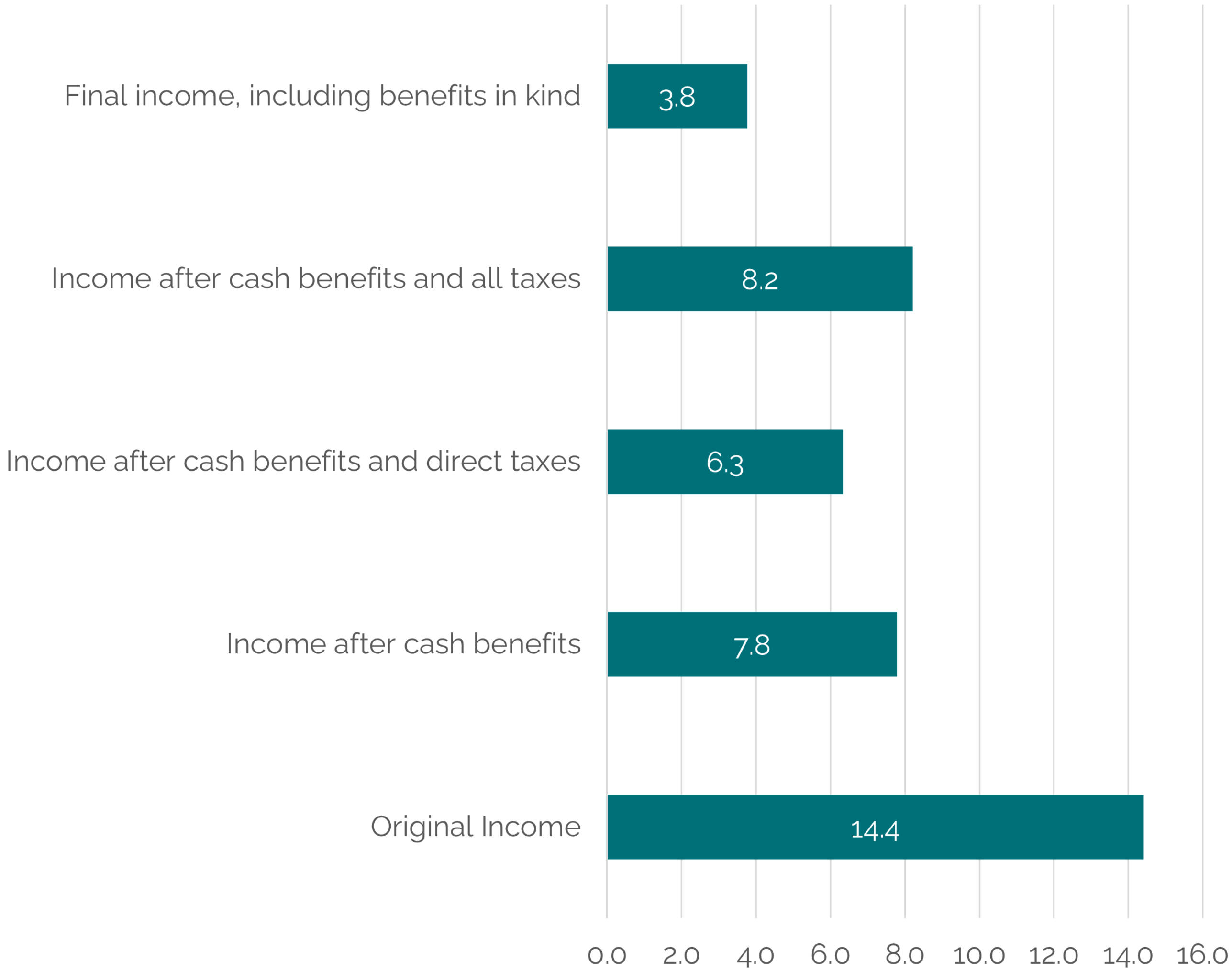

*Source: HMRC, MHCLG, ONS, Scottish Government, Revenue Scotland, Welsh Government, Welsh Revenue Authority, Northern Ireland Executive*

## Figure 7: Household income by quintile in the UK in 2021-22, showing the effects of benefits and taxes



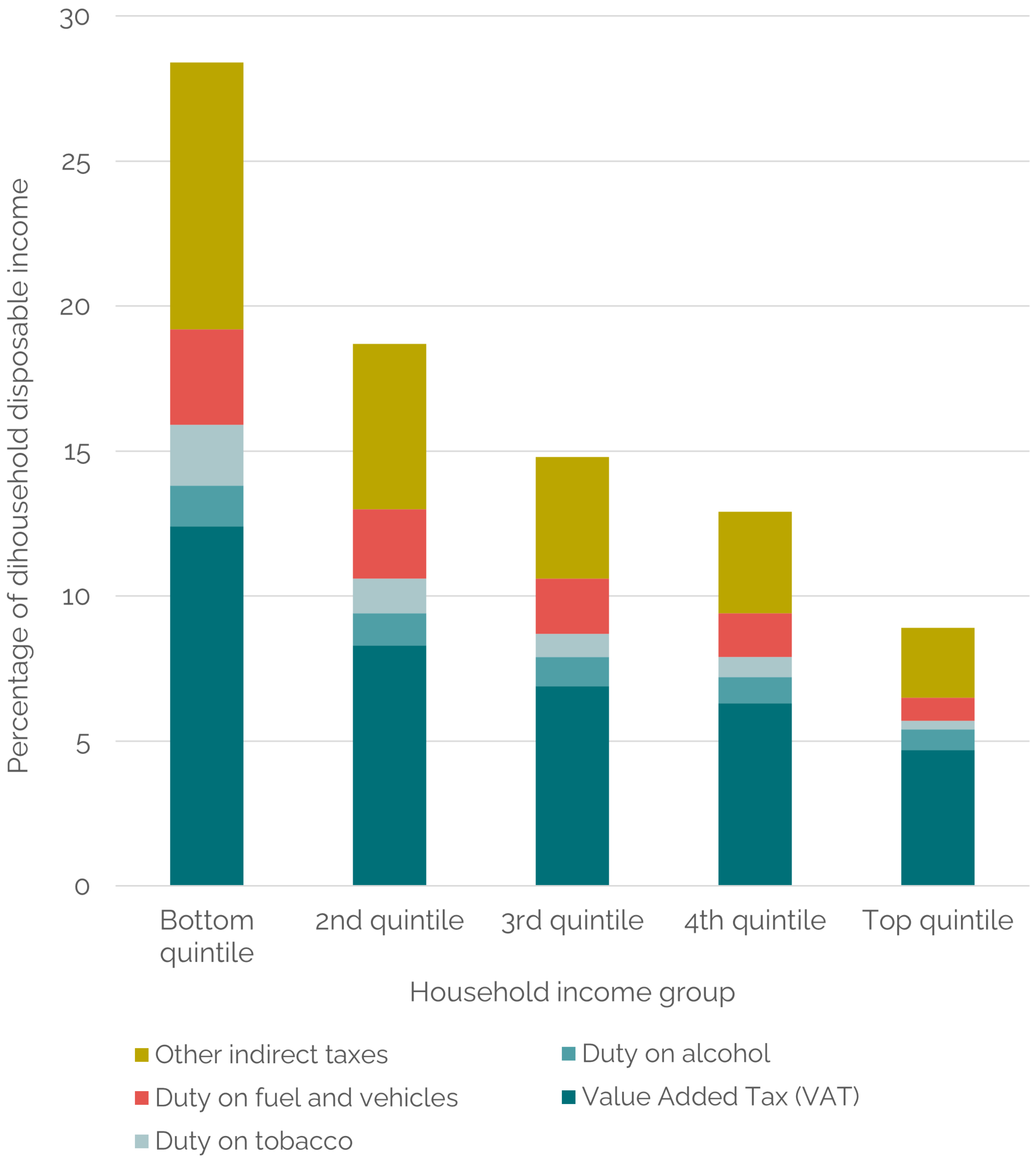

*Source: ONS: Effects of taxes and benefits on UK household income financial year ending 2022*

## Figure 8: Ratio of top quintile to bottom quintile household income in the UK in 2021-22



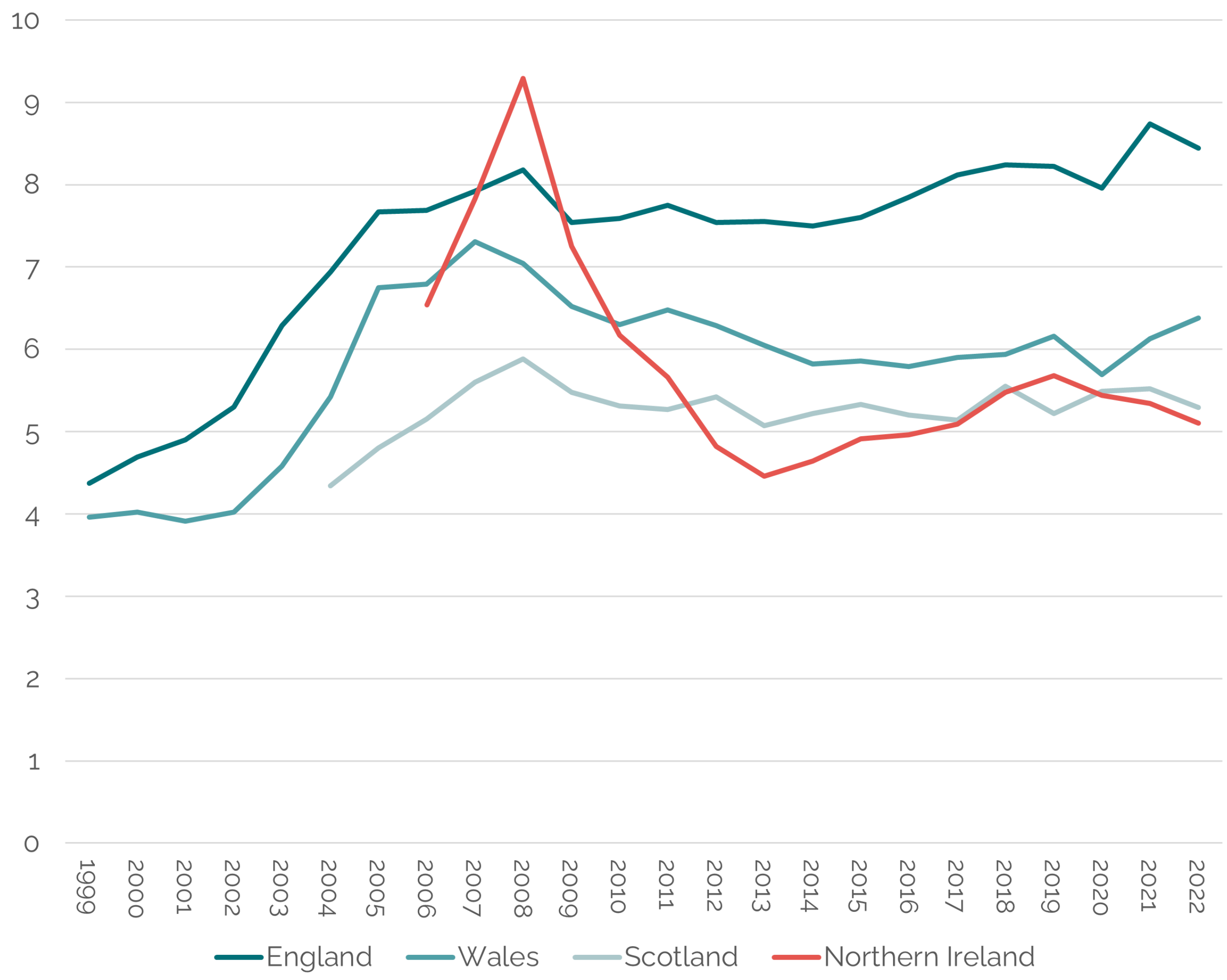

*Source: ONS: Effects of taxes and benefits on UK household income financial year ending 2022*

### Figure 9: Mean indirect taxes as a percentage of household disposable income, 2021-22



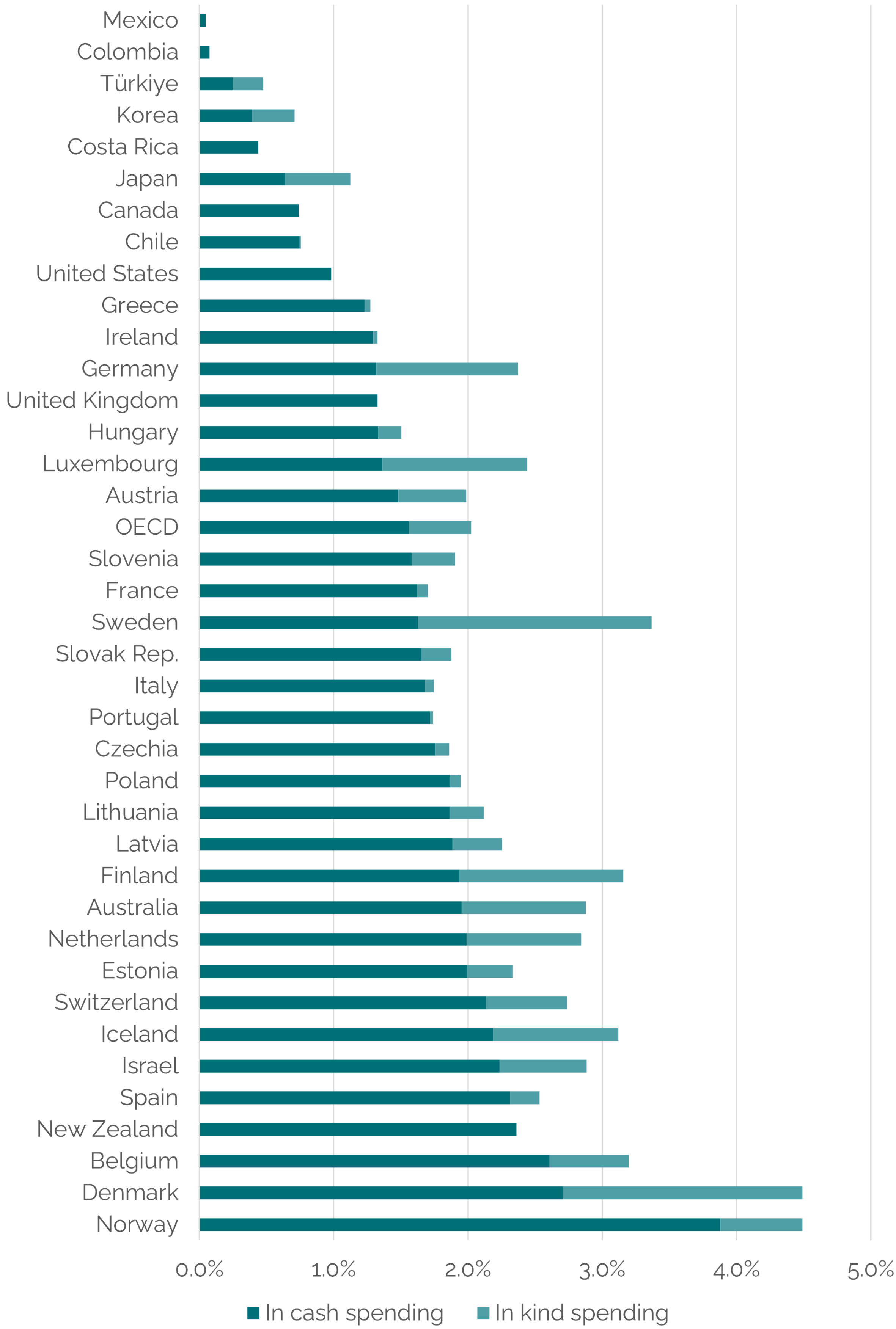

*Source: ONS: Effects of taxes and benefits on UK household income financial year ending 2022*

## Figure 10: Ratio of median house price to median income 1999-2022



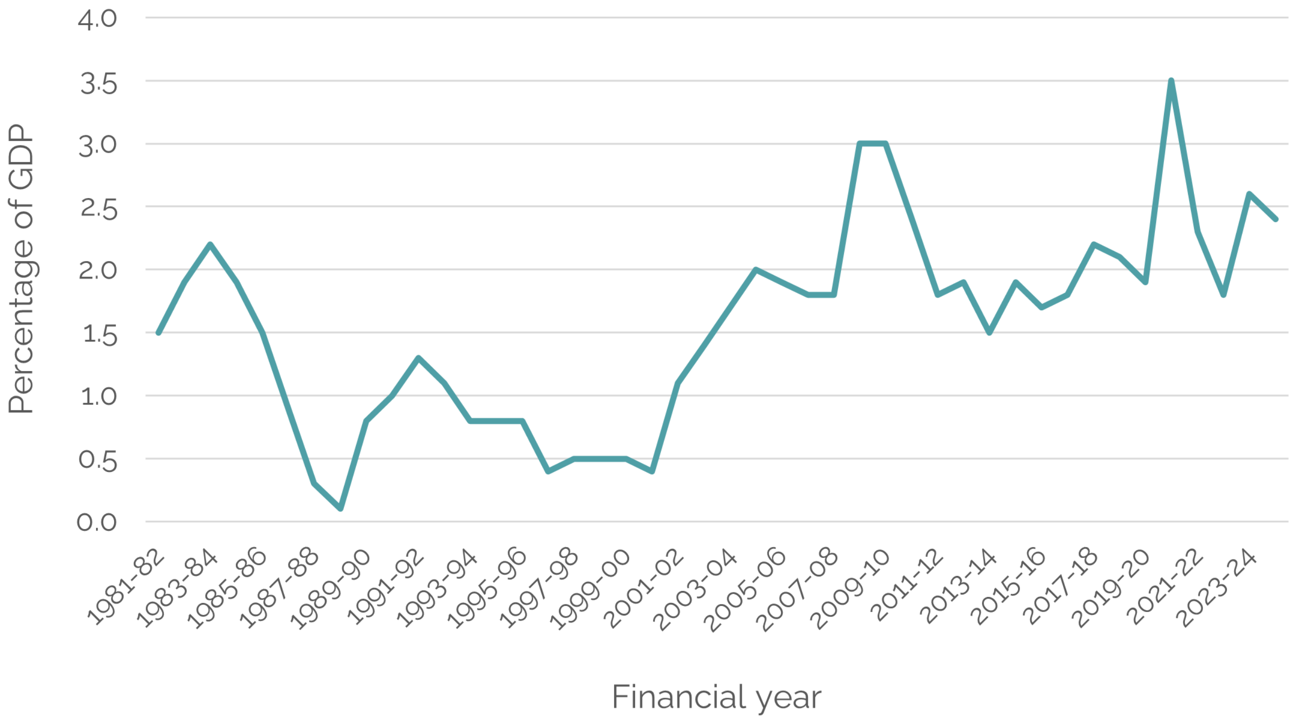

*Source: ONS Housing Purchase Affordability 2022*

## Figure 11: Public spending on incapacity in cash and in kind in OECD countries 2019




*Source: OECD: Public Spending on incapacity'*

### Figure 12 Public Sector Net Investment as a percentage of GDP 1981-82 to 2024-25




*Source: HM Treasury Public Expenditure Statistical Analyses 2024*

# Financing the Future

## Discussion paper

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