

Labour has to avoid hypothecated taxes for the NHS

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John McDonnell [discussed the possibility of hypothecating national insurance charges](#) to cover increasing NHS charges yesterday. Labour last discussed doing so in 2014. I said it was a mistake then and it still is now. [This is what I wrote at the time](#) and part from a few numerical details not a lot will have changed now:

Reports suggest that Labour is considering hypothecated national insurance increases to pay for additional NHS spending during the next parliament. I have to admit I am disappointed. Hypothecation makes no sense to me. Hypothecating national insurance makes even less sense. I need to explain why.

First, and very obviously, there is a problem with NHS funding. The Institute for Fiscal Studies suggest that in real terms NHS spending per head of population may fall 10% this decade, and when age weighted it might be even more extreme. The idea that NHS spending is, as a consequence, being ring fenced and protected is, just wrong and a complete political misrepresentation of the truth. It is important to note this in the context of what follows: I do not think this cut in spending appropriate, and I would wish the NHS to be protected from such cuts, as I would wish other areas of government spending to be protected because I believe they all represent social need. As a consequence, please do not think that in writing this I am saying that I support cuts: far from it.

That said, the proposal to increase National Insurance for the purpose of paying for the NHS is another wholly misleading political message representation that plays on the belief that many people have that National Insurance either pays for pensions, or the NHS, or both, when in fact none of these things is true. National Insurance is, for all intents and purposes, just another tax. According [to this year's budget](#) *National Insurance will raise about £110 billion this year whereas the cost of the NHS will be £140 billion and the state pension over £100 billion. Quite clearly NIC can't cover all this.*

But there is something more important to realise about National Insurance, which is that it is a deeply regressive tax for two reasons. The first is that National Insurance

charge on [employees falls from a rate of 13.8%](#) to just 2% when earnings exceed £41,865 a year. This means that as earnings rise above this point the overall percentage rate of contribution paid by a higher earning employee falls as a part of income.

Secondly, National Insurance is regressive because it only applies to earned income. That means that if a person can live off investment earnings, or they can recategorise their earnings as investment income, as many self-employed people do by recording their income through a company and then pay themselves dividends, then national insurance is not paid and this has the result of making this particular tax in some part in voluntary, and in another part a tax only on labour, and not on capital. Both factors suggest that that the tax is already deeply unfair when every member of society benefits from the tax paid. If, therefore, any tax was to be hypothecated, National Insurance is definitely not the one to use.

That said though, I have a real problem with hypothecation in any event. There are, as is usually the case with me, a number of reasons for this but the most important one by far is that, as a matter of fact, governments do not raise tax for its own sake. They have only ever, throughout history, raised tax because they wish to spend. It makes no sense to raise tax for its own sake: that process would simply take money out of the economy for which a government was responsible to make everyone worse off (which is also why running budget surpluses is also quite illogical). Given that running a tax system always gives any government grief, no one would do it just to make their population worse off, and so it is only the act of spending that justifies taxation.

The supposed philosophy of a hypothecated tax is, however, that a government cannot spend until it can raise money, but in fact this is the wrong ordering of events. Again, throughout history, governments have proved that they can spend without raising taxation. They can borrow, of course (and the present government has turned this into an artform) and they can print money, as the UK government did from 2009 to 2012, during which period it issued debt of £426 billion and repurchased about £375 billion of debt, meaning that in net terms it borrow just £51 billion, and effectively printed money to cover the rest. Hypothecation, then, denies this fundamental truth that the ability to raise money is not a precondition of government spending it. It is therefore premised on a falsehood, and that's never a good basis for taxation.

But the problems only get worse the longer one thinks about hypothecation. If we can agree that in the chicken and egg scenario of tax and spend then it was always spend that came first, and tax was the way in which once upon a time kings tried to reclaim the cost of their wars, and now governments try to reclaim the cost of their commitments to their electorates, then to pretend that spending on the NHS is dependent upon raising tax is simply wrong. The spend comes first. The tax comes second. Hypothecation gets this completely the wrong way round. It's as fundamental a mistake as most people and politicians make about the way money is created, and has to be put right.

What is more though, to pretend that this particular spend on the NHS is dependent upon raising tax from a particular group in society — who are those who by and large earn less than average, and those who by and large have lower savings, and who are, therefore, in the main, those to whom wealth and income should be redistributed — is little short of absurd. If it is spending that has the priority in any government's agenda (and that must be true) then because no one raises tax without there being a spending priority, then it is ridiculous to raise a tax in a way that contradicts the spending priority inherent in the commitment to the NHS.

And, as a matter of fact, that spending commitment to the NHS is about redistribution; it is about the creation of equality; it is about overcoming disadvantage; it is about equal access for all, and it is about making available to all what would otherwise only be available to some (as the USA proves). And yet, the form of hypothecation that is being chosen achieves the exact opposite result. Those who can already afford healthcare, come what may, will not suffer any significant burden as a result of this additional hypothecated tax and yet those to whom income and wealth should be redistributed will bear additional costs right down to, and including, those who might not even pay income tax. Nothing about that makes micro economic sense, or sense in the context of any form of social justice.

Nor however does this make any sense in macroeconomic terms. If spending comes first, as I believe has always been the case with regard to government, then tax has never been about raising revenue, as such. Tax is, instead, about re-claiming the cost expended by government for a number of reasons. The first, and very straightforward reason for reclaiming that expenditure by tax is to make sure that the government's currency is used as the medium for exchange in the economy which it regulates, and this happens because it demands settlement of tax liability in that currency, thereby making sure that it is the primary medium for exchange in use in the economy, which then, vitally, lets it spend using that currency as the way it can undertake its own spending. Without tax its currency might have no use in the economy, which may decide to use another currency instead e.g. US dollars, and the government could not then spend as it wishes.

Second, the decision as to how much to spend is key to fiscal policy. Deficits have been vital for two purposes. One is economic stimulus and the second is keeping inflation going — which is, again, vital to prevention of recession. So tax is not decided upon to cover spend, it is only reclaimed to the extent considered necessary to keep the macroeconomy going in the right direction.

And third, tax is used to reinforce the social policy inherent in spending decisions. So, it is used to reprice goods and services that the market gets wrong, and it is used to redistribute income and wealth. These are vital roles and in the process tax represents the choice that is available in a democracy, which is perhaps its greatest merit.

Hypothecation, in contrast, puts forward the pretence that we are in the market and

that we can only have what we can pay for. This has, quite simply, never been true of government, and never need be true of government, precisely because it can print money, and precisely because it has to run deficits to keep the economy moving in a direction where recession is avoided, full employment is the aim, and sustainability is aimed for in a way consistent with both. The very logic of hypothecation is, in that case, in contrast with the principle of universality on which the NHS was founded.

The Labour Party is making a mistake if it backs hypothecation. It's making an even bigger mistake using NIC for that purpose.

Labour does need to reclaim more of the spending it will make in the economy: that much may be true. But if it is then it is the tax gap it needs to tackle. This it could do. It should not raise NIC.