# Government Spending Would Have to Fall by 25% to Meet Debt Target

**Thursday 30 October, 2014**

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Political promises to pay for future pensions and healthcare are not included in measures of public sector debt, which at present stands at over 75% of GDP. In the face of an ageing population our long-term fiscal situation is unsustainable unless significant spending restraint or reform of social security entitlements is undertaken. The only alternative would be crippling tax hikes for our children and grandchildren.

In *Defusing the Debt Timebomb*, authors Prof Philip Booth and Ryan Bourne find that the scale of the debt challenge would necessitate a reduction in government spending equivalent to £168 billion each year (to reduce the debt-to-GDP ratio to 20% by 2063.) This is comparable to halving health, welfare and pensions spending, or cutting overall spending by a quarter.

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**Key findings:**

- **The government's own figures show a need to save an amount equivalent to scrapping all NHS spending immediately.** OBR figures show that to have a national debt of 20% of GDP by 2063/64 we need a more or less immediate and sustained fall in government spending of 6.5% of GDP – around £112 billion. This is roughly equivalent to scrapping all current transfers to pensioners, including the state pension, or ending all NHS spending.
- **But government figures are overly optimistic.** OBR figures make a controversial assumption that healthcare productivity will grow at the same rate as the rest of the economy. In fact, its average increase between 1979-2010 was just 1% a year. Assuming this trend continues, the scale of our debt problem becomes much more stark: spending would have to be cut by the equivalent of **cutting all spending to pensioners, abolishing tax credits and reneging on public sector pensions in payment.**
- If we are more realistic about healthcare productivity, likely immigration policy, as well as the composition of spending (the government still ring-fences spending in several expensive areas) **total spending cuts necessary to keep debts under control would be equivalent to £168bn every year from now.**
- This means that to ensure a sustainable national debt of 20% of national income in 50 years' time,**government spending must be cut by 25%.** This is equivalent to halving health, welfare and pensions spending. These adjustments would hit the debt target, but would not allow any room for tax cuts.

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- **Some of the current government's policies have exacerbated the UK debt problem.** The triple-lock on pensions, the ring-fencing of healthcare spending, the Dilnot reforms to social care and the abolition of contracting-out of the state pension have all significantly worsened the long-term UK debt challenge.

**Spending restraint on this scale would fundamentally change the role of government. Realistically, the debt time bomb is likely to be defused by a combination of:**

- **Changing eligibility for pensions and healthcare.** Raising the state pension age further and linking increases in the state pension only to increases in prices would help the public purse significantly. It may also be inevitable that pricing or charging for some aspects of healthcare be introduced to reduce demand in some areas.

- **Policies to improve the growth prospects for the UK economy.** Despite rising life-expectancy, the UK's employment for 55-59 year old men has fallen by 20% in forty years. The government should try and boost work participation for those aged over 55 by removing employment protection legislation in areas which currently incentivise early retirement.

- **Fundamental reform of pension and healthcare provision.** Replacing the state pension with a compulsory, private defined-contribution pension arrangements – which have succeeded in Australia – should be considered. Compulsory healthcare insurance system would also benefit future generations. Unfortunately, little can be done about the current debt, which has already been incurred as a result of commitments already made.

**Commenting on the report, Prof Philip Booth, Editorial Director at the Institute of Economic Affairs, said:**

*"Politicians must wake up to the size of the debt time bomb in the UK. Older generations have voted themselves benefits that will indebt future generations, meaning crippling tax hikes for our children and grandchildren. Very significant spending restraint and reform of entitlements will be required in the next parliament and beyond to get our debt levels back under control."*

**Notes to Editors:**

For media enquiries, please contact Camilla Goodwin, IEA Communications Officer: cgoodwin@iea.org.uk or 07821 971 443.

To download the full report, *Defusing the Debt Time Bomb – Challenges and Solutions*, click *here.*

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