Beyond Our Means

Policy Exchange

A Plan to Tame Public Spending

The sixth part of Policy Exchange's Policy Programme for Prosperity

Roger Bootle, Iain Mansfield, Ben Ramanauskas and Ben Sweetman

Foreword by Sir Robert Chote

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About the Authors

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Endorsement

"I am delighted to see this high quality and very timely report. The next budget is likely to be one of the most anti growth we have seen in 20 years. All at a time when public spending is rising, the interest charge on our debt burden is compounding and GDP per capita growth has stalled.

There has been no example that I am aware of where the government of a large mixed economy has achieved economic growth by taxing those with the greatest ability to deliver it.

There is no doubt that a change in approach is needed. Governments are elected to make tough decisions for the benefit of the whole country and for the long term. Policy Exchange sets out a compelling guide on where to begin, with bold policy ideas on how to control state spending. This is the lever over which the government has more control than any other, they need to find the resolve to pull it."

Lord Agnew of Oulton, former Minister of State at HM Treasury and the Cabinet Office.

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Foreword

By Sir Robert Chote, former Chairman of the Office for Budget Responsibility (2010 – 2020)

The UK public finances have deteriorated significantly in recent years and without action will deteriorate further in the years to come, with pressure to spend more on defence, healthcare and support for older people and some tax receipts likely to diminish. The situation is not yet such as to require policymakers (and would-be policymakers) to think the unthinkable. But they certainly need to ponder the unpalatable, and this paper will help them do so.

Public sector borrowing and the headline measure of net debt have been hovering around 5 and 95 per cent of GDP respectively over the past few years. There is no malign magic number at which these variables can be guaranteed to trigger a crisis, but these figures are certainly cause for concern. They are high by international standards, and the debt ratio has not been sustained at levels as elevated as this in the UK since the early 1960s.

Partly as a result, the UK Government is having to pay an uncomfortably high interest rate to borrow, which makes the dynamics of the public finances that much more challenging. Like the deterioration in the budget deficit and the debt ratio, this is partly a reflection of global shocks and policy decisions that have hit the UK relatively hard. But it likely also reflects a lack of confidence not just in the current Government's willingness and ability to take difficult fiscal decisions and make them stick, but that of potential alternative governments too.

In this environment, it is important to take a clear-sighted look at where the government spends our money and how it raises the taxes to (at least partially) pay for it. This paper makes an important contribution to the former task, setting out concrete proposals for savings and estimating transparently how much can be raised – never an exact science. Sensibly it focuses on the big-ticket items – such as pensions, welfare and health – where savings could make a significant difference to the overall ratio of spending to GDP.

The authors recognise that a paper such as this can only go halfway to achieving lasting reductions in spending, if that is the route down which policymakers wish to travel. They can assess the situation and make proposals, but it is for the politicians to adopt them and persuade the voters. That is quite an ask, but failure to act increases the risk that the unthinkable becomes not merely unpalatable but eventually unavoidable.

1. Executive Summary

- The UK faces a twin-pronged fiscal crisis. First, at about 100% of GDP, public debt is inordinately high and is set to rise a good deal further.
- Debt interest alone accounts for about three quarters of the government's budget deficit. There is a serious danger of a vicious circle as more borrowing causes debt interest to rise which causes the deficit to increase, etc., etc.
- Second, at close to 45% of GDP, the share of government spending in GDP is close to a post-war high. This leads to levels of taxation that are stifling economic growth. These high levels of taxation can only be reduced by significantly reducing public spending.
- The fastest way to reduce debt is also to reduce government spending and that in turn will then have further favourable effects on government spending through reductions in the debt interest bill. There could then be a virtuous circle as the markets were prepared to lend to the government at lower rates of interest.
- The most basic requirement of state expenditure is that it should provide for the defence of the realm and internal security/law and order. These things are public goods par excellence and cannot properly be provided by private individuals or even groups within society. While there are exceptions, the presumption should be that an activity should take place within the private sector unless there is good reason for it not to be.
- Various people say that continued increases in government spending are inevitable because of the impact of demographics. It is true that demographic pressures are currently adverse. But many of the factors increasing government spending and borrowing have resulted from government decisions which could have been taken differently. They should have been.
- For example, government has made active decisions to increase the state pension faster than inflation, to expand the number of people going to university, to repeatedly expand eligibility for free school meals and for free childcare, and to increase the number of civil servants.
- It has also failed to take actions that would significantly reduce the number of migrants crossing the Channel in small boats or the number of people on out of work benefits. Decisions by the courts have also increased Government spending, whether in increasing the cost of infrastructure or expanding the eligibility for certain

welfare payments, and Government has chosen not to legislate to reverse these decisions. None of these choices was inevitable.

- Moreover, the UK's ratio of government spending to GDP is higher than many of our international comparators – in the top half of our comparator group of countries, which is the 38 OECD members plus Singapore. Its current level of nearly 45% of GDP puts it considerably above what much of the academic literature suggests is the optimal range, of between 30% - 40% of GDP.
- Furthermore, here in the UK we have twice in recent times been able to reduce government spending as a share of GDP by substantial amounts. Under Mrs Thatcher's governments it came down from 41.5% when she became Prime Minister after 1978-79 to 34.5% in 1988-89. Under the Coalition and subsequent Conservative governments it was brought down from about 46% in 2010 to 39% in 2018-19.
- The prime culprits for the recent surge in government spending are spending on pensions, welfare, health and debt interest. No credible programme of savings can make a significant reduction in public spending without significant savings in at least one of these areas – and ideally in all four.
- We propose a series of measures that would reduce public spending by £115 billion per annum by 2030, or 3.2% of GDP which, if implemented, would reduce public spending as a share of GDP to just over 40%. This includes reducing the bill for pensions by £22 billion per annum by 2030 and welfare by almost £30 billion per annum by that year.[1]
- The prime pensions measures proposed are:
  - The state pension is to be frozen for three years and thereafter to rise by CPI inflation, in the process abolishing the state pension triple lock);
  - Means testing various pensioner benefits;
  - We also propose raising the state pension age to 70 by 2040, which would ultimately save at least an additional £20 billion annually in real terms, and a major reform of public sector pensions, transforming these to defined contribution schemes with a standardised employer contribution of 10%, with some of the headline savings reinvested into increasing pay. Although these will not result in savings reductions within the immediate five year period, both are essential for reducing the UK's longer-term public sector spending liabilities.
- On welfare reforms our main proposals are:
  - Working age benefits to be frozen for three years, and thereafter to rise by CPI inflation (in line with pensions);
  - Broader systemic reforms on eligibility to begin reducing the number of people claiming out of work benefits and personal independence payments to their pre-pandemic levels.
- Other savings include reversing the recent unaffordable increases

1. Unless indicated otherwise, all figures are in nominal prices.

in childcare and free school meal eligibility, eliminating some green subsidies as part of a less rushed pathway to Net Zero, reducing the number of university places and further reducing international development spending.

- We also propose cutting the cost of the civil service and other arm's length bodies by 25%, alongside implementing improved working practices. These include measures to reduce 'churn', a return to office-based working and greater levels of performance-based pay, as well as permitting Permanent Secretaries to offer up greater reductions in headcount in exchange for greater uplifts in staff pay – to create a much smaller, better paid and higher performing civil service.
- Health is more complex. As part of our initial proposals for reducing public spending we include the introduction of a small charge for visiting a GP. This would raise roughly £5 billion a year.
- But major savings on health would require a complete redesign of the NHS, involving a social insurance system with universal coverage of the sort common on the continent. The Netherlands is our favoured model, as set out in our paper, *The NHS – a Suitable Case for Treatment?*[2]
- If this resulted in taxpayer finance for health falling from the current 9% of GDP to 4.5%, which is perfectly plausible, then this would reduce public sector spending by a further £120 billion per annum.[3] Admittedly, this would not lead to a lower deficit because we presume that any savings would be passed on to households in the form of reduced tax rates, not least in order to enable households to afford to pay the new health insurance premiums. Such changes are not included in our five year programme.
- Over the next five years, our reform programme would bring public spending down to just over 40% of GDP, with the public finances in balance and debt falling as a share of GDP. This in turn would lead to reduced borrowing rates and a reduction in debt interest payments, creating a virtuous circle.
- Over a ten-year period, our reform programme would bring public spending down to approximately 35% of GDP, the same as it was at its low point under Mrs Thatcher.
- There is a good case for going further and reducing the spending to GDP ratio to 30%, which would be slightly lower than Switzerland's ratio but still miles higher than Singapore's, which is at just over 15%.
- In order to reduce our spending ratio to 30% of GDP, in addition to the measures outlined above, we would need to more fundamentally rethink public sector spending, including the universality of the state pension and the nature of our current non-contributory welfare system.
- There is a legitimate debate to be had about how to deploy the

2. The NHS – a Suitable Case for Treatment?, Policy Exchange, 2025, Link
3. This would not reduce total spending on healthcare by 4.5% of GDP – although, as set out in our former paper, one could expect both efficiencies and improvements in the healthcare delivered as a result of the better incentives in the new system. It would, however, reduce public sector spending – and therefore spending that must be financed via taxation – by 4.5%.

savings released by our programme of expenditure reductions. We favour using about half of the proceeds to reduce the deficit, a quarter to finance increases in other sorts of public spending, principally defence and law and order, with the other quarter being used to reduce taxes.

- Eventually, the aim should be to reduce taxes by a substantial amount. But this shouldn't be attempted until the public finances are stabilised.
- Nevertheless, it is important that we make a start soon so as to give businesses and individuals a clear sign of the direction of travel.
- Increasing economic growth is also essential. In other papers, we have discussed and will continue to make the case for supply side reforms, increasing private sector investment, reengineering regulation, and reforming public services to increase productivity and improve economic growth. Yet recent history has shown that the bond markets will not accept plans for tax cuts or public spending increases based on unproven plans for increasing growth. Governments should indeed take action to increase growth – but they must not use this as an excuse to duck the difficult but necessary decisions on public spending reductions.
- Many critics will doubt the economic rationale for our programme. Yet the need to reduce the debt ratio and stabilise the public finances is palpable. Otherwise we will have to endure a debt crisis with untold awful consequences.
- Moreover, the international evidence suggests a clear link between governments spending a small proportion of GDP and high economic growth rates.
- Other critics may say that whatever the economic merits of our proposals, they are politically impossible. Yet the periods of spending reduction in the 1980s and 2010s stand against this – and, what is more, the governments that implemented those reductions went on to win re-election. Moreover, Sweden implemented a large fiscal consolidation package in the mid-1990s, which included a reduction in public expenditure of more than 5% of GDP over three years, largely targeting welfare.[4] This led to a sustained period of strong economic growth from 1997, reaching 4.6% growth in 1999.[5] And while the final verdict is not yet in, in Argentina President Milei has made very radical reductions in spending while retaining, at least initially, a reasonable level of popular support. More recently, a recent electoral defeat in Buenos Aires has sparked a currency crisis, leading to concerns that his reforms might be losing public support – but the ultimate outcome remains to be seen.
- So it is possible to make a major reduction in the size of the state. The first requirement is to understand the problem and to really want to tackle it. The second is to devise a practical programme for reducing state spending. The third is to muster the political will

4. Although the governing party did face an electoral backlash from this policy, it remained the largest party in Parliament.
5. 'Controlling Spending and Government Deficits', Policy Exchange (2009), Link.

to see it through. The fourth is to persuade the voters to lend their support for such a programme.

- This study is a contribution to fulfilling the first and second requirements. The third and fourth are up to our political leaders.

2. Summary of Proposed Savings

This paper sets out proposed savings that would deliver £115 billion of savings (3.2% of GDP) per year by 2030 and reduce public spending as a share of GDP to just over 40%, with debt falling as a share of GDP.[6]

Savings are presented in nominal terms, with the baseline used being the forecast spending in the relevant area in 2030.[7]

Alongside further reforms, particularly in healthcare, these would put public sector spending on track to fall to 35%, the same as it was at its low point under Mrs Thatcher, within 10 years. Where relevant, we will discuss those reforms that would have savings in the longer term – such as increasing the state pension age – even where it is not possible to 'score' these within the five-year period considered.

The paper sets out savings across a number of broad policy areas, of which the most significant are pensions, welfare and healthcare. Each of these measures could be beneficially implemented as a stand-alone item, even by a Government that did not share the authors' overall objective of lowering public sector spending as a share of GDP.

The specific areas in which savings are proposed, with the savings scored within the immediate five year time period, are:

1. **State Pension Reform (£22.5 billion).** Freeze the state pension for three years, after which it should increase by CPI inflation. The state pension age should also be increased to 69 in 2035 and to 70 in 2040, which would ultimately generate at least an additional £20 billion a year of savings in 2024 prices, although not within the initial five-year period.
2. **Means-Test Pensioner Benefits (£3.4 billion).** Pensioner benefits that are not currently means-tested – including free bus passes and prescriptions – should be means-tested and restricted to only those pensioners in receipt of pension credit. Those benefits which are means-tested using a different threshold should also be restricted to those in receipt of pension credit. Age eligibility should be harmonised with the state pension age.
3. **Welfare (£30 billion).** Most working age benefits should be frozen for three years, and thereafter rise by CPI inflation (in line with pensions). Broader systemic reforms on eligibility, as set out in Policy Exchange's report "For Whose Benefit?"[8], should be introduced to begin reducing number of people claiming out of work benefits and PIP back to their pre-pandemic levels.
4. **Healthcare and the NHS (£11 billion).** Introduce a small charge

6. Unless otherwise stated, all figures are in nominal terms.
7. Where OBR forecasts are available, these forecasts have been used; in the small number of cases where there is no such forecast, assumptions have been made about continuation of current spending, which are set out in the paper.
8. For Whose Benefit?, Policy Exchange, 2025, Link

for GP appointments, end national pay bargaining, charge for better hospital accommodation and various administrative savings. In the longer term, major savings on health will require a complete redesign of the NHS, shifting to a social insurance system with universal coverage of the sort that exists in the Netherlands and elsewhere in Europe.

5. **Reducing the Size and Cost of the Civil Service (£2 billion).** A 25% reduction in administrative costs, primarily through reductions in the number of staff and better deployment of technology. Various arm's length bodies to be abolished, merged or down-sized.
6. **Public Sector Pensions (N/A).** Legislate such that, from 2031, all public sector pensions, with the exception of the armed forces, should be moved to defined contribution schemes, with a standardised employer contribution rate of 10%. A third of the headline savings should be spent on pay – funding a pay increase of 6% for teachers and civil servants, and 8% for the police.

This would decrease the headline cost of the system[9] by £22 billion annually, from £51 billion to £30 billion (in 2024 pounds), while eliminating the further growth of long-term public sector pension liabilities. It would, however, cause a short-term increase in public sector liabilities, due to the need to invest the remaining 10% employer contribution into a pension fund rather than returning it to the Treasury.

7. **Green Subsidies (£6 billion).** Abolish Great British Energy, end electric vehicle and boiler upgrade subsidies, abolish the public sector decarbonisation scheme, as part of a less rushed approach to Net Zero. These savings do not include the impact from wider policy changes that could be delivered from revising our policies on Net Zero, including reducing or phasing out green subsidies where the costs are borne by industry or consumers. Such reforms would have wider positive economic effects, even though they would not directly reduce public sector spending.
8. **International Development (£7 billion).** Reduce overseas development assistance to 0.1% of GDP. Government would focus on only those areas where there is the clearest case for Government intervention, such as immediate relief after major natural disasters, or countering disease outbreaks of global significance.
9. **Universal Infant Free School Meals (£0.7 billion).** Do not extend eligibility for free school meals in September 2026. End universal entitlement for infant free school meals and restrict eligibility to children from families with low income, as in the rest of the school system.
10. **Post-18 Education (£1.4 billion).** Reduce the number of university places by 30%. Establish an area review process to support mergers, transformations and closures while protecting

9. Excluding the armed forces.

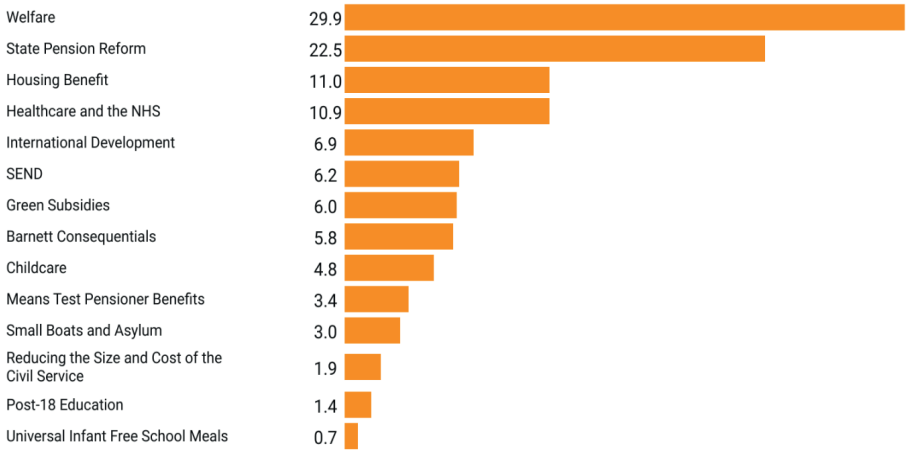
students. Half the savings to be reinvested into further education and apprenticeships.

11. **Childcare (£4.8 billion).** End the costly and inflexible 'free' childcare scheme and replace with a flexible voucher scheme for 3-4 year olds and disadvantaged 2 year olds. Deregulate childcare settings and end Ofsted inspections of childminders. Create a new £1 billion Sure Start programme targeted at the most vulnerable and disadvantaged.
12. **Special Educational Needs and Disability (SEND) (£6.2 billion).** As set out in Policy Exchange's report *Out of Control*[10], Education, Health and Care Plans should be restricted to those at special schools, with schools and local authorities given greater flexibility to meet identified need. The system should transition from the current demand-led model to a budget-led model where schools and local authorities manage need based on the resources they have available.
13. **Small Boats and Asylum (£3 billion).** Halve the approximately £6 billion spent annually on asylum hotels and associated costs, via implementing the measures set out in Policy Exchange's report, *Stopping the Small Boats: A Plan B*.
14. **Housing Benefit (£11 billion).** Reduce the housing benefit bill by just under a third, by tightening eligibility and by reducing the level at which Local Housing Allowance rates are set. Accelerated house building would also in the medium term help to reduce the housing benefit bill further.
15. **Barnett Consequentials (£5.8 billion).** Barnett consequentials are applied to savings in devolved areas, including childcare, SEND, healthcare and the NHS, free school meals, agricultural subsidies, some of our welfare reforms, and some pensioner benefits.

Figure 1 shows the contribution of each of these reforms to the total savings.

10. Out of Control, Policy Exchange, 2025, Link

Figure 1: Annual Savings by 2030, £ billion (2030 prices)



Source: Policy Exchange analysis

As set out in the Executive Summary, we propose that half of the proceeds should be used to reduce the deficit, a quarter to finance increases in defence (primarily) and in domestic law and order, including the courts and prison systems, with the final quarter being used to reduce taxes.

A full itemisation of the annual savings resulting from these reforms is set out in Table 1.

Table 1: Annual Savings, £bn

Annual Savings, £bn Policy	2026	2027	2028	2029	2030
State Pension Reform	6.9	9.4	13.7	18.0	22.5
Means Test Pensioner Benefits	3.2	3.2	3.3	3.4	3.4
Welfare	8.7	13.8	19.8	24.7	29.9
Healthcare and the NHS	10.1	10.3	10.5	10.7	10.9
Reducing the Size and Cost of the Civil Service	0.4	0.8	1.1	1.6	1.9
Green Subsidies	3.3	4.6	5.0	5.5	6.0
International Development	4.8	6.5	6.5	6.8	6.9
Universal Infant Free School Meals	0.7	0.7	0.7	0.7	0.7
Post-18 Education	0.1	0.3	0.7	1.1	1.4
Childcare	4.4	4.5	4.6	4.7	4.8
SEND	0.0	1.0	2.3	4.0	6.2
Small Boats and Asylum	0.6	1.2	1.8	2.4	3.0
Housing Benefit	2.0	4.1	6.3	8.6	11.0
Barnett Consequentials	3.5	4.1	4.6	5.2	5.8
Total	**48.7**	**64.6**	**80.9**	**97.4**	**114.6**
% of GDP	**1.6%**	**2.0%**	**2.4%**	**2.8%**	**3.2%**

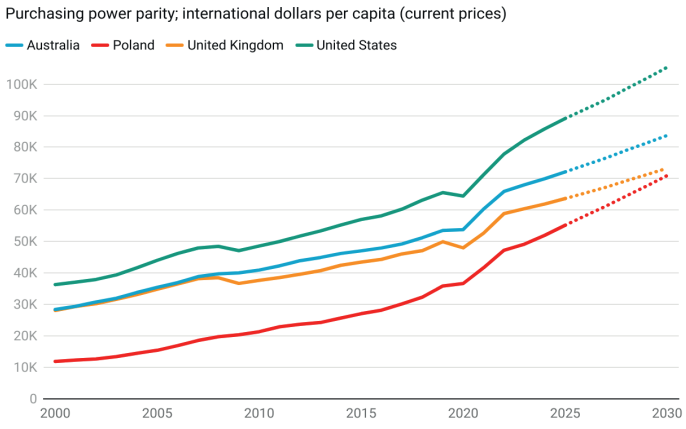
3. Introduction

The UK's Public Sector Net Debt stands at about 95% of GDP – a near record high for the last fifty years. Interest payments last financial year were over £100 billion – and are forecast to be £111 billion in 2025 – 2026. Public spending in 2025-26 is forecast to be 45% of GDP, the highest level since 1976-77, excluding the aftermath of the pandemic and the Financial Crisis. Public sector net borrowing also remains high, at 5.1% last year and is forecast to be 3.9% this year – although recent decisions on welfare, and lower than expected economic growth, may increase this figure further.

Britain's public sector debt has steadily climbed since 2001, with sharp increases after the financial crisis in 2008, the COVID pandemic and the energy price shock of the early 2020s. Measures to reduce public spending as a share of GDP in the 2010s, although successful to an extent, were not sufficient to prevent debt as a share of GDP continuing to grow – and have been almost entirely negated (in aggregate terms) by the increase of state spending from 2020 onwards.

The struggle to constrain public sector spending as a share of GDP has been exacerbated by sluggish productivity growth which has plagued Britain since 2008. The country has never returned to the growth rates it saw prior to the financial crisis and, in several recent years, GDP per capita has actually decreased. A major contributor to this is low or negative productivity growth in the public sector, in particular in the NHS, but private sector productivity growth has also disappointed. Countries which have avoided this fate, such as the United States or Australia, are now significantly richer per head than Britain, while others such as Poland – much poorer two decades ago – are rapidly catching up. (See Figure 2.)

Figure 2: GDP per capita in Australia, Poland, UK, and USA.



Uses IMF forecasts to 2030. Source: IMF

What had been a chronic issue has been brought into sharp relief by three factors:

- Rising interest rates around the globe have sharply increased the amount that the UK must pay to borrow. UK yields have risen even more: 10-year gilts have hit yields not seen since 1998 and, at the time of going to publication, stood at 4.59%.[11] This has significantly increased the cost of new borrowing, and means that the UK is now spending more on interest payments than on any of defence, crime and justice or education.
- A more hostile geopolitical environment – with a land war in Europe, conflict in the Middle East, an increasingly assertive China and a United States less willing to carry the burden of European defence – has both heightened the economy's vulnerability to external shocks and the need for a rise in defence spending, now acknowledged by both Labour and the Conservatives.
- High rates of taxation – with tax receipts as a share of GDP now standing at 35% and projected to reach 36.8% in 2025-26, the highest since 1949-50. This is beginning to have a noticeable impact on economic growth. The OBR has said, "The increase in employer NICs is also likely to be contributing to falling recruitment and rising redundancies;"[12] the impact of the £90,000 VAT registration threshold for businesses can be seen clearly in company turnover statistics. High marginal tax rates at £60,000 - £80,000 and £100,00 - £125,000 are deterring some people from seeking to improve their earnings and recent changes to Non-Dom taxation are also affecting the decisions of many of the wealthiest residents of the UK, who pay the highest proportion of tax.

Together, these factors point to the need for an urgent reckoning with public spending. The level of savings needed – to bring down the deficit and thus the debt, to free up funds needed for defence and to reduce the historically high burden of taxation – cannot be met by salami slicing alone. Indeed, some public services, such as the criminal justice system, have faced real-terms cuts, with consequent impacts on public service delivery – and need to have their budgets increased.

At the same time, many of the largest areas of public spending – pensions, welfare, health, social care and education – have grown significantly, and are on track to continue to do so. Serious questions in these areas must be asked about what the state does, how it does it, and at what level activity is funded, if the share of public spending as a share of GDP is to be reduced by the significant quantity required.

11. Bloomberg, accessed on 14 October 2025, Link
12. OBR, Economic and Fiscal Outlook March 2025, Link

Reducing public spending is the only path to a sustainable future

Arguments that the UK should not, or cannot, meaningfully reduce public spending typically take one or more of three principal forms.

Firstly, some argue that a rise in the share of public spending is inevitable due to demographic change, an ageing population and a shift in the dependency ratio. A related argument is that Baumol's cost disease[13] – a phenomenon where rising productivity in manufacturing causes costs in the services sector, where productivity growth is lower, to also increase – is causing an unavoidable increase in costs in service-intensive industries, coincidentally those primarily funded by the state, such as health and education, and so, again, increases in public sector spending cannot be avoided.

It is undoubtedly true that demographic change places upward pressure on state spending, with the increased spending on the elderly outweighing any modest savings on education. However, the argument that demographic change makes our current level of spending inevitable ignores the fact that, in numerous areas of large-scale state spending, the Government has either actively increased the scope of state activity, or has made an explicit decision to increase spending above inflation – the latter, most notably, with the state pension triple lock, a decision which is now forecast to cost £15 billion a year by 2030.

The number of people on out-of-work benefits has increased significantly since 2015, reaching 6.5 million today, and health and disability benefits are forecast to reach around £100 billion by 2030. Childcare entitlements have increased significantly since 2010, with expected early years block spending set to reach over £8 billion by 2028. Free school meal eligibility was expanded to a universal entitlement for infants in 2014 and to all on Universal Credit in 2025 (to commence in 2026). The number of civil servants has increased from 384,000 in 2016 to 516,000 today; the number of university students from 2.3 million to 2.9 million in the same period. A shifting approach to how society approaches mental health has increased both the number of young people claiming out of work benefits and SEND costs in schools. The Department for Health and Social Care has received a real-terms budget increase of over 30 billion pounds – or 21% - since 2018/19, while quality-adjusted productivity in the NHS has fallen by 7% compared to pre-pandemic levels.[14]

Each of these decisions may or may not have been good. But they were not inevitable. So regardless of the pressures placed upon public spending by demographic change, there are clearly multiple areas where costs could be reduced while maintaining benefits and services at or above the levels that prevailed in the mid-noughties.

The second argument takes the form that the UK's sluggish productivity growth is due to not investing enough. Typical areas in which greater investment – invariably paid for by the taxpayer – is often called for include infrastructure (transport, energy, housing), skills or healthcare.

13. A more detailed description of Baumol's Cost Disease can be found here.

14. Office for National Statistics, 2024, Link

Again, there is some factual support for this argument. The UK has lagged behind comparator countries on investment – in both the public sector and private sector. Indeed, the UK's proportion of GDP spent on gross fixed capital formation (17.4%) is the lowest of all the G7 countries, which average 21.8% of GDP. It is very likely that this has contributed to our sluggish productivity growth. A greater share of our national wealth going into productivity-enhancing investment would be highly welcome.

It is a mistake, however, to assume that this should mean additional spending by the state. The great growth areas of public sector spending have not been in areas of productive economic infrastructure. Our expansion of spending in the NHS, education and welfare have not led to productivity increases. In contrast, governments of all colours have consistently raided capital budgets to fund current spending. Even in the most recent Spending Review, which saw a significant increase in public spending, the lion's share of this went towards increasing current, rather than capital, spending.

The bond markets will impose a harsh penalty for increased borrowing. In consequence, even those who believe that increased Government investment in certain areas is the key to unlocking further growth must, to fund them, nevertheless seek significant savings in the areas outlined in this report – including pensions, welfare, health and education.

The third major argument is that the budget can only be balanced through tax rises. A balanced budget achieved through tax rises would, in likelihood, be preferable to further increases in the national debt and corresponding interest payments. But with the tax burden already at its highest level since the 1950s, further increases in taxation will have a negative impact on future rates of economic growth – and thereby on the wellbeing and prosperity of the UK's citizens.

Moreover, without a commitment to fiscal discipline, increased taxation is just as likely to be used to fund greater public spending – as in the October 2024 Budget, when taxes rose by £36 billion, borrowing by £32 billion and public spending by £70 billion. There have been repeated periods, including the late 1980s and the early 2010s, in which the deficit and the burden of taxation (as shares of GDP) fell in parallel – and, equally, other periods in which both rose together.

Fiscal rules alone cannot be relied upon to restore the public finances

Discussion of the national debt can all too often become a discussion about the Chancellor's fiscal rules. This is misguided for a number of reasons, not least because the fiscal rules are fundamentally concerned with debt and borrowing – not with the overall share of GDP raised by taxes and spent by the public sector.

While fiscal rules can serve a useful purpose, in the view of the authors of this paper, it is a mistake to focus upon them as the be-all and end-all.

As Fraser Nelson has said, we have had *"years of Chancellors of left and right*

spending as much as they thought they could get away with. We have grown used to talk about Chancellors having more 'fiscal headroom' as if it was more money to spend. We came to forget the difference between a bank balance and a credit card limit."[15]

It is certain that the current fiscal rules are not fit for purpose. Setting a target that debt must be falling in five years' time places an undue reliance on the forecasts of the OBR – an inherently uncertain measure – and means that small changes in assumptions, or in macroeconomic conditions, can require major short-term measures to stay within target (or, conversely, allow for unjustified splurges due to the appearance of an ephemeral 'headroom' that may vanish at the next fiscal event).

Even more problematically, the ever-advancing five-year target allows Governments to increase spending – or to schedule tax cuts – in the early years of the period, while scheduling savings or tax rises that they have no intention of making (most infamously, the repeatedly cancelled rise in fuel duties) in the later years of the forecast to, on paper, balance the books. The five-year target encourages and enables an Augustinian approach to fiscal discipline, in which savings are always in the future.

Better fiscal rules are possible. A commitment that the deficit must fall by a certain amount each year– perhaps by a certain minimum amount – would be both less reliant on forecasts and less easily gamed.[16] A Government wishing to reduce public spending could – and perhaps should – adopt a rule that public spending as a share of GDP should also fall each year, until it reached a target level. Adopting such rules would be preferable to the status quo. However, so long as Governments treat the fiscal rules as a target, rather than an upper bound, efforts to restore fiscal discipline are likely to fail.

Furthermore, there is a more fundamental problem in looking to fiscal rules for the answer. They say nothing about what the overall level of public spending and taxation should be. Good fiscal rules may help, but they are no substitute for a genuine commitment to fiscal discipline and to reducing the size of the state.

How should savings be used?

In this paper we set out a wide range of savings proposals, which if adopted, would deliver an annual reduction in public spending of £115 billion in 2030 (in 2030 prices), or around 3% of GDP, compared to the current planned spending trajectory, or a cumulative spending reduction of over £405 billion over the five year period. We also point to other areas of more complex reforms – including in health, in social housing and in stopping the small boats – that would be likely to take multiple years to deliver, but that are essential if the UK is to fully get to grips with the size of the state.

How then, should these savings be put to best use? We argue that there are three pressing calls.

Firstly, and most importantly, the savings should be used to reduce the deficit, currently standing at close to 5% of GDP. We recommend that at least half of the savings be used for this purpose, to begin placing the

15. Anatomy of a debt bomb, Fraser Nelson (2025), Link

16. Fiscal rules, being at the discretion of the Chancellor, can of course be suspended or ignored in circumstances of genuine crisis, such as a war, global recession or pandemic.

UK's finances back on a sustainable footing. If half the savings were used this way, this would reduce public sector net borrowing from its current forecast of 2.1% (in 2029-30) to close to zero, with debt as a share of GDP falling, and the current budget (as opposed to the total budget, which includes investment spending) in surplus. Total public sector net debt would be more than £200 billion lower than current projections, with direct consequential reductions in interest payments. Furthermore, the sight of a Government taking concrete and meaningful steps to reduce public sector spending and bring the public finances back into balance would reassure the bond markets, leading to a virtuous circle in which borrowing rates are reduced further below current projections, generating further savings.

Secondly, around a quarter of the savings should be spent on defence, security and law and order. Spending at least an additional 0.7% of GDP on defence spending – just under a quarter of the savings – would be a meaningful uplift towards the government's target to spend 3.5% of GDP on defence, and constitute an additional £75 billion for defence over the five year period. A relatively small amount - £4 billion to £5 billion annually – should be spent on domestic law and order, to construct additional prison places, resolve the courts backlog and recruit additional police officers, as set out in Policy Exchange's report, *The Costs of Crime – and How to Reduce Them* (2024).[17]

Thirdly, we consider it essential to begin the process of reducing the burden of taxation from its current record levels. As discussed above, the current high levels of taxation are having a deleterious impact on the economy, reducing economic growth and thereby depressing both household incomes and future tax revenues. Recent increases in corporation tax and in employers' National Insurance Contributions have made the UK a worse place in which to invest and do business.

Some might argue that with the current high levels of debt, cutting taxes is irresponsible. We would disagree: just as it is essential to demonstrate to the bond markets that the Government is committed to reducing the deficit and debt, so too it is important to demonstrate to business and individuals that the Government is committed to reducing the current high levels of taxation. Crucially, however – and unlike some previous proposed tax cuts, such as those in the 2022 'Minibudget' – in our proposals, any and all reductions in taxation are funded by reductions in public spending, and take place concurrently with reductions in the deficit, thereby pairing tax reduction with fiscal responsibility.

There are many options as to which taxes should be reduced. Our recommendation is that the Government should prioritise taxes which have the greatest negative impact on growth, such as taxes on labour, corporation tax and stamp duty. Devoting a quarter of the total savings to lowering taxes could, for example, be used to, by the end of the period, do any one of the following[18]:

17. The Costs of Crime – and How to Reduce Them, Policy Exchange (2024) Link

18. Figures derived from gov.uk, Direct effects of illustrative tax changes, June 2025, Link

- Reduce the base rate of income tax by 3 percentage points.
- Reduce Class 1 Employee National Insurance Contributions by 5 percentage points.
- Reduce Class 1 Employer National Insurance Contributions by 2 percentage points, with £5 billion left over.
- Reduce Corporation Tax by 7 percentage points.
- Entirely eliminate all property transaction taxes, including Stamp Duty, with a little left over.

Policy Exchange will be addressing reform of the tax system more fully in a future report.

Why Curtail Government Spending?

What is the ideal percentage of government spending in GDP? In general terms, the answer is the percentage that maximises national welfare, subject to the loss of welfare caused by the tax needing to be levied to finance government spending. So this question is closely related to the question of what is the optimum percentage of tax in relation to GDP. Accordingly, the two have to be considered together. This principle may sound clear enough but, as we shall see, it yields no easy answers. Nevertheless, we try to give some guidance below.

Although opinions vary, there is a significant amount of academic literature that suggests the optimal size of the state should be some way below 40% of GDP. For example, in Public Spending and the Role of the State, Schuknecht argues that, "*A pragmatic 'optimum' for the size of government, something that is realistic and reachable, is normally not more than 30–35% or perhaps 40% of GDP.*"[19] *Similarly, in Estimating optimal government spending: A psycho-econometric approach,* Ho et al estimate the optimal spending at just under 37% of GDP.[20]

One exception to this close connection between optimum spending and optimum taxation is where a state has significant sources of income apart from taxation with which to finance expenditure. The most obvious example is Middle Eastern oil-producing countries where governments receive substantial revenues directly from the oil producers. It is normal in such states to levy no personal taxation whatsoever. This effectively drives a wedge between the amount of money that the state can spend and the amount of revenue it has to derive through taxation. Needless to say this is not the position of most western states.

The most basic requirement of state expenditure is that it should provide for the defence of the realm and internal security/law and order. These things are public goods par excellence and cannot properly be provided by private individuals or even groups within society.

With certain well recognised exceptions (the presence of externalities, monopoly power etc.), it is widely accepted that the private sector, driven by competition and the profit motive, is a more efficient provider of goods and services than the public sector. Given this, the presumption should be that an activity should take place within the private sector unless there is good reason for it not to be. Whether a service is, or is not, a public good

19. Public Spending and the Role of the State, Schuknecht, 2020, Link
20. Estimating optimal government spending: A psycho-econometric approach, Ho et al, 2023, Link

provides a starting point for assessing whether this activity should take place within the public sector.

In this vein, there can be a role for the state in funding infrastructure, although it may be possible/desirable for much funding to be provided by the private sector with the state giving firm direction and commitment to the project in question.

In addition, the state can undertake the role of providing a safety net for the poor, although this would be over and above individuals' own savings and the support of family and charities. This is not the same thing as actively engineering a different distribution of income from the one that would exist as the outcome of market forces playing out unhindered. But this is also a possible objective for state spending. In that case, there would be as many optimum percentages for state spending in the economy as there are opinions on the most desirable distribution of income.

Even if we stick to the most essential role of the state, namely providing for the defence of the realm, how much spending this amounts to in practice will vary enormously depending upon circumstances. Nor do circumstances themselves precisely dictate what amount should be spent. This decision involves a choice by the government of the day about how seriously to regard possible threats and how much sacrifice of current benefits it is prepared to make in order to defend against those threats.

For instance, until very recently the British government has been content to spend about 2% of GDP on defence. But now, the new aspiration pressed upon member states by NATO, is 5% of GDP. And during the Second World War the amount spent by the British government on "defence" was about 50% of GDP. So what is the "right" amount to spend on defence? There is no single correct answer.

Similarly, once the state accepts social obligations, then the amount of spending these give rise to will depend on demographic and other social factors. For instance, once the state is committed to an old age pension, how much spending this involves will depend upon the size of the age cohort covered by the pension. Similarly for spending on education. How much is spent will depend partly upon how many children there are to be educated.

The search for a firm theoretical foundation for the optimum share of government spending in GDP is liable to prove unfruitful. International comparisons or our own history are likely to be a better guide.

International Comparisons

As is set out below, for developed countries (taken here to be those in the OECD + Singapore) higher Government expenditure as a proportion of GDP is negatively correlated with average real GDP growth over the last decade.

Table 2 gives figures for government expenditure as a proportion of GDP, GDP per capita, and real GDP and GDP per capita growth over the last 10 years for OECD countries and Singapore. While of course there are countless other factors that determine a country's economic prosperity

and growth, the intention here is to see whether lower government expenditure (as a proportion of GDP) is correlated with economic prosperity, or whether the opposite is the case. It should be noted that a correlation to this effect would not formally rule out the possibility of reverse causation – in which richer countries spend less as a share of GDP as they need to spend less to meet their citizens' needs – but this is considered by the authors to be unlikely.

The countries in Table 2 are ordered by their level of government expenditure as a proportion of GDP.

Table 2: Government expenditure (% of GDP), GDP per capita (international $) and average GDP growth across OECD countries and Singapore

Country	Total government expenditure (% of GDP), 2023	GDP per capita, PPP (current international $), 2023	Real GDP growth (annual average % from 2015-2024)	Real GDP per capita growth (annual average % from 2015-2024)
Singapore	14.8	143,786	3.2	2.3
Costa Rica	18.5	28,075	3.5	2.7
Ireland	22.7	124,901	7.6	6.1
Korea	23.2	52,204	2.4	2.2
Chile	27.4	32,801	2.0	1.0
Mexico	28.6	24,855	1.4	0.5
Switzerland	32.1	90,506	1.8	0.8
Türkiye	33.2	42,326	4.8	3.7
Colombia	35.4	20,944	2.6	1.3
United States	37.1	82,305	2.5	1.8
Lithuania	37.1	50,915	3.2	3.4
Australia	37.2	70,513	2.3	0.8
Japan	39.1	49,897	0.5	0.8
Israel	39.4	53,401	3.5	1.5
New Zealand	41.3	53,854	2.6	0.9
Portugal	42.0	47,426	2.1	1.9
Canada	42.1	64,463	1.8	0.2
Latvia	43.1	41,810	2.2	2.9
Netherlands	43.2	78,305	2.0	1.4
Estonia	43.7	46,790	1.9	1.5
Czech Republic	43.9	53,217	2.2	1.8
United Kingdom	44.8	57,915	1.4	0.7

Iceland	45.3	76,667	3.5	1.3
Spain	45.4	53,230	2.2	1.7
Norway	45.9	100,437	1.5	0.7
Slovenia	46.5	53,952	2.9	2.6
Denmark	46.8	73,737	2.5	1.9
Luxembourg	47.0	142,425	1.9	-0.1
Poland	47.0	46,758	3.7	4.1
Slovak Republic	47.9	43,950	2.4	2.4
Sweden	48.4	67,259	1.9	1.1
Germany	48.4	68,693	0.9	0.6
Hungary	49.2	45,368	2.8	3.1
Greece	49.5	41,182	1.5	2.0
Austria	52.6	70,479	1.2	0.4
Belgium	53.3	69,059	1.6	1.0
Italy	54.0	57,893	1.1	1.4
Finland	55.8	61,613	0.9	0.6
France	56.9	58,318	1.2	0.8
Average	**41.3**	**62,621**	**2.3**	**1.7**

Source: World Bank, World Development Indicators; IMF, World Economic Outlook Database

There is not a strong correlation between government expenditure and GDP per capita. The correlation coefficient is -0.11, which is a weak result and not statistically significant. The top six countries with the highest GDP per capita are Singapore, Luxembourg, Ireland, Norway, Switzerland and the United States. Of these, Singapore, Ireland, Switzerland and the United States could be considered to exhibit relatively low levels of government expenditure.

Luxembourg, with its small population, is an interesting case. With government expenditure at about 47% of GDP, it has a large financial sector and manages to be one of the EU's top tax havens, attracting many investment funds and corporations. It is able to attract a disproportionate level of corporate activity relative to its size and so has a large tax base.

Norway's government spends some 46% of its GDP while tax revenues[21] sit at around 41% of GDP, not dissimilar to the UK's current level. It is a highly productive economy, and its natural resource exports contribute to its GDP. Crucially, around 32% of government revenues[22] come from oil and gas, with Norway is well endowed.[23] Notably, the Norwegian state owns a majority stake in Equinor, an oil and gas company, and also has a sovereign wealth fund which can be partially used to supplement the government's budget. These additional revenues allow for Norway's welfare state through which it provides high quality health services,

21. Including oil-related taxes.
22. Some of which are not included in the 41% tax revenue figure.
23. EITI, Link.

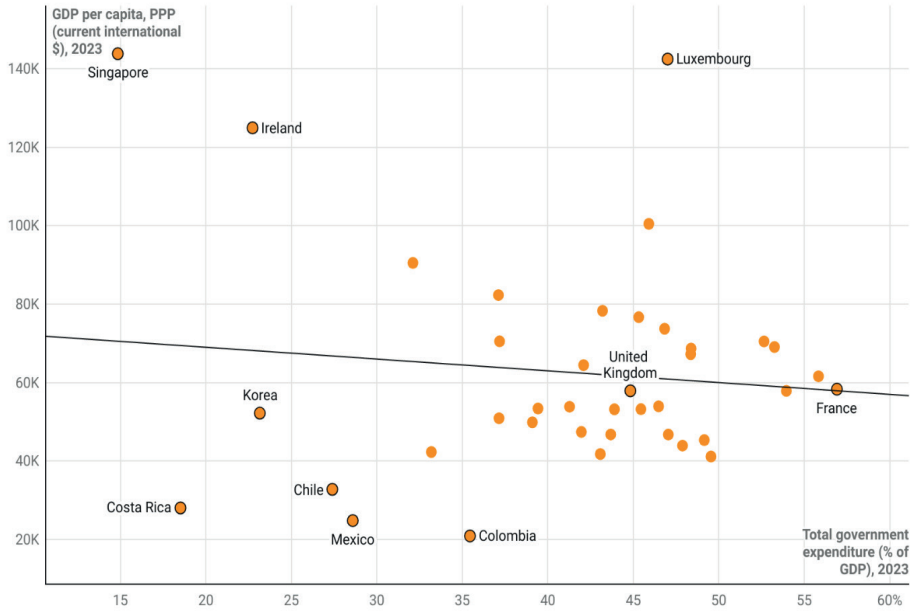
education and transport infrastructure. However, it is noticeable that Norway's economic growth over the last decade is somewhat below the average of these countries, as is also true for Luxembourg.

There is, however, a moderate negative correlation between government expenditure and recent real GDP growth (and GDP per capita growth). The correlation coefficient between government expenditure and real GDP growth is -0.50, a moderate negative correlation. This result is statistically significant at the 1% level. Similarly, the correlation coefficient between government expenditure and real GDP per capita growth is -0.34, a slightly weaker result. This was also statistically significant at the 5% level.

This trend is particularly apparent for countries whose governments spend the lowest (Singapore, Costa Rica, Ireland) and the highest (France, Finland and Italy) as a proportion of GDP.

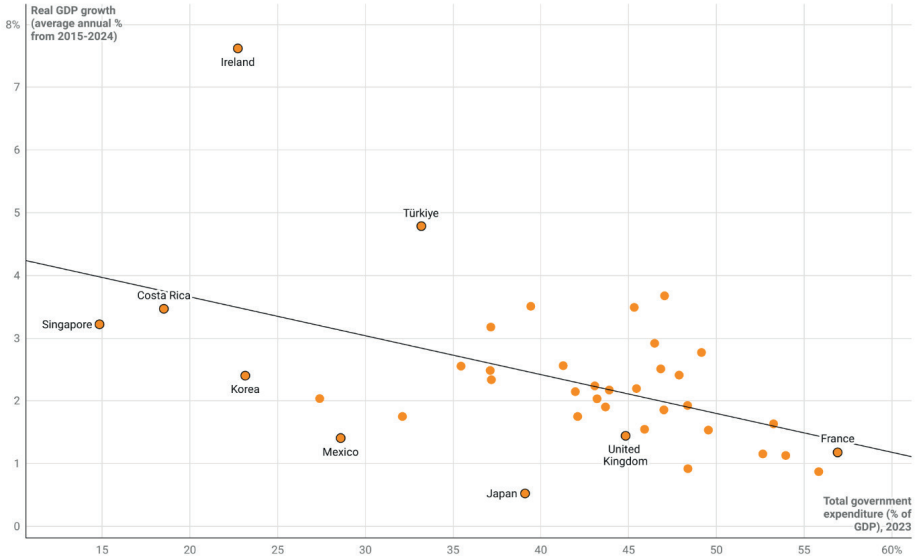
While not proving causation by itself, particularly given the many relevant factors that can influence prosperity, the correlation is still likely to show a relation between government expenditure and GDP growth. Figures 3 and 4 present some of this data in the form of scatter plots which enable readers to visualise these correlations.

Figure 3: Government expenditure in 2023 (% of GDP) and GDP per capita (current international $) for OECD countries and Singapore



Source: IMF, World Economic Outlook Database; World Bank, World Development Indicators.

Figure 4: Government expenditure in 2023 (% of GDP) and average real GDP growth over the last decade for OECD countries and Singapore.



Source: IMF, World Economic Outlook Database; World Bank, World Development Indicators. Real GDP growth is measured from 2015-2024.

In Annex C we set out in more detail the components of public spending for six countries in comparison with the UK: Australia, Singapore, the United States, Japan, Sweden and Switzerland.

UK Historical Experience

The history of UK public spending is set out in Annex A. And when you look at state spending historically, you see a remarkable pattern. In the 19th century no British minister or leading politician had a view on the optimum size of government spending as a % of GDP. For a start, they wouldn't even know what GDP was, either conceptually or in amounts of pounds. Instead, there was a prevailing philosophy that the state should take as little of the country's resources as possible. And the amount that this equated to was heavily affected by wars and their long-term financial consequences.

So, throughout the 19th century, the main components of government spending were defence expenditure and debt interest. Moreover, the debt interest component related almost exclusively to borrowing that had been incurred earlier to finance war expenditure; in this case, mainly the Revolutionary and Napoleonic Wars.

Things changed dramatically after the Second World War. The government now assumed a series of social responsibilities, including the provision of free healthcare, more generous pensions, and various forms of social assistance. Moreover, the extent of these obligations increased markedly over time.

There was a clear political explanation for this trend. In democratic systems, politicians find it attractive to offer benefits to the public without clearly specifying who will pay for them or in what form. Accordingly,

they usually think there are votes to be won in promising higher spending, even if the taxes that are needed to finance this spending will themselves be unpopular.

Moreover, ministers and the civil servants supporting them will naturally tend to press for more government spending on their departments, both because this increases their own power and prestige and because they will tend to see such spending as in the national interest. Furthermore, when something bad occurs, both Opposition politicians and the media will typically ask Ministers what they intend to do in response, either to mitigate its effects or to prevent similar events from occurring again – which again creates pressure for greater spending.

Accordingly, there is a natural force propelling public expenditure ever upwards. It is only when the system hits some sort of buffer, in the form of a financial crisis or a belated recognition of the burden of taxation, that governments will be prodded into measures to rein back the size of the state.

There have been exceptions to this trend – and in this report we look in depth at two of the principal post-war examples. The Thatcher Government cut total public spending by 6.7% between 1979 and 1990; and the Cameron Government cut spending by 6.9% from 2010 to 2018.

These reductions demonstrate what can be achieved politically by Governments of principle and courage. It is noteworthy that despite the reforms being carried out in the teeth of stiff opposition from vested interests, Thatcher won re-election in 1983, 1987 and her successor, John Major, won re-election in 1992; meanwhile, Cameron won re-election in 2015, and his Conservative successors won (narrowly) in 2017[24] and in 2019, demonstrating that, contrary to some fears, significant public spending cuts can be achieved politically without sacrificing electoral success.

The upshot

So, establishing a firm principle to guide an assessment of the share of government spending in GDP is not easy and the answer will change with different circumstances. Even so, a number of key principles can be laid out:

i. It isn't necessary for a state to be highly effective for it to spend a high proportion of GDP. Singapore is the key example. It has a strong state which intervenes across the whole of the economy and large parts of society yet its share of government spending in GDP is extremely low. In many western countries, we are in the opposite position. We have feeble states which nevertheless consume a huge proportion of GDP.

ii. We can usefully take the share of government spending in GDP at some recent points in the past as a guide to what we should be aiming to achieve. For instance, there is no good reason why government spending as a share of GDP should be higher now

24. The Conservative Party was the largest party in Parliament but was short of a majority; they retained power by means of a 'confidence and supply' arrangement with the DUP.

than it was before the pandemic, or even why it should be higher now than at its post-war low point in 1989-90.

iii. There is plenty of evidence that productivity in the British public sector is shockingly low. Accordingly, by improving this productivity, it should be possible to reduce the percentage of state spending in the economy without harming the quality or quantity of public services provided.

iv. Given the natural tendency for public spending to grow inexorably in just about all western countries, the answer to the question of what is the optimum share of government spending in GDP is "lower than it is now".

v. Given the natural proclivities of the public and private sectors and the baleful effects of taxation on the economy, all types of public sector activity should be subject to two key tests:

vi. Should this activity take place within the public sector at all?

vii. If it should, how can we sensibly minimise its costs and therefore reduce the burden placed upon taxpayers?

So how much does public spending need to be cut? UK Total Managed Expenditure is currently 45% of GDP, forecast to fall to 43.9% in 2030. This contrasts with total Public Sector current receipts, at 41.1% of GDP, forecast to rise to 41.7% in 2030.

At the least, public spending should be cut sufficiently to bring the budget into balance. In the view of the authors, however, this is insufficiently ambitious, given the current high levels of debt, the need to increase spending on defence and the importance to economic growth of reducing the tax burden.

Accordingly, in this report, we identify over £110 billion of public sector spending cuts, sufficient to reduce Total Managed Expenditure to just over 40% by 2030-31.

Over a ten-year period, and taking into account more major reforms to health, our reform programme would bring public spending down to approximately 35% of GDP, the same as it was at the low point under Mrs Thatcher, and approximately midway between that of Switzerland (32.1%) and the United States (37.1%), both of which are prosperous nations.

4. How Should the Government make Savings?

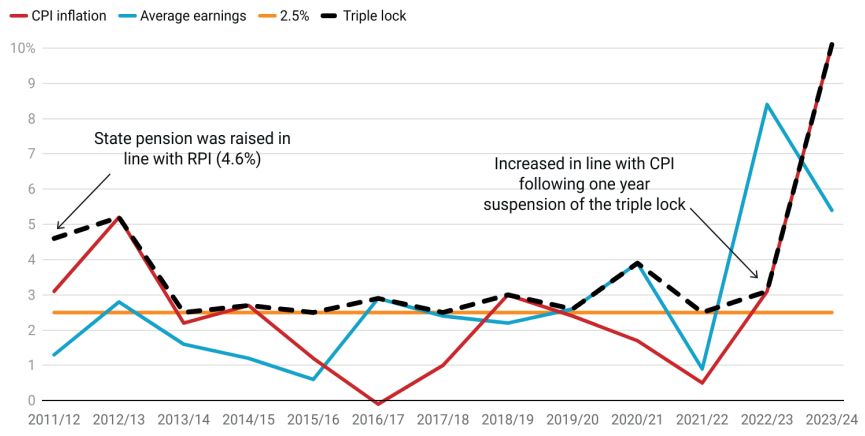
Unless otherwise stated, all figures are in nominal terms.[25]

4.1 State Pension Reform

The State Pension Triple Lock guarantees that the state pension will increase each year by the higher of 2.5%, inflation (CPI) or the increase in pay (measured by the average weekly earnings index). The policy was introduced in 2010 by the Coalition Government, in the context of a thirty year decline in the value of the basic state pension as a proportion of average earnings – from 26% in 1979 to 16% between 2000 and 2010,[26] as one of a number of measures to implement concerns over pensions identified by the Work and Pensions Select Committee in their report of 2006.[27]

The Triple Lock was introduced at a time when increases to the state pension age were being accelerated under the Pensions Act 2011, and ensured that – although people would have to work longer – the value of the pension they received would be not only preserved, but increased. It has proved to be a politically potent and enduring pledge, receiving cross-party support in the 2024 election. In April 2025, the Government announced that, in line with the triple lock, the state pension would increase by £470 that year, and up to £1,900 more over the course of the Parliament.[28] It is set to increase by another 4.7% in April 2026, based on the latest wage growth data.[29]

Figure 5: Growth in the elements of the triple lock (%), 2011/12 - 2023/24

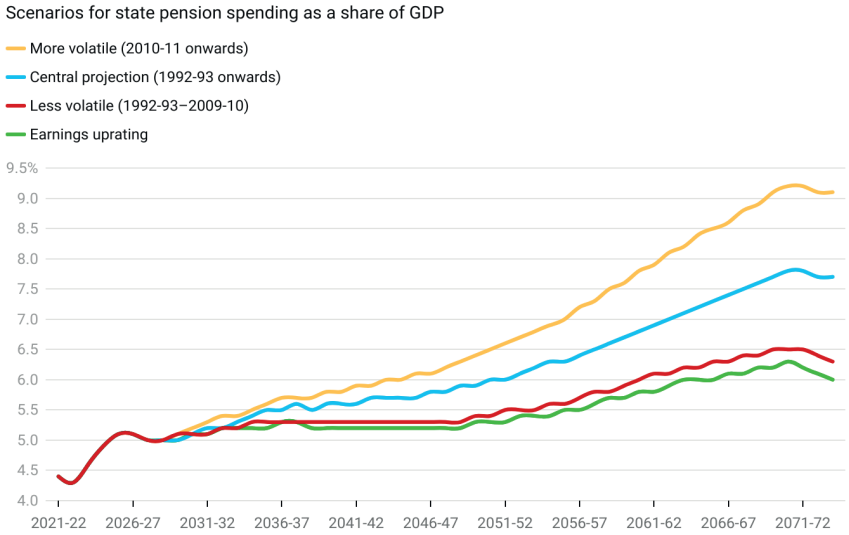


Source: House of Commons Library, State Pension triple lock

25. This is the case throughout Section 4.
26. House of Commons Library, 2023, Link
27. Pensions Reform, House of Commons Work and Pensions Committee, 2006, Link
28. Department for Work and Pensions, 2025, Link
29. ONS, Earnings and Working Hours, 2025, Link

The Triple Lock has also proved to be expensive. During the period between 2010 and 2024, prices (as measured by CPI) increased by 49.7%,[30] average weekly earnings increased by 55.6%[31] - and the basic state pension increased by 73.6%, from £97.65 a week to £169.50 a week.[32] The OBR has calculated that over the first two decades of its operation the triple lock will cost three times as much as had been first predicted - £15 billion a year more by 2029-2030. It further estimates that maintaining the triple lock would account for 1.6 percentage points of the projected 2.7 percentage points of GDP increase in state pension spending over the next 50 years.[33]

Figure 6: State Pension Scenarios[34]



Source: OBR- Fiscal risks and sustainability, July 2025

There were understandable reasons for introducing the triple lock. However, times have changed. Pensioners are the least likely age-group to be in poverty: only 16% of pensioners are in relative poverty, compared to 21% of the population as a whole.[35] And after almost two decades of low growth and stagnant incomes, can the country afford to continue to increase pensioner incomes in a way which ensures that, over time, they will consistently rise faster not only than inflation, but than average earnings?

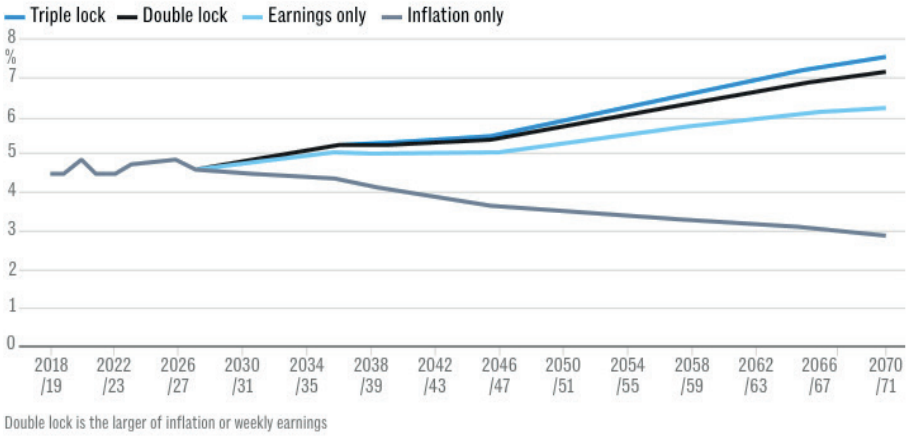
Ending the triple lock and instead increasing the state pension by inflation – as was done between 1980 and 2010 – would generate significant savings, while continuing to protect pensioner incomes in real terms.[36] An alternative approach, that would also deliver savings, would be to increase it by earnings. Both approaches are defensible – and both are preferable to the current triple lock.

Either proposal has the potential to significantly reduce state expenditure on pensions as a share of GDP: as shown in Figure 7, the Institute for Fiscal Studies has calculated that, by 2070, linking the state pension to CPI would see pension spending falling from its current 4.5% of GDP to 3% of GDP – whereas maintaining the triple lock would result in it soaring to

30. Bank of England Inflation Calculator, Link
31. Average weekly earnings in Great Britain, Office of National Statistics, 2024, Link
32. Basic State Pension Rate, Royal London, Link
33. OBR Fiscal Risks and Sustainability, 2025, Link
34. Figure taken from OBR Fiscal Risks and Sustainability, 2025, Link
35. UK Poverty 2025, Joseph Rowntree Foundation, 2025, Link
36. Linking the state pension to earnings is also a defensible position and would produce significant savings, although not as much as linking it to CPI, particularly over the next five years.

above 7% of GDP.[37]

Figure 7: Projected state expenditure on pensions as a fraction of GDP[38]



Double lock is the larger of inflation or weekly earnings

To achieve greater savings within the immediate five year period, we propose that the state pension should be frozen for three years, after which it would increase by CPI inflation. The Government's actions in freezing most benefits (although not the state pension) for four years from 2016 – 2020 provides a clear precedent. Politically, the challenge of amending the triple lock is likely to be large and the Government should therefore maximise the fiscal impact of such a decision, in order to ensure that the country as a whole can more clearly see the benefits.

Table 3: Savings from State Pension Reform

Annual Savings, £ billion Year	2026	2027	2028	2029	2030
State pension is frozen for three years, followed by increasing with CPI[39]	6.9	9.4	13.7	18.0	22.5

Increasing the State Pension Age

When the modern state pension was introduced in 1948, life expectancy stood at 66 years for men and 70 for women.[40] Today, the latest data shows it stands at 79 years for men and 83 years for women. In 2021 – 2023, considering life expectancy at age 65, the average man could expect to live for an additional 18.5 years and the average woman an additional 21 years.[41] And yet the state pension, after sex equalisation, has risen by only three years – from 65 to 68.[42]

The state pension was not designed to support people in a long and healthy retirement – however pleasant this might be for the individuals fortunate enough to receive it. And with the worsening dependency ratio, the state will become even less able to support such largesse into the future. Although it will not be popular, any Government serious about reducing the long-term direction of public sector spending must consider a further

37. Pensioners Deserve Better than the Triple Lock, Institute for Fiscal Studies, 2023, Link
38. 'Pensioners deserve better than the triple lock', Institute for Fiscal Studies, 2023, Link, first published in The Telegraph, December 2023, Link. Source of data cited as Department for Work and Pensions.
40. Facts and Figures on the NHS at 70, Nuffield Trust, Link
41. National Life Tables, ONS, Link
42. From 1948 to 2010, the State Pension age was 60 for women and 65 for men.
39. Analysis by Policy Exchange based on data from Economic and Fiscal Outlook, Office for Budget Responsibility, March 2025, Link and Welfare spending: pensioner benefits, Office for Budget Responsibility, January 2024, Link

increase in the retirement age, first to 69 and then to 70. As with the more recent increase from 65 to 68, this should be phased in well in advance, so that those who are only a few years from retirement age are not affected.

Increasing the state pension age will not deliver direct savings in the next five years – but it is nevertheless important in getting the public sector's long-term liabilities under control. Although the principal benefits are in the longer term, such a clear indication that the UK is willing to take difficult decisions to curb the trajectory of public sector spending may provide reassurance to the bond markets, reducing the interest rates at which they are prepared to lend to the UK, thereby reducing the fiscal deficit.

4.2 Means-test pensioner benefits

In addition to the state pension, a wide variety of other benefits are available to older people. There is little consistency over who is eligible, from what age and whether or not they are means-tested:

- Some are means-tested, such as Winter Fuel Payment or Free TV Licenses, whereas others are universal, such as the Christmas Bonus and free prescriptions.
- Some are payable from state pension age (Older Person's Bus Pass) whereas others are payable from either a younger age (free NHS eye tests from 60) or an older age (Free TV license).
- Some are organised on a national basis (pension credit) while others vary between local authorities (Council Tax Support for pensioners).

A summary of the major pensioner benefits (beyond the state pension) is set out below.

Table 4: Major benefits available to pensioners

Italicised benefits are dependant on whether citizen claims Pension Credit.

Universal	Means-tested
Older Person's Freedom Pass (London bus pass)	Winter Fuel Payment
Free NHS prescriptions	Housing Benefit
Free NHS eye tests	Council-run leisure concessions
Attendance Allowance*	Pension Credit
	Free dental treatment
	Council tax reduction
	Free TV licence
	Cold Weather Payment
	Warm Home Discount Scheme
	Christmas Bonus
	Support for Mortgage Interest

**Only eligible for those with disabilities/health conditions.*

Over time, there has been a trend towards greater means-testing of pensioner benefits (beyond the state pension), with an increasing number of benefits limited to those in receipt of pension credit. In 2020, under the then Conservative Government, free TV licenses for the over 75s, previously a universal benefit, were restricted to those on pension credit.[43] In 2024, the Labour Government made the decision to means-test Winter Fuel Payment to those in receipt of pension credit or other specified means-tested benefits.[44] In June 2025, it partially reversed this policy, to restore it to all those with incomes of £35,000 or below, meaning that 9 million pensioners, or approximately three-quarters of the cohort, will now receive the payment.[45]

In the current fiscal situation, the Government's original position – that pensioner benefits should only be for those most in need – was the correct one. This would have reduced the burden on the taxpayer while ensuring benefits were retained by those who needed them. We argue not only that the Government should revert to its original position on Winter Fuel Payments, but further that this principle should be extended to the remaining major universal pensioner benefits, with the exception of the state pension:

- Older Person's Bus Pass
- Free Prescriptions
- Free NHS Eye Tests

In addition, the age eligibility for free prescriptions and free NHS eye tests should be aligned with the state pension age.[46]

Winter Fuel Payment

The Government should revert to its former policy on Winter Fuel Payments, restricting it only to those in receipt of pension credit or other specified means-tested benefits. Compared to the current £35,000 income threshold, this would save approximately £1.25 billion per year. [47]

Older Person's Bus Pass

In the year to March 2023, there were 8.7 million concessionary bus passes in England, of which 90% were held by older people. The total cost to the taxpayer of concessionary travel was £877 million.[48]

Latest DWP data shows that there are 1.4 million pensioners receiving pension credit, out of a total of 12.97 million people receiving the state pension.[49] Just under 11% of pensioners receive pension credit.

Assuming that this proportion is reflected among those in receipt of concessionary bus passes, restricting the Older Person's Bus Pass to those in receipt of pension credit would therefore save approximately 89% of the current cost, or £700 million a year.

43. TV licences for the over-75s, House of Commons Library, 2024, Link
44. Winter Fuel Payment, UK Government, Link
45. UK Government, 2025, Link
46. The Conservative Government consulted in March 2024 on aligning the age of free prescription eligibility with the state pension age but, following the General Election, the new Labour Government chose not to take these proposals forward. Link
47. UK Government, 2025, Link
48. Concessionary Bus Travel, House of Commons Library, 2024, Link
49. DWP benefits statistics: February 2025, Link

Free Prescriptions and Eye Tests

For those aged 60 or over in England, NHS prescriptions are free of charge.[50] This is a non-means-tested benefit. In 2021, the Government consulted on aligning the age of free prescriptions with the State Pension age; however, following the general election the Government decided not to do so.[51]

Prescription charges generate approximately £600 million a year in revenue. However, 90% of the more than a billion prescriptions issued annually are issued free of charge, with two-thirds of these being issued free of charge due to the recipient's age.[52]

As one means of reducing spending, the Government could abolish free prescriptions for all people over 60, with those in this age bracket only receiving prescriptions if eligible on the basis of income, similar to those in other age brackets.

To calculate the savings to the taxpayer if free prescriptions were scrapped, one cannot simply multiply the number of prescriptions issued by the cost of a single prescription. This is because individuals who are likely to require a large number of prescriptions may purchase a Prescription Prepayment Certificate (PPC), which covers all of their prescriptions for a year for a set price. Take-up is not universal. However, the Government's Impact Assessment for the 2021 consultation estimated the total savings from raising the free prescription age to 66, taking into account prescriptions required, likely take-up of PPCs and the proportion of the population that would continue to be eligible for free prescriptions, estimated that the savings would be £226 million a year.[53]

Scaling this up to all people over 60, using today's population figures for people in England aged 60 or over,[54] adjusting for inflation, and making the conservative assumption that people aged 66-90+ have the same use of prescriptions as those aged 60-65 (which is likely to be an underestimate), we calculate that the total savings would be approximately £1.1 billion a year.

Those aged 60 or over are also eligible for free NHS eye tests, with the Government reimbursing opticians for the cost of the test. Opticians can claim £23.53 for the cost of each test.[55] Government recommends that adults over 60 have an eye test every two years.[56] In reality, however, most people aged 60 would go for an eye test less regularly than this. Under the assumption that each person over 60 receives a free NHS eye test every five years, and that 22% have an income-related exemption,[57] the savings for the taxpayer are approximately £52 million a year.

50. In Scotland, Wales and Northern Ireland prescriptions are free for all ages.
51. Consultation Outcome: Aligning the upper age for NHS prescription charge exemptions with the State Pension age, Department of Health and Social Care (2025), Link
52. Impact assessment: increasing the upper age exemption for prescription charges in line with the state pension age, Department of Health and Social Care (2021), Link
53. Ibid.
54. Population estimates for England and Wales, ONS, 2024, Link
55. Letter setting out general ophthalmic services fees, payments, optical voucher values and hospital eye service maximum charges from 1 April 2024, Department of Health and Social Care, 2024, Link
56. Eye care and people with learning disabilities, Public Health England, 2020, Link
57. Impact assessment: increasing the upper age exemption for prescription charges in line with the state pension age, Department of Health and Social Care (2021), Link

Table 5: Savings from means-testing pensioner benefits

Annual Savings, £ billion Year	2026	2027	2028	2029	2030
Restrict Winter Fuel Payments to those in receipt of pension credit	1.3	1.3	1.3	1.4	1.4
Restrict free bus passes to those in receipt of pension credit	0.7	0.7	0.8	0.8	0.8
Means-test free prescriptions for over 60s	1.1	1.1	1.1	1.2	1.2
Means-test free eye-tests for over 60s	0.05	0.05	0.06	0.06	0.06
Total	**3.2**	**3.2**	**3.3**	**3.4**	**3.4**

4.3 Welfare

Earlier sections of this report examined the Triple Lock and Pensioner Benefits which are some of the key drivers of increased welfare spending. Here we investigate the other key drivers: spending on health and disability benefits and working age welfare.

The latest OBR forecasts suggest that we will spend a total of £373.4 billion a year by 2029-2030 on welfare. Of this, pensioner spending is forecast to account for £181.8 billion[58], disability benefits £56.3 billion[59] and health and disability benefits £97.7 billion[60], child benefit £13.6 billion and Universal Credit and legacy equivalents £99 billion.

Table 6: Welfare spending (£ billion, current prices)[61]

	£ billion, unless otherwise stated						
	Outturn	Forecast					
	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Pensioner spending[1]	141.9	150.7	158.6	166.3	169.1	173.8	181.8
UC and legacy equivalents[2]	87.3	87.8	88.8	92.2	93.4	95.7	99.0
Disability benefits[3]	36.3	41.4	44.9	48.9	51.1	53.4	56.3
Child benefit	12.5	13.3	13.3	13.6	13.6	13.6	13.6
Other spending[4]	18.3	19.9	20.6	21.3	21.6	22.0	22.6
Total welfare spending	**296.4**	**313.0**	**326.1**	**342.1**	**348.8**	**358.5**	**373.4**
of which:							
Inside welfare cap	146.3	157.8	160.7	168.1	172.3	177.4	183.8
Outside welfare cap	150.1	155.3	165.5	174.0	176.5	181.1	189.6
Memo: total welfare (per cent of GDP)	*10.8*	*10.9*	*10.9*	*11.0*	*10.8*	*10.7*	*10.8*
Memo: health and disability benefits[5]	*66.3*	*75.7*	*81.2*	*86.9*	*90.1*	*93.5*	*97.7*
of which:							
Children	*3.7*	*4.5*	*5.1*	*5.6*	*6.1*	*6.6*	*7.0*
Working-age adults	*50.2*	*56.9*	*61.0*	*65.2*	*67.6*	*69.7*	*72.3*
Pensioners	*12.5*	*14.2*	*15.1*	*16.0*	*16.4*	*17.2*	*18.3*

[1] Pensioner spending includes pensioner housing benefit, pension credit, winter fuel payment, and state pension expenditure.
[2] UC and legacy equivalents includes personal tax credits, housing benefit (excluding pensioner part), incapacity benefits (which comprise employment and support allowance, income support for incapacity, severe disablement allowance, and incapacity benefit), income support, and income-based and contributory jobseeker's allowance.
[3] Disability benefits includes disability living allowance, personal independence payment, and attendance allowance.
[4] Other spending includes Northern Ireland social security expenditure.
[5] Health and disability benefits includes standard allowance and health element expenditure for UC health-related claimants, employment and support allowance, incapacity benefit, severe disablement allowance, income support for incapacity, disability living allowance, personal independence payment, attendance allowance, UC carer's element expenditure, carer's allowance, and income support for carers. Excludes Northern Ireland disability benefits expenditure and cost of living payments. A breakdown of the components of this line, along with an alternative definition which excludes carer-related spending, is available in our detailed forecast tables.
Source: DWP, HMRC, OBR

58. Pensioner spending includes pensioner Housing Benefit, Pension Credit, Winter Fuel Payment, and State Pension Expenditure
59. Disability benefits include Disability Living Allowance, Personal Independence Payment, and Attendance Allowance.
60. Health and disability benefits includes standard allowance and health element expenditure for UC health-related claimants, employment and support allowance, incapacity benefit, severe disablement allowance, income support for incapacity, disability living allowance, personal independence payment, attendance allowance, UC carer's element expenditure, carer's allowance, and income support for carers. Excludes Northern Ireland disability benefits expenditure and cost of living payments.
61. OBR, Economic and fiscal outlook, March 2025, Link.

The Government's Green Paper setting out reforms to working age health and disability benefits has been scored by the OBR to be £5.3 billion lower than was originally forecast in October 2024. However, even had those reforms taken place, spending on working age health and disability benefits was still set to increase by more than £15.4 billion over the course of the Parliament and to increase by an average nominal growth rate of 4.9% – the reforms would only have slowed the increase in spending.[62] Subsequent U-turns by the Government over these reforms mean that the savings in practice are likely to be much smaller than initially estimated, or potentially non-existent and the OBR forecast will account for these changes in the Autumn.

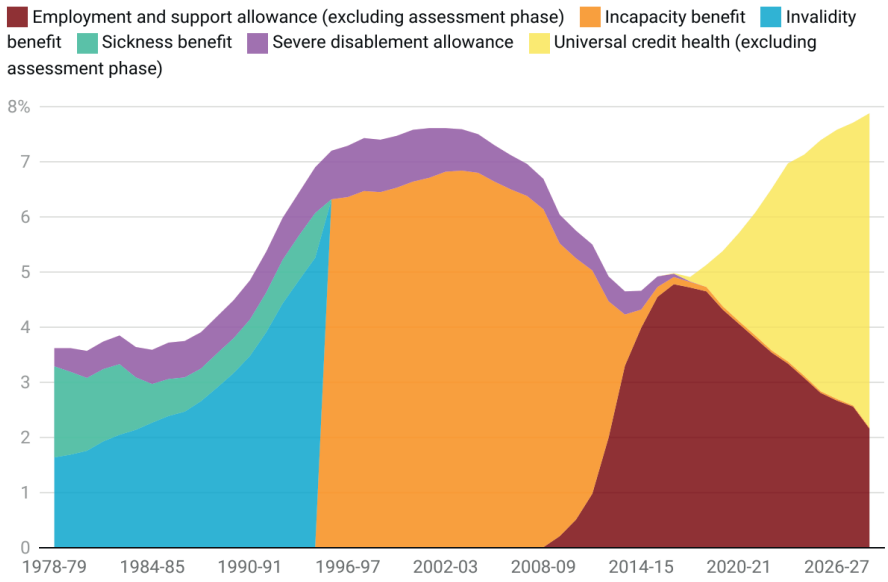
The Chancellor will certainly have to find an alternative way to raise about £5 billion (alongside the policy reversal on winter fuel payments). The OBR, which has always been sceptical of welfare policy proposals that are intended to save money, will be even less likely to score indicative welfare savings.[63] In effect, the now named Universal Credit Bill will not generate any "net savings" by 2029/2030.

Beyond the fiscal challenges, this presents a significant societal challenge. Almost 1 in 10 people of working age are now on at least one sickness or disability benefit.[64] We have a near record high number of 2.8 million people out of work because of long-term sickness[65] and nearly 300,000 are leaving work each year due to a health condition.[66] Since the pandemic, the number of disabled working-age people in England and Wales has increased by 17%, but the number of people receiving incapacity or disability benefits has increased by twice as much, i.e. by 34%.[67]

There has been a particularly stark uptick for young people, as well as those with mental health conditions. We have one in eight young people who are not in work, education or training.[68] More than 639,000 graduates are claiming Universal Credit.[69] A thousand people a day are claiming Personal Independence Payment (PIP) benefits.[70] Figure 8 shows how the proportion of working-age people on incapacity benefits has changed from the late 70s to today, and how it is set to continue to increase in the coming years.

62. OBR, Economic and fiscal outlook, March 2025, Link.
63. I.e. proposals that rely on behavioural changes in order to produce savings.
64. Consultation Spring Statement 2025 health and disability benefit reforms – Impacts, July 2025, Link.
65. Universal Credit and Personal Independent Payment Bill debate, Hansard, July 2025, Link.
66. Secretary of State for Work and Pensions speech to the House of Commons on Pathways to Work reform, March 2025, Link.
67. New Economics Foundation, May 2025, Link.
68. BBC News, May 2025, Link.
69. The Times, July 2025, Link.
70. Secretary of State for Work and Pensions speech to the House of Commons on Pathways to Work reform, March 2025, Link.

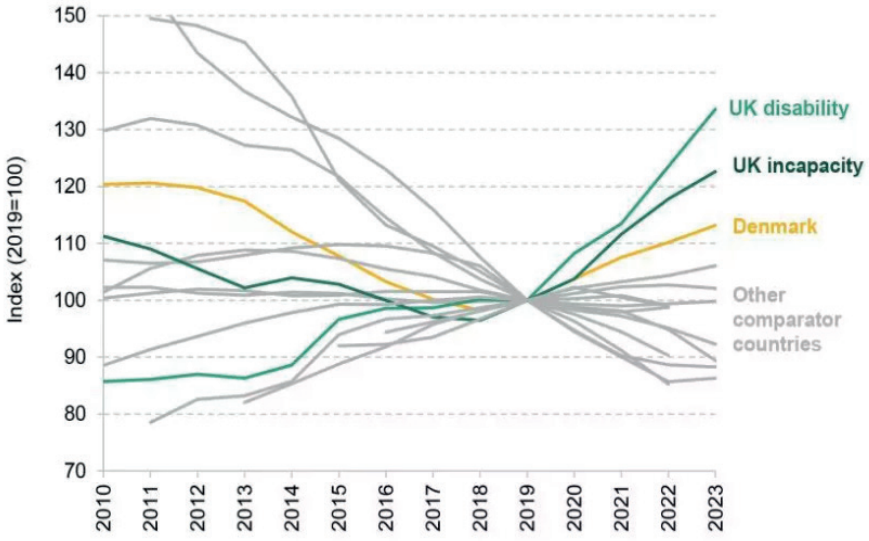
Figure 8: Proportion of Working-Age People on Incapacity Benefits, 1978/79 – 2027/28[71]



Source: OBR, Welfare trends report, October 2024

We are also an outlier compared to peer nations with a continuing steady rise in those claiming health and disability benefits while in many comparator nations the numbers have fallen. (See Figure 9.)

Figure 9: Index of working-age population claiming health benefits in the UK and comparator countries, 2010 – 2023 (indexed to 2019)[72]



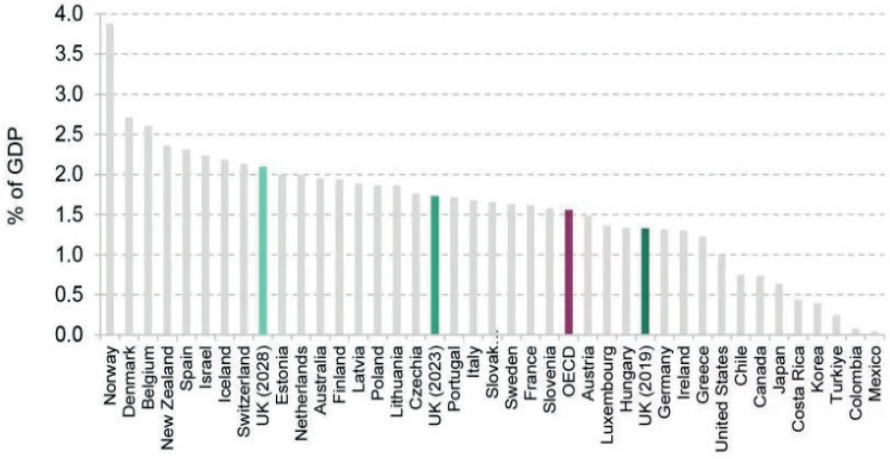
Source: *IFS, Health-related benefit claims post-pandemic: UK trends and global context (2024)*

Note: *Comparator countries comprise Australia, Austria, Canada, Denmark, France, Germany, Ireland, the Netherlands, Norway, Sweden and the US.*

71. OBR , Welfare trends report, October 2024, Link.
72. IFS, Health-related benefit claims post-pandemic: UK trends and global context (2024), Link.

Figure 10 puts these international spending trends in context. While admittedly the UK spent lower than the OECD average on incapacity benefits in 2019, this is no longer the case and we are projected to be among the higher-spend countries by 2028.

Figure 10: Sickness and disability benefit expenditure on the working-age population in OECD countries (2019) and the UK (2019, 2023, 2028)[73]



***Source:** IFS, Health-related benefit claims post-pandemic: UK trends and global context (2024)*

Note: *These figures only include cash spending.*

There are a set of core principles which unite everyone. These are that we should have a system that:

- Protects the most vulnerable.
- Is a safety net, not a way of life.
- Rewards work.
- Is fair to the taxpayer.
- Is financially sustainable over the long term.

The challenge for any government is not about these core principles but rather about where one draws the line between them. What does one consider to be a system that sufficiently "protects" the most vulnerable, that sufficiently "rewards" work, and that is "fair" to the taxpayer and is "sustainable"? It is these judgment calls that are the crux of any welfare reform. Ultimately, the Government needs to win two fairly significant points of principle: that our spending on welfare is indeed unstainable and that our system is letting down an entire generation of our fellow citizens. Fixing our welfare state is a moral crusade as well as a fiscal one.

There are different ways one might tackle changes to the health and disability benefit system and working age welfare.

73. IFS, Health-related benefit claims post-pandemic: UK trends and global context (2024), Link.

1. **Make a case for the rebalancing of the system. However, this is not a strategy that generates immediate savings.** Tackle the fundamental questions about our welfare system. Given the shift in societal norms, our system now captures the impact of some health conditions differently from what was intended when the system was designed. Policy Exchange has looked at this in the paper, "For Whose Benefit?". Among many recommendations, we suggested that qualifying criteria should be evaluated every two years and voted on by Parliament. We also argued that PIP should become conditional on being in education, employment or volunteering for those aged 16-30 and that medical evidence should be required for every single claim.

   One could take a slightly different approach and look at diversifying the support on offer. This could take the form of a catalogue scheme, a voucher system, one-off grants or a receipts-based approach. You could argue that for certain types of disabilities, a fiscal transfer is the wrong type of support.

   These are long-run reforms intended to change the way we perceive these benefits and consider our support for disabled people, but do not answer the immediate fiscal imperative. They do represent, however, a fundamental overhaul of the disability and ill-health benefits system.

2. **Change the boundaries and generosity of PIP and incapacity benefits (eligibility and thresholds).** This is the approach the Government took with many of the measures in its Green Paper but, due to a rebellion among Labour backbenchers, most of the measures were removed. The Green Paper proposed a minimum score of four points on a single daily living activity to qualify for the daily living element of the benefit. The Government decided to reduce the generosity of the health element of Universal Credit by freezing it until 2029/2030 while increasing the rate of the standard allowance.

   The initial assessment estimated that, due to the proposed changes, 150,000 more working-age adults would be in relative poverty after housing costs by FYE 2030.[74] Ultimately, the government had to remove the minimum score proposal and indeed remove all policies related to PIP. In the end, while the package ultimately focused on rebalancing UC, and while DWP estimates that 50,000 individuals (children and working-age people) would be in relative poverty in Great Britain in 2029/30, as a result of the changes, the Bill now costs the Government money rather than saving it.

   The problem with the Government's approach was that the measure was perceived as a crude cut that had limited intellectual underpinning. It was premised on the notion that the Government is spending more, and one cannot adequately explain why there is

74. Spring statement social security changes – Updated impact on poverty levels in Great Britain, DWP, Link

an increase in claims, so action needs to be taken to limit financial support. This leaves the Government open to the argument that the changes are just a cost saving exercise, do not save a significant amount, and they are not starting from a policy imperative to improve people's lives.

Ultimately, the Universal Credit Bill, in its final form, did look at addressing some of the incentives in our working-age benefit system by rebalancing, to some small extent, the financial discrepancy between those on the standard allowance of Universal Credit and those in receipt of the health top-up. This is a positive reform, but it does not go nearly far enough in trying to rectify the significant challenges our benefit system faces.

3. **Setting a top-down savings target**. A third option is to set a top-down savings target that sets an objective of saving by reducing the growth in claimants. This would need to be matched by policy actions. One needs to be able to make a compelling moral argument (as outlined above) over a sustained time period to enact meaningful reform. Indicative examples are given below:
   - ***Return to pre-pandemic levels.*** The OBR calculated in July 2023 that the increase in working age inactivity due to long term sickness during the pandemic had resulted in a negative fiscal impact of £15.7 billion.[75] This was based on an increase in health-related inactivity of 442,000 between Dec-Feb 2020 and Feb-April 2023.[76] As of May 2025, the number represents an increase of approximately 440,000 compared to the pre-pandemic baseline of 2.34 million in Dec-Feb 2024. Therefore, if we returned to pre-pandemic levels we could expect to save approximately **£15.7 billion.**
   - ***Maintaining Levels.*** If the numbers of those claiming working-age health and disability benefits were maintained at the 2025/26 level, rather than rising, then the Government would spend **£14 billion** less than currently forecast over the Parliament by 2029/2030. [77]
   - ***Uprating by CPI + Population Growth (0.7%).*** If you uprated Heath and Disability benefits by CPI+ Population Growth you would spend approximately £**9 billion** less than currently forecast over the Parliament by 2029/2030.

4. **Under-Uprating.** Under-Uprating options focus on making benefits less generous rather than looking at restricting the growth of benefits. Under the Coalition Government, most working age benefits were capped at a growth rate of 1% for 3 years from 2013. A Government could take many different approaches to this. For example:
   - Freezing working-age benefits for one year at 2025/26 levels, excluding disability and health benefits, would save £2.7

75. OBR, Fiscal risks and sustainability report, July 2023, link
76. ONS, Rising Ill-Health and economic inactivity because of long-term sickness, link
77. This figure was calculated using the on current forecasts taken from DWP benefit and expenditure caseload. For 29/30 we assume expenditure grows at the average growth rate across the current five-year scorecard. CPI forecasts are from OBR's March 2025 EFO.

billion in 2026/27.

- Uprating working age disability and incapacity benefits by 1% for one year rather than CPI would save £3.3 billion against the forecast spend in 2026/27.
- Uprating by 1% for two years, (rather than CPI) would save and additional £4.9 billion in 2027/28 - or £20.8 billion throughout the period 2026/27-2029/2030.

5. **Devolving PIP.** The current PIP benefit could cease to exist in its current form, and be replaced with a cash model that was devolved to councils by creating a managed budget as part of Departmental Expenditure Limits, with councils then responsible for distributing a fixed pot of funding to those in need. The level of funding would be set below the current PIP forecast. Either the growth rate of projected NHS usage or population growth could be used to create the parameters for this fund.

In the costings set out below, we have assumed that reforms along the lines of those set out in our report "*For Whose Benefit?*" succeed in limiting the number of those on welfare to current levels and ultimately begin reducing the numbers of those on out-of-work benefits, and on PIP. The goal in both cases should be to restore these to pre-Pandemic levels.

In modelling the savings, we have assumed that sufficient steps are taken to reduce the increase in out-of-work sickness by two-thirds of the difference between current levels and pre-pandemic levels, thus saving two-thirds of the £15.7 billion fiscal impact estimated by the OBR, after adjusting for inflation.

We have also proposed that working age benefits be frozen for three years, followed thereafter by increases in line with CPI.

Table 7: Savings from welfare reforms

Annual Savings, £ billion Year[78]	2026	2027	2028	2029	2030
Reduce numbers on out-of-work sickness benefits	2.2	4.4	6.7	9.2	11.7
Freeze working age benefits for three years, then increase in line with CPI	6.5	9.4	13.0	15.5	18.2
Total	**8.7**	**13.8**	**19.8**	**24.7**	**29.9**

4.4 Healthcare and the NHS

The UK provides healthcare free at the point of use to British citizens on the NHS. While other departments and public services have often experienced real terms cuts to their budgets, this has not been the case for healthcare. For example, from 1955/56 to 2022/23, in real terms health spending increased by an average of 4% per annum. Over this period as a whole,

78. Data is sourced from 'Department for Work and Pensions, Benefit expenditure and case-load tables 2025' and years here correspond to financial years rather than calendar due to data collecting. We assume a CPI rate of 2% in 2030.

real health expenditure per capita rose by about 850%.[79]

Government funded current expenditure on healthcare in the UK amounts to approximately 9% of GDP. The healthcare budget is now the same size as the entire GDP of Portugal.[80]

It is right that the Government ensures that everybody can access healthcare, regardless of their income. However, the evidence suggests that the current healthcare model in the UK is not only expensive, but it is also not delivering good quality outcomes for patients.

For example, although NHS productivity has started to increase, it is still significantly below its pre-pandemic level. Moreover, the UK performs poorly when compared to other highly developed economies on key healthcare metrics including avoidable mortality and healthy life expectancy. In a group of developed countries, ranks second from last for these and other important metrics, with only the United States performing worse.[81]

Healthcare funding for the UK is unusual when compared to many other countries as it predominantly financed through general taxation.

There are two main ways in which savings can be achieved. We shall discuss these below.

Reforms to reduce costs and increase efficiencies within the existing model

- A fee of £20 should be paid by patients for a GP appointment. This would raise around £5 billion a year for the NHS, reduce demand, and cut back the number of missed appointments.
- Free prescriptions as well as eye and hearing tests for the over 60s should be abolished and instead subsidised on the basis of financial need only. This would save approximately £1 billion each year.
- Charging for more luxurious hospital accommodation. This has the potential to raise revenue in the region £0.7 billion per annum.
- Reducing the use of expensive agency staff could save in the area of £1billion every year.
- Abolishing centralised pay bargaining would not only increase the ability to plug vacancy gaps, it could also potentially save approximately £2 billion each year.
- Administration costs could be reduced significantly if new technologies were utilised, saving in the region of £1.4 billion per annum.
- Taken as a whole, these changes would achieve annual savings of approximately £11 billion.[82]

Substantial savings could be achieved if the UK shifted to a funding model based on a combination of insurance, co-payments, charges, and taxation as is common in most other highly advanced economies. This would shift the burden away from taxpayers while also ensuring that those on the lowest incomes and other vulnerable people still receive free

79. Institute for Fiscal Studies, 'IFS Spending Composition Sheet', 2024
80. Hayward, E., 'NHS budget as big as Portugal's GDP after spending review', *The Times*, June 2025
81. Bootle, R., Ramanauskas, B., & Sweetman, B., 'The NHS - A Suitable Case for Treatment?', *Policy Exchange*, July 2025
82. *Ibid*

healthcare. There is precedent for this provided by the experience of the Netherlands which itself shifted from a model similar to that of the NHS to one based largely on social-insurance.

While the shift to an insurance style system would be preferable, it is unlikely to be implemented in the short term. However, the UK has the potential to significantly cut public spending in the short to medium term while maintaining the current funding model. Introducing charges and co-payments has the potential to reduce costs by approximately £11 billion each year.

Table 8: Savings from health reforms

Annual Savings, £ billion Year	2026	2027	2028	2029	2030
Ending national pay bargaining in the NHS	2	2.0	2.1	2.1	2.2
Halving the administrative cost of the DHSC through better use of technology	1.4	1.4	1.5	1.5	1.5
More efficient staffing procedures reducing the use of agency staff	1	1.0	1.0	1.1	1.1
Charging £20 to see a GP	5	5.1	5.2	5.3	5.4
Charging for more luxurious hospital accommodation	0.7	0.7	0.7	0.7	0.8
Total	**10.1**	**10.3**	**10.5**	**10.7**	**10.9**

'The NHS - a Suitable Case for Treatment?', Policy Exchange, 2025, link

4.5 Reducing the Size and Cost of the Civil Service

Over the last decade, the growth of the civil service has been extraordinary. From a low of 385,000 Full Time Equivalent (FTE) staff in 2016, it has swollen to over 510,000 FTE today – an increase of over 30%.[83] Growth has been concentrated in mid-level and senior ranks: the Senior Civil Service has increased by 60% since 2013, the 'policy profession'[84] has nearly doubled since 2016,[85] and the number of middle-management grades – Grades 6 and 7 – has increased by 121% since 2010.[86]

The Government has pledged to cut government running costs[87] by 15% by the end of the decade, saving £2.2 billion.[88] If this resulted in a 15% reduction in jobs, this would reduce headcount by approximately 75,000 – or just over half of the increase since 2016, and leave the civil service with around 435,000 FTE.

While there is clearly the potential to go significantly further, simply targeting a reduction in numbers would be likely to give rise to perverse and undesirable effects. Previous efficiency rounds that focused on arbitrary

83. Civil Service Statistics, 2025, Link
84. A term used to refer to civil servants working on developing Government policy, as opposed to those in operational, finance, communications or other roles.
85. Smaller, Better, Higher Paid? Policy Exchange, 2025, Link
86. Annual Whitehall Stocktake, Institute for Government, 2025, Link
87. The Government does not publish an aggregate cost for the civil service. However, this appears to be based on the 'Administration Budget' in the Public Expenditure Statistical Analyses, which totals £14 billion in 2024 – 2025, of which £9.4 billion are staff costs. Link
88. Spring Statement, HM Treasury, 2025, Link

headcount targets have resulted in low paid staff being disproportionately cut. The most junior grades have almost halved since 2010, with the essential administrative tasks these staff were performing simply moving upwards. Similarly, median pay remains very similar in real terms to its 2010 level, with grade inflation wiping out the savings delivered by pay freezes and caps.[89] In other words, pay restraint at each individual grade has been negated by more civil servants moving into higher grades.

At the same time, the civil service suffers from widely reported challenges on managing poor performance (regularly one of the worst performing areas in the civil service Staff Survey), high rates of churn and low staff morale, which has fallen for three years running.[90] The proportion of staff dismissed for poor performance is negligible: only 0.5% of headcount across the civil service as a whole, and falling to fewer than 1 in 1000 staff in some traditional Whitehall policy-focused departments such as the Cabinet Office and the Department for Education.[91]

Policy Exchange has covered these subjects extensively, including in Getting a Grip on the System (2024)[92] and in Government Reimagined (2021).[93] While savings are urgently needed, the solution must be to pursue these in tandem with reform: combining more ambitious reductions in costs of 25% over the next five years, with reforms that give Permanent Secretaries significantly greater ability – and expectations – to manage their departments in ways that would increase productivity and performance, alongside higher performance-related pay if they succeed.

In Spending Reviews, Permanent Secretaries should be granted greater powers to offer up additional headcount reductions in exchange for a greater uplift in staff pay – provided the pay-bill as a whole remains below target limits. This would enable a move to a smaller, higher performing civil service which pays the salaries required to attract and retain the most capable staff. As discussed in the following section, reforms to public sector pensions could also allow some of the savings to be recycled as front-line pay.

Greater flexibility on grading should be introduced, with a reduced emphasis on line management spans, so that – particularly in specialist areas such as economics, IT procurement and law – there is a greater ability to appoint talented individuals into key roles at Deputy Director and Director level salaries without the expectation that they will manage large teams of people.

The pernicious impact of 'churn' – by which staff remain in posts for increasingly short periods of time, diluting expertise and accountability – should be addressed with both carrots and sticks. Firstly, an expectation should be created that staff will normally remain in a role for at least two years (at Grades 6 and 7) or four years (within the Senior Civil Service), with line managers empowered and expected to deny requests to move or apply for other roles prior to that period, other than in exceptional circumstances.[94] Simultaneously, departments should be granted greater flexibility to provide above-inflation pay increases to high performing staff in post, to combat the fact that, for many staff, the only way to get a

89. Annual Whitehall Stocktake, Institute for Government, 2025, Link

90. Ibid

91. Civil Service Statistics, Cabinet Office, 2024, Link

92. Getting a Grip on the System, Policy Exchange, 2024, Link

93. Government Reimagined, Policy Exchange, 2021, Link

94. This would not preclude managed moves where it is in the organisation's best interests.

pay rise is to move jobs.

As major private sector employers increasingly recognise the benefits of in-office working, the civil service should follow suit, with a default expectation imposed on all civil servants of at least four days a week in the office, or pro rata for part-time employees. Exceptions to this could be agreed on an individual basis, but only where it was genuinely in the best interests of the organisation.

To tackle poor performance and avoid the flight of the most talented, where staff cuts must be made, compulsory redundancy exercises should be made the default, with voluntary redundancy rounds only authorised with the sign-off of both the Chancellor of the Exchequer and the Chancellor of the Duchy of Lancaster.

Permanent Secretaries and Director-Generals should be explicitly tasked with getting a grip on managing poor performance, with each given a mandatory objective to do so and held to account accordingly – including when considering their eligibility for performance-related pay. To assist in this, they should be given powers to agree incentive payments for mutually agreed exits for weaker performers without the need for Treasury authorisation, in line with best practice in the private sector.

The Cabinet Secretary should also be personally tasked with overseeing – and then delivering – a rapid review to fundamentally overhaul civil service procedures on recruitment, managing poor performance and dismissal, to put an end to the policies which incentivise managers to ease performers into other teams, rather than dismissing them.

These reforms, combined with the 25% reduction in Government running costs set out in Policy Exchange's previous report, *Smaller, Better, Higher Paid*[95], would deliver a leaner, more efficient and higher performing civil service.

Arm's Length Body Efficiencies

In addition to Ministerial Departments, the Government operates a large number of arm's length bodies (often referred to as Quangos). The exact number of these depends upon the definition: the Government's website lists 580 'Departments, agencies and public bodies' in addition to the 24 Ministerial Departments;[96] the Cabinet Office's 'Arm's Length Bodies Landscape Analysis', says that, in 2023, there were 304 arm's length bodies.[97]

These bodies are classified in different ways, including Executive Agencies, Non-Departmental Public Bodies (both Executive and Advisory), Non-Ministerial Departments, Tribunals, Corporations Sole. Collectively these disburse large amounts of public funding to front-line public services, but they also have administrative costs of their own. This chapter focuses upon the administrative costs of these arm's length bodies.

Staff in some arm's length bodies, including Non-Ministerial Departments and Executive Agencies, are civil servants, and efficiencies in these bodies are included in those set out above. Staff at Non-Departmental Public Bodies (NDPBs), however, are not classified as civil servants, and

95. Policy Exchange, 2025, Link
96. Departments, agencies and public bodies, accessed May 2025, Link
97. ALB Landscape Analysis 2023, Link

yet similar efficiency savings could be found there.

There is no consolidated account of the administrative costs of NDPBs, whose number is regularly changing and which each produce their own set of accounts across different time frames. For example, in March 2025, it was announced that NHS England, the single largest arm's length body, would be abolished and its functions merged back into the Department of Health and Social Care.

An approximation of the savings can be made by considering the headcount – approximately 150,000 – and assuming a proportionately similar level of savings compared to that of the civil service as a whole. A 25% reduction in NDPB running costs would, therefore, generate approximately £0.4 billion of savings.

A more ambitious programme of consolidation could yield further savings – although these are not costed in this report. There are other arm's length bodies that could be abolished or downsized so that core policy-making functions can be brought back under direct ministerial control. As is already proving to be the case with NHS England, this would allow the realisation of efficiency gains.

Some arm's length bodies such as the College of Policing and the Climate Change Committee could be straightforwardly abolished and the functions returned to their parent departments. Many arm's length bodies, however, have both operational roles and policy-making functions. For organisations such as Social Work England, the Office for Students, UK Research and Innovation and the Environment Agency, savings could be made by moving the policy functions to their parent departments and leaving the bodies focused upon their operational role. Some arm's length bodies are also carrying out functions that the state simply does not need to do, including Visit Britain, Active Travel England, as well as a large number of smaller arm's length bodies, including the Groceries Code Adjudicator, Pubs Adjudicator and the Great Britain-China Centre.

Table 9: Savings from civil service reforms

Annual Savings, £ billion Year	2026	2027	2028	2029	2030
Civil Service efficiency savings	0.3	0.6	0.9	1.2	1.5
Arm's length body efficiency savings	0.09	0.17	0.26	0.35	0.44
Total	**0.4**	**0.8**	**1.1**	**1.6**	**1.9**

Consultancy Spending

Consultancy spending increased rapidly over COVID – and then remained at high levels. New data produced by the market insight firm Tussell showed that in 2023-24, £3.4 billion was spent by the UK Government on consultancy, a 62% nominal increase over pre-pandemic levels of 2019-20.[98] The problem was exacerbated by the decision, in February 2023, to abolish central Cabinet Office controls for most consultancy spending.[99]

98. Scandalous' £3.4bn UK state spending on private consultants last year, The Guardian, 2024, Link

99. The Guardian, 2025, Link

In November 2024, the Government set out new measures to bring consultancy spending under control and to halve Government spending on consultancy in future years – expected to save £1.2 billion a year. Under the new procedures, any consultancy spend over £600,000 or lasting more than nine months requires ministerial sign□off, with any spending over £100,000, or of over three month duration, requiring approval at permanent secretary level.[100]

The Government's steps to control consultancy spending are welcome. The Government should closely monitor and enforce these, with Departments that do not reduce consultancy held to account, including via additional reductions in their administrative budgets. Importantly, once spend has been reduced, the controls must be maintained as prior experience has shown that consultancy spending tends to rise rapidly once such controls are removed.

4.6 Public Sector Pensions

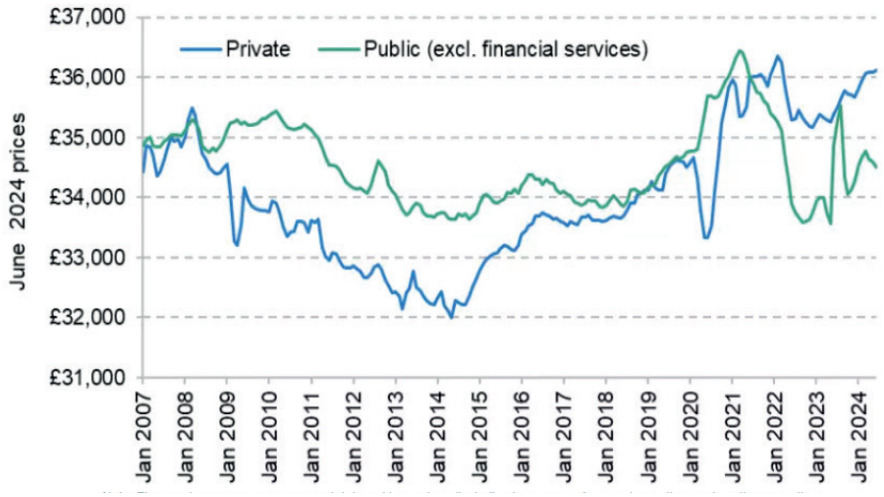
Public sector remuneration (including headline salary, pensions and employer National Insurance contributions) currently stands at about £286 billion a year – or approximately a fifth of all Government spending.[101] However, compared to the private sector, an unusually high proportion of public sector remuneration is received as pension contributions, with employers making a contribution of 25% - 30%, compared to typically 5% - 10% in the private sector.[102]

There is a misconception that large pension contribution in the public sector is to make up for significantly larger salaries in the private sector. While it is true that at very senior levels – particularly when shares and bonuses are factored in – public sector pay significantly lags private sector pay, on average, public sector pay is less than 5% lower than private sector pay, as Figure 11 shows.[103]

Studies have also shown that many public sector employees do not fully value the level of the prospective pension that they will receive in retirement,[104] and that therefore a remuneration package that was more in line with that in the private sector could be more effective at helping to attract and retain talented individuals to work in the public sector, while saving public money.

100. New controls across government to curb consultancy spend and save over £1.2 billion by 2026, Cabinet Office, 2024, Link
101. Office for National Statistics, GG: Wages and salaries, paid (D11) and GG: Total employers social contributions, paid (D12), Link and Link
102. Average private sector employer contributions are 6%. Institute for Fiscal Studies, Adequacy of future retirement incomes: new evidence for private sector employees (2024) Link
103. Graph taken from Pressures on Public Sector Pay, Institute for Fiscal Studies (2024), Link
104. What's the Value of a Pension? Actuaries in Government (2024), Link

Figure 11: Real mean earnings by sector[105]



In addition to higher employer contributions, public sector employees also benefit from increased certainty, being in receipt of Defined Benefit pensions as opposed to the Defined Contribution pensions that are overwhelmingly more common in the private sector. Furthermore, most public sector pension schemes, with the exception of the Local Government Pension Scheme, where contributions are paid into a fund and invested, are 'unfunded', meaning that the employer contributions are not invested, but simply return to the Treasury, with pensions paid out of current expenditure. This means that the generous public sector pension schemes are building up major future liabilities for the taxpayer. These were recently estimated at £1.4 trillion.[106] Additionally, some public sector workers, such as the police and the armed forces, are able to take their pension well before the age at which one would become eligible for the state pension.

Details of Public Sector Pension Schemes

Over 95% of public sector pension scheme members are enrolled into one of the six largest schemes.[107]

105. 'Pressures on Public Sector Pay', Institute for Fiscal Studies, (2024),
106. UK public sector pension liabilities, ICAEW (2024) Link
107. Civil Service Pensions, Martin Stanley, Link

Table 10: Details of public sector pension schemes

	Employee contribution	Employer contribution	Type[108]	Accrual Rate[109]	Number of active members[110]	Number of contributing members[111]
Civil Service Pension Scheme[112]	4.60% - 8.05%	28.97%	Career Average	2.32%	1.7 million[113]	0.6 million
Teacher Pension Scheme[114]	7.4% - 12%	28.68%	Career Average	1.75%	2.2 million[115]	0.72 million
NHS Pension Scheme[116]	5.2% - 12.5%	23.7%	Career Average	1.85%	3.8 million[117]	1.9 million
Police Pension Scheme[118]	12.44% – 13.78%	35.3%	Career Average	1.80%	325,000[119]	120,000
Armed Forces Pension Scheme[120]	0%	65.5%	Career Average	2.13%	1 million[121]	194,000
Local Government Pension Scheme[122]	5.5% – 12.5%	21.1% (average contribution)	Career Average	2.04%	6.7 million[123]	2.1 million

Table 10 above demonstrates two further elements of public sector pensions. First, despite the reforms of the Coalition Government, which were intended to make public sector pensions more affordable, overly-optimistic assumptions at the time of the reform have meant that the level of employer contributions has increased over the last 15 years, from around 16% in 2009 to closer to an average of around 27% today.[124] Moreover, the levels of member contributions are high compared to private sector schemes.[125] This has resulted in some public sector employees opting out of their pension schemes – despite their generosity – for reasons of affordability.

For example, 15% of nurses in the starting band and 20% of doctors in core training have opted out of the pension scheme, which means they also receive no employer contribution to their pension either. Again, this reinforces the thesis that many public sector employees would be better off with a balance of remuneration which was less tilted towards pensions at the expense of take-home pay.[126]

How to reform

The unfunded nature of most public sector pension schemes (with the exception of the LGPS) creates a challenge for how to reform them. Reducing the generosity by cutting the employer contribution rate, and thereby the accrual rate, would not save any money in the short term – as the employer contribution is in most cases simply paid by the employer back to the Treasury.

Switching to a funded, defined contribution scheme, with a lower rate, would actually cost the government money in the short run – as the employer contribution would then need to be paid into a fund. Savings would start to arise as retiring employees began to collect – for their most recent years – a defined contribution pension, paid for from their invested pension pot, rather than an unfunded pension calculated on a defined

124. Briefing: Public Sector Pay and Pensions, Taxpayers' Alliance, (2024), Link
125. The default employer contribution under the statutory auto-enrolment scheme is, for example, 5%.
126. Pressures on Public Sector Pay, Institute for Fiscal Studies (2024), Link
108. Each of the schemes also contains a degree of inflation protection, whereby the sum accumulated is uplifted by either CPI, or CPI plus a fixed percentage, each year.
109. The proportion of one's salary that is added to a member's annual pension each year.
110. All numbers include people paying into the scheme, people being paid a pension, and people who have a pension they have deferred. The schemes are England and Wales only, other than the Civil Service Pension Scheme and the Armed Forces Pension Scheme which are UK wide. Figures are for March 2024 other than for the Police Pension Scheme which is March 2020: this was the most recent available figure.
111. References as for Number of Active Members.
112. Civil Service Pension Scheme, Link
113. National Audit Office, Link
114. Teacher Pension Scheme, Link
115. Department for Education, 'Teachers' Pension Scheme (England and Wales) Annual Report and Accounts 2023-24' Link
116. NHS Pensions, Link
117. Department of Health and Social Care, 'NHS Pension Board Annual Report 2023 to 2024', Link
118. Police Pension Schemes, Link
119. Government Actuary's Department, 'Police Pension Schemes (England and Wales) Membership data' March 2023, Link.
120. Armed Forces Pensions, Link
121. Ministry of Defence, 'Armed Forces Pension Scheme Annual Report 2023-24', Link.
122. Local Government Pension Scheme, Link
123. Local Government Pension Scheme, Link.

benefit basis; however, in the short term, these savings would be small compared to the additional costs. We are thus in the position that some of the most powerful actions Government could take to reduce the long-term liabilities for the country would cost money in the short-term.

Nevertheless, if the Government wishes to shift public sector spending on to a more sustainable trajectory, public sector pension reform must be tackled.

We propose that, with the exception of the Armed Forces – who face genuinely exceptional circumstances with no parallel in other occupations – public sector pension schemes are reformed to provide a maximum employer contribution of 10%. The money should be placed in new, funded, defined contribution schemes. At the same time, the minimum contributions from employees should be reduced, bringing them in line with the auto-enrolment default of 5%. Although a reduction from the current rate, this would still result in a level of employer contribution higher than all but the most generous private sector schemes.

Existing accrued entitlements should be protected.

Based on ONS data on total government employers' wages and salaries paid[127], and using an estimate of 27% for employer pension contributions, [128] this would result in a reduction in nominal public sector compensation of approximately £33 billion a year (although, as discussed above, this would not be an actual cash saving for the Government in the short run). Approximately a third of the savings[129] should be used to increase headline pay, which would be sufficient to fund a pay increase of approximately 6% for civil servants and teachers, 3% for local government employees, 4% for NHS workers and 8% for the police.[130] It is recognised that this would place an additional immediate pressure on public sector finances, but it is nevertheless recommended both to counter recruitment crises in parts of the public sector, and to reduce the risk of – and public support for – strikes which could otherwise be damaging and make these reforms politically unviable.

Implementing the reforms

Making these changes would require legislation in order to move public sector employees on to the new pension schemes.

We propose that legislation be introduced and passed as soon as possible, with the new reforms to take place five years after the legislation gains royal assent – to ensure that those within five years of retirement would be unaffected.

The new schemes – and corresponding increases to headline pay – would therefore take effect in the early 2030s, potentially as early as 2031.

Calculating the cost

Calculations here are indicative, presented in 2024 pounds, of the nominal savings and cash flows that would result as a result of these reforms, in the first year of operation, rounded to the nearest billion.

Reforms to the funded Local Government Pension Scheme (LGPS) result

127. Office for National Statistics, GG: Wages and salaries, paid (D11), Link

128. The ONS data does not disaggregate employer NICs and employer pension contributions.

129. By savings we refer to the difference in headline costs between the current system and our proposed system.

130. Headline increases are slightly lower than a third of the difference between the current contribution rates and 10% as Employer NICs and pension contributions must be paid on the increased headline salary.

in real savings. As just over a third of scheme members who are currently paying into their pension are in the LGPS, this is significant, although the fact that the current LGPS employer contribution is the lowest of the major schemes means that the proportion of the nominal savings accounted for by LGPS reform is only approximately 30% of the total.[131]

Reforms to the unfunded schemes, however, create real short-term costs – due to the need to invest the remaining 10% employer contribution into a pension fund rather than returning it to the Treasury, despite the fact that in the long-term these reforms will significantly reduce public sector liabilities.

Table 11 shows both the nominal savings and the real pressures on cash flow.[132]

Table 11: Costs of current and reformed public sector pension schemes

	LGPS	Unfunded Schemes[133]	Total
Members currently paying in	2.1 million	3.3 million	5. 4 million
Employer contribution rate	21.1% average contribution	23.7% – 35.3%	N/A
Current System			
Headline cost of public sector pensions	£17 billion	£34 billion	£51 billion
Paid for via public sector spending	£17 billion	0	£17 billion
Reformed system			
Headline cost of public sector pensions	£8 billion	£10 billion	£19 billion
Salary uplifts	£3 billion	£8 billion	£11 billion
Total nominal costs	£11 billion	£18 billion	£30 billion
Paid for via public sector spending	£11 billion	£18 billion	£30 billion

Note: Figures and totals may not sum precisely due to rounding

In the current system, there is a £34 billion gap between the nominal cost of the system and what is paid for out of current public spending. This gap is generating liabilities, in the form of unfunded public sector pension schemes, that represent a future demand on public sector spending.

The reforms eliminate this gap, and therefore any new future liabilities, by simultaneously:

(a.) Significantly decreasing the headline cost of the system by £20

131. The total mentioned here includes the armed forces.
132. The figures given in Table 11 are estimates based on data for employer contributions and public sector salaries, amongst other figures.
133. Excluding the Armed Forces Pension Scheme which is not in scope of the reforms

billion annually, from £51 billion to £30 billion.

(b.) Crystallising the costs of the system, by creating funded pension pots out of which future liabilities will be met – thereby increasing public sector spending by £12 billion.

4.7 Green Subsidies

Successive Governments have introduced a number of subsidies for the purpose of lowering carbon emissions and thereby helping the United Kingdom in reaching its ambitions towards Net Zero. They have approached this task by providing incentives to both households and firms to become more energy efficient. The UK Government has also sought to offset some of the costs associated with this while also supporting the development and construction of renewable energy infrastructure.

Many of the costs associated with these subsidies are funded by energy companies but the incidence tends to fall on households and firms in other industries in the form of higher energy bills. Other subsidies are provided directly by the Government and funded through taxation and public borrowing. This section shall discuss both.

However, this paper is primarily concerned with public expenditure. As such, the primary focus of this section will be on schemes which are directly funded by the Government and so only these figures will be considered in the final costing table.

Nevertheless, the impact of the schemes where costs fall upon business and consumers is also significant. Although they do not show up in the Government's expenditure figures, they are still economically damaging. They impose costs on both firms and households in the form of higher energy bills and compliance costs.

Indirect costs

The Balancing Services Use of System (BSUoS) and the Transmission Network Use of System (TNUoS) are costs associated with managing the energy grid to accommodate renewable energy sources such as solar and wind power. This includes grid balancing costs such as managing the variability of supply and also transmission network costs such as funding grid expansion to connect renewable energy projects such as offshore windfarms.

The Renewables Obligation requires electricity providers to source a proportion of their electricity from renewable sources, evidenced by Renewables Obligation Certificates. Although the scheme is now closed to new entrants, it continues to support existing projects and will continue to do so.[134]

In 2010 the Government introduced the Feed-in-Tariff (FiT) scheme which was designed to provide support for small-scale renewable energy projects. Although costs are expected to decrease as contracts expire over the coming decade, the total cost of the scheme is estimated to be approximately £1.86 billion and paid by energy companies.[135]

134. OFGEM, 'Renewables Obligation Annual Report', March 2024, link

135. Ofgem, 'Feed-in Tariffs Annual Report', December 2024, link

As this scheme involves contracts with firms which have been agreed, it would be inappropriate for the Government to cancel them. As such – and because it is an indirect cost – this is not included within the table of potential savings. However, it does demonstrate the costs associated with the push towards Net Zero.

Direct costs

The creation and operation of Great British Energy will cost approximately £8.3 billion over the course of the current Parliament.[136] This means that, adjusting for inflation, abolishing Great British Energy would save approximately £1.7 billion a year over the course of this Parliament.

The Government provides subsidies for electric vehicles. For example, it has established a package worth £4.5 billion over five years. This includes the £650 million Electric Car Grant which enables buyers to obtain up to £3,750 off the price of a new electric car up to a purchase price of £37,000. It also includes £63 million for an EV charger roll-out programme.[137]

Subsidies for EVs are controversial. Not only do they impose costs on taxpayers, but they are open to legal challenges from other countries and also act as an incentive to other countries to offer subsidies to their own automobile industries.[138] The Government should abolish these subsidies and in doing so save approximately £0.9 billion each year.

There is also a direct subsidy for the upgrading of boilers. The Boiler Upgrade Scheme covers part of the cost for households switching their boiler from one which utilises fossil fuels to a biomass boiler or a heat pump. The annual cost of this is £295 million.[139]

The Government has implemented the Public Sector Decarbonisation Scheme. The rationale behind this programme is to assist public sector organisations to reduce their carbon emissions by upgrading facilities and transitioning to cleaner energy sources. This has been estimated to cost approximately £475 million per year.[140]

The Government also provides subsidies for sustainable farming and agriculture. It has recently committed £5 billion over two years to the Sustainable Farming Incentive. The programme works by providing subsidies to farmers to incentivise them to adopt sustainable farming practices that benefit the environment.[141] The scheme is now closed to new applicants and there is uncertainty as to what the Government will do in the future.

Assuming that the Government spends a similar amount of approximately £2.5 billion each year, this would represent a very generous cash transfer from the Government to farmers, many of whom have significant amounts of wealth. Moreover, many of the farms are unprofitable and would probably be unable to continue operating without taxpayer funded support.[142]

Furthermore, agricultural subsidies – even when they are designed to achieve a socially beneficial aim – are distortionary. They divert resources from more productive areas of the economy towards the agricultural sector while shielding farmers from competition and thus removing

136. UK Government, 'Great British Energy legislation passes through Parliament', May 2025, link
137. UK Government, Discount of up to £3,750 on electric cars set to slash costs for thousands', July 2025, link
138. OECD, 'How subsidies shape global car and EV production', February 2025, link
139. Ofgem, 'Boiler Upgrade Scheme', link
140. Department for Energy Security & Net Zero, 'Public Sector Decarbonisation Scheme', April 2023, link
141. Defra, 'An update on the Sustainable Farming Initiative', March 2025, link
142. Gittins, P., 'Supporting UK farmers towards net-zero agriculture', Leeds University Business School, August 2023, link

the incentive to innovate.[143] There is also evidence to suggest that they undermine their stated aim by causing greater environmental damage.[144]

The UK Government should follow the example of countries such as Australia and New Zealand which eliminated the vast majority of their agricultural subsidies. These countries demonstrate that it is possible to remove a significant proportion of financial support for the agricultural industry while maintaining a thriving farming sector.[145] The UK Government should gradually reduce these subsidies and commit to only spending approximately 0.1 billion per annum from 2030.

In this section we have seen that the UK Government provides subsidies in order to promote the renewable energy industry. It is important that the Government does take the risks posed by climate change seriously. Moreover, it would be wrong of the Government to abolish some of the schemes as that would involve it reneging on its contractual obligations to firms.

However, the current plethora of subsidies represents a significant proportion of Government spending which is placing a substantial burden on households and firms either through the tax system or higher bills. Reducing and abolishing a number of these subsidies would achieve an annual saving of approximately £5.8 billion by 2030.

Table 12: Savings from green subsidies

Annual Savings, £ billion Year	2026	2027	2028	2029	2030
Abolition of Great British Energy	1.7	1.7	1.7	1.8	1.8
Abolition of EV Subsidies	0.9	0.9	0.9	1.0	1.0
Abolition of the Boiler Upgrade Scheme	0.3	0.3	0.3	0.3	0.3
Abolition of the Public Sector Decarbonisation Scheme	0.5	0.5	0.5	0.5	0.5
Abolition of Agricultural Subsidies	0.0	1.2	1.5	2.0	2.4
Total Annual Savings	**3.3**	**4.6**	**5.0**	**5.5**	**6.0**

4.8 International Development

In February 2025, Prime Minister Sir Keir Starmer announced that international development spending would reduce to 0.3% of GNI, in order to pay for increased spending on national defence. Speaking to Parliament, the Prime Minister said:

> *"This investment means that the UK will strengthen its position as a leader in NATO and in the collective defence of our continent, and we should welcome that role. It is good for our national security. It is also good for this Government's defining mission to restore growth to our economy, and we should be optimistic*

143. World Bank, 'Unfair Advantage: Distortive Subsidies and Their Effect on Global Trade', 2023, link
144. International Expert Group on Environmentally Harmful Agricultural Subsidies', 'Identifying Environmentally Harmful Agricultural Subsidies at the International Level', June 2025, link
145. Greenville, J., 'Analysis of government support for Australian agricultural producers', *Australian Government*, May 2020, link

about what it can deliver in those terms. But, in the short term, it can only be funded through hard choices. In this case, that means we will cut our spending on development assistance, moving from 0.5% of GNI today to 0.3% in 2027, fully funding our increased investment in defence.

I want to be clear to the House that this is not an announcement that I am happy to make. I am proud of our pioneering record on overseas development, and we will continue to play a key humanitarian role in Sudan, Ukraine and Gaza, tackling climate change and supporting multinational efforts on global health and challenges like vaccination. In recent years, the development budget was redirected towards asylum backlogs, paying for hotels, so as we are clearing that backlog at a record pace, there are efficiencies that will reduce the need to cut spending on our overseas programmes. None the less, it remains a cut, and I will not pretend otherwise. We will do everything we can to return to a world where that is not the case and to rebuild a capability on development. But at times like this, the defence and security of the British people must always come first. That is the No. 1 priority of this Government."[146]

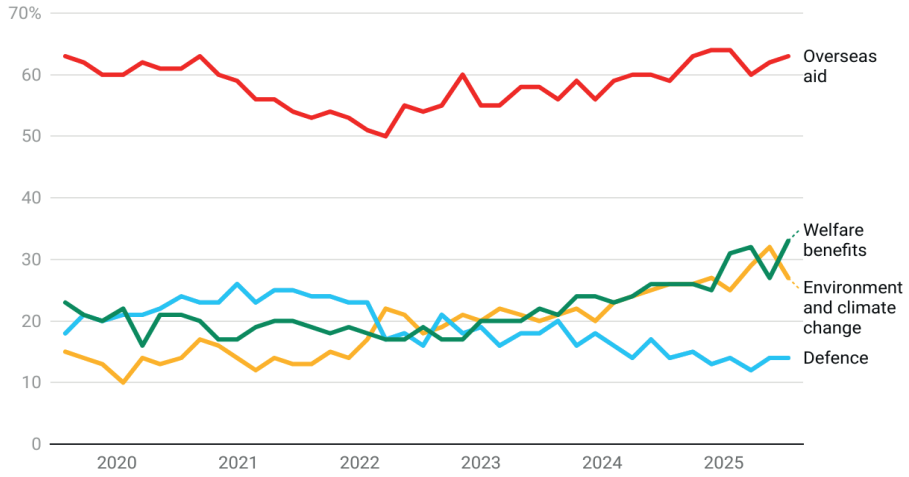
The Chancellor's Spring Statement went on to say:

"The increase in defence spending will be funded by reducing ODA from 0.5% to 0.3% of Gross National Income (GNI) by 2027, and reinvesting it into defence. This difficult choice reflects the evolving nature of the threat and the strategic shift required to meet it while maintaining economic stability, a core foundation of the Plan for Change."[147]

The Government was correct to make the decision it did. The defence and security of the British people must always come first. The case for state spending on most international development is, at the best of times, debatable. There is no obvious market failure, no coordination problem that requires the intervention of Government for it to be overcome,[148] and the public consistently identifies overseas aid as the pre-eminent area in which the Government is spending too much. See Figure 12.[149]

146. Hansard, 26 February 2025, Link
147. Spring Statement, 2025, Link
148. With a small number of exceptions, such as countering the Ebola outbreak from 2014 – 2016.
149. YouGov, 2025, Link

Figure 12: What sector is the UK government spending too much on?



Source: YouGov. Full question: And if the government were to cut the amount of money it currently spends, which of the following areas do you think the government should REDUCE spending in the most? Please tick up to three.

Since the Government made its decision, the UK's economic situation has deteriorated further. Following the move by the United States to impose tariffs on almost all countries, including the UK, the IMF has significantly downgraded global growth projections, including downgrading that of the UK from 1.6% to 1.1%.[150] UK annual borrowing exceeded forecasts by almost £15 billion.[151] The Government will need to make further savings simply to maintain the fiscal situation that was believed to exist at the time it announced the reductions in overseas development.

A further reduction in ODA spending to focus on only those areas where there is the clearest case for Government intervention – immediate relief after major natural disasters, or countering disease outbreaks of a global significance such as the 2014-16 Ebola outbreak – is now warranted. This would require, at most, an annual spend of 0.1% of GDP. Assuming that this future reduction followed the same trajectory as the existing cut from 0.5% to 0.3%, the potential savings are set out in Table 13 below.

Table 13: Savings from international development

Annual Savings, £ billion Year	2026	2027	2028	2029	2030
Lowering ODA spending to 0.1% of GNI	4.8	6.5	6.5	6.8	6.9

4.9 Universal Infant Free School Meals

The provision of free school meals to children who require them has a lengthy history and has been carried out, in one form or another, since the Education Act of 1944.[152] The objectives are generally considered to include the reduction of inequality, support for children in poverty, and improving the educational attainment of children who might otherwise

150. International Monetary Fund, 2025, Link
151. Public sector finances, Office for National Statistics, 2025, Link
152. Food poverty: Households, food banks and free school meals, House of Commons Library, 2024, Link

be hungry during the school day.

Free school meals are available for children whose parents are in receipt of a number of benefits such as Universal Credit (subject to an earned income threshold), or who were in receipt of such a benefit while the child was still in their current phase of education. [153] Currently, 24.6% of pupils are eligible to receive free school meals.[154] The full eligibility criteria published by the Department for Education are set out in the screenshot below.[155]

Who is eligible for free school meals?

Free school meals are available to pupils in receipt of, or whose parents are in receipt of, one or more of the following benefits:

- Universal Credit (provided you have an annual net earned income of no more than £7,400, as assessed by earnings from up to three of your most recent assessment periods)
- Income Support
- Income-based Jobseeker's Allowance
- Income-related Employment and Support Allowance
- Support under Part VI of the Immigration and Asylum Act 1999
- The guarantee element of Pension Credit
- Child Tax Credit (provided you're not also entitled to Working Tax Credit and have an annual gross income of no more than £16,190)
- Working Tax Credit run-on – paid for four weeks after you stop qualifying for Working Tax Credit

In addition, the following pupils will be protected against losing their free school meals as follows:

- Since 1 April 2018, all existing free school meals claimants have continued to receive free school meals whilst Universal Credit is rolled out. This applies even if their earnings rise above the threshold during that time.
- In addition, any pupil gaining eligibility for free school meals after 1 April 2018 will be protected against losing free school meals until March 2025.
- After March 2025, any existing claimants that no longer meet the eligibility criteria at that point (because they are earning above the threshold or are no longer a recipient of Universal Credit) will continue to receive free school meals until the end of their current phase of education (i.e. primary or secondary).

A pupil is only eligible to receive a free school meal when a claim for the meal has been made on their behalf and their eligibility, or protected status, has been verified by the school where they are enrolled or by the local authority.

Universal Infant Free School Meals, by contrast, are a more recent innovation, announced by then Deputy Prime Minister Nick Clegg in 2013[156] and brought into effect by the Children and Families Act 2014.[157] The policy requires all state schools to provide a free lunch to every child in Reception, Year 1 or Year 2, regardless of their parents' income.

The Department for Education provides schools with £2.58 per meal per eligible child, based on 190 meals per year, for a total of £490.20 per eligible child per year. The rate is due to increase to £2.61 per meal

153. Note that in London, all primary school children receive free school meals, with the additional costs of this policy being met out of London's devolved budget.
154. Schools, pupils and their characteristics, Department for Education, 2024, Link
155. Free School Meals, Department for Education, 2024, Link
156. Free school lunch for every child in infant school, Deputy Prime Minister's Office, 2013, Link
157. Children and Families Act 2014, legislation.gov.uk, Link

in September 2025.[158] In 2023-24, there were 1.6 million pupils eligible to receive Universal Infant Free School Meals,[159] giving a total cost to the taxpayer of approximately £780 million a year.

It is unclear why the taxpayer should pay for the lunches of children from medium or high income families – or why there should be an inconsistency between the eligibility for infants and eligibility for children throughout the rest of the school system. Aligning the eligibility for infant free school meals with the eligibility in the rest of the school system would allow the Government to realise savings while continuing to support poorer children who require a free meal to be provided.

The Department for Education sets out that 1.3 million of the 1.6 million pupils currently in receipt of Universal Infant Free School Meals would not normally be eligible for free school meals under the standard criteria.[160] Aligning eligibility and ending the universal entitlement would therefore save approximately £640 million.

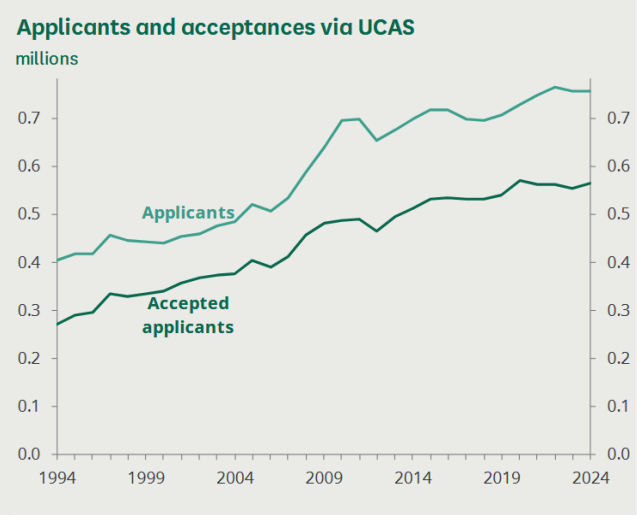
Table 14: Savings from free school meals

Annual Savings, £ billion Year	2026	2027	2028	2029	2030
Aligning eligibility for infant free school meals in line with school system	0.7	0.7	0.7	0.7	0.7

4.10 Post-18 Education

UK undergraduate numbers have steadily increased this century. This has enjoyed cross-party support, from John Major's decision to convert the polytechnics to universities, through Tony Blair's decision to set a target to send 50% of young people to higher education, and culminating in the Coalition Government's decision to remove controls on student numbers in 2014.

Figure 13: Applicants and acceptances via UCAS[161]



Source: End of cycle data resources 2024 (and earlier), UCAS

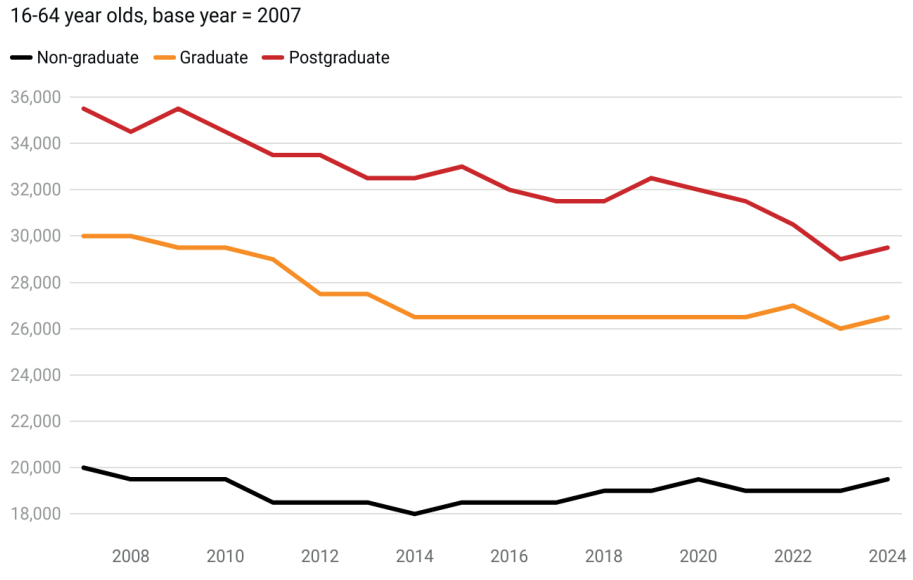
158. Department for Education Update, April 2025, Link
159. Schools, pupils and their characteristics, Department for Education, 2024, Link
160. Ibid.
161. House of Commons Library, 'Higher education student numbers' (March 2025), Link.

Despite this, over a third (36%) of graduates are overqualified for their role,[162] and repeated studies have found that approximately a third of graduates are in 'non-graduate' jobs.[163] Looking at the most recent Graduate Outcomes data, which assesses graduate outcomes 15 months after graduation, only 59% of graduates are in full time work, and only 68% of graduates were in either highly skilled employment (full or part time) or further study.[164]

Whereas historically, people would enter careers such as social work, journalism, banking, the police force or being a paramedic without a degree, either directly after leaving school or following a further education course in a local college, these roles are becoming - either as a direct requirement or by changing norms - increasingly dominated by graduates.

The lifetime graduate premium – the amount that graduates can expect to be better off over their lifetimes, after accounting for student loan repayments and other costs, as a result of going to university – has been steadily declining. (See Figure 14.) At least one in five graduates (15% of women, 25% of men) would have been better off had they not gone to university – and this is very likely to be an underestimate, as the cohort upon which this study was conducted entered university over fifteen years ago, when significantly fewer people went and the graduate premium was higher. [165] A recent report has suggested that the falling premium may be driven in part by the addition of large numbers of graduates with low prior academic achievement, who would not previously have gone to university and (on average) gain little or no benefit from doing so.[166]

Figure 14: Real median salaries by graduate type (£), 2007-2024



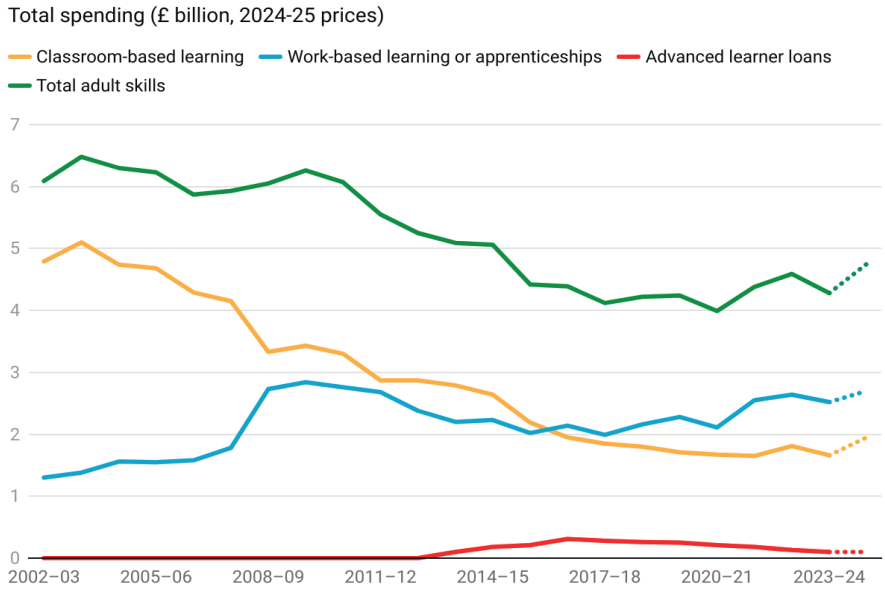
Source: Gov.uk, Graduate labour market statistics

The decision to focus so relentlessly on higher education has led to a major reduction in the funding and places available for further education, as Figure 15 demonstrates[167], as well as failing to provide employers with the skills they need, with over three quarters reporting skill shortages as a

162. Growing proportion of UK graduates ending up in low-skilled jobs, where they experience lower levels of job and life satisfaction, CIPD, 2022, Link
163. A survey of the evidence can be found in the Review of Post-18 Education and Funding (2019), Link
164. Graduate Outcomes Data, HESA, 2025, Link
165. The impact of undergraduate degrees on lifetime earnings, IFS, 2020, Link
166. Mass HE is not working, Paul Wiltshire, 2025, Link
167. Chart taken from Adult Education and Skills, IFS, 2025, Link

significant problem.[168]

Figure 15: Public spending on adult education and skills (actual and projected for 2024-2025)



Source: IFS, Adult education and skills: https://ifs.org.uk/education-spending/adult-education-and-skills

Even though the average person going to university still benefits, the benefits of the marginal additional place – to both the individual and also to the nation – are now likely to be negative. This is particularly so when one considers the opportunity costs:

- Of scarce government funds being spent on university expansion, rather than on transport infrastructure, energy generation, or other things that would increase our competitiveness and growth – or on reducing the deficit or burden of taxation.
- Of taking people out of the labour market when labour is in short supply.
- Of student indebtedness, which depresses consumption and living standards, and of which almost a third is ultimately written off, with the cost being borne by the taxpayer.

Government funds undergraduate higher education with just under £22 billion a year, £20.2 billion of which is via student loans (both fees and maintenance) and the remaining £1.6 billion is in the form of resource and capital grants issued via the Office for Students.[169,170] Not all of this funding is a long-term cost to Government, as students will pay back part of their loan. The cost of loans issued under Plan 5 (the current plan) is represented by the Resource Accounting and Budgeting (RAB) charge – the portion of the loan not currently paid back – which stands at 29%.[171] The impact of this on the public finances can be seen in OBR forecasts as the change in public sector fiscal net debt accounted for by student loans,

168. Labour shortages remain a blocker for business potential, CBI, 2023, Link
169. Student Loan Forecasts for England, Department for Education, 2025, Link
170. Guidance to the Office for Students from the Secretary of State for Education, 2024, Link
171. Forecast Resource Accounting and Budgeting (RAB) charge, by loan product, Department for Education, 2025, Link

set out in Table 6.2 of the OBR's Economic and Fiscal Outlook.[172]

There are a number of ways in which the Government could reduce spending on Higher Education. One way of doing this would be to alter the terms of existing borrowers' loans, increasing the repayment rate, reducing the repayment threshold or extending the repayment term (so that borrowers repaid for more years before the balance was written off). Adjusting the terms of existing borrowers, however, would be highly controversial, as it would involve a retrospective change to the terms on which the money was borrowed.

Alternatively, and more acceptably, it could freeze the repayment threshold (currently forecast to rise from 2026) for further years, increasing repayments from future borrowers. It could also freeze tuition fees again or, alternatively, only allow providers with high quality teaching – as demonstrated by a Teaching Excellence Framework award of Silver or Gold, or via positive outcome metrics such as low drop-out rates or progression to highly skilled employment – to raise fees in line with inflation. These options have not been costed here.

A more straightforward way would be to reduce the numbers currently attending higher education by reimposing the place controls that existed until 2014 and gradually reducing numbers, focusing upon those providers with the highest drop out rates and lowest progression to graduate employment. This would directly reduce costs while also releasing additional employees directly into the labour market.

By how much should the number of students going to higher education be reduced? While any target is somewhat arbitrary, one objective would be to reduce the Higher Education Participation Rate at aged 20 from its current historically high level of 49.1% to approximately 33.6%, the level at which it stood at the turn of the century, when the current data series begins in 2001/2 – approximately a 31% reduction in the current numbers. This would reverse the ill-conceived expansion of Higher Education begun by Tony Blair and continued under the Coalition and Conservative Governments.

This would need to be done over a number of years, to allow the sector to adjust and downsize. The Government should also reinvest some of the funding into further education and apprenticeships in order to improve the provision of the skilled workforce that UK employers need.

Table 15 shows the effects of a 6% year-on-year reduction in numbers enrolling to 2030, which would achieve the desired 30% reduction.[173] Cost savings are presented as a proportionate reduction in total outlay. In reality, the cost savings are likely to be higher than this, as it is likely to be the least able students – on weaker courses – who do not go to university under our reforms. Such students are more likely to repay less of their loans.

172. Economic and Fiscal Outlook, OBR, 2025, Link

173. Though the full savings impact would not be realised until after the end of this period, as undergraduate degrees are typically 3 years long.

Table 15: Savings from post-18 education reform

Annual Savings, £ billion (unless otherwise stated)					
Year	**2026**	**2027**	**2028**	**2029**	**2030**
Reduction in public sector fiscal net debt accounted for by student loans	10.6	11.2	11.5	11.7	12
Reduction in number of UK undergraduate students entering higher education	6%	12%	18%	24%	30%
Approximate net savings[174]	0.2	0.7	1.4	2.1	2.9
Reinvested in FE and Apprenticeships	(0.1)	(0.3)	(0.7)	(1.1)	(1.4)
Total Annual Savings	**0.1**	**0.3**	**0.7**	**1.1**	**1.4**

As Policy Exchange has previously written, when undertaking major changes to the higher education system [175]it is vital to safeguard against any upheaval resulting from these changes, including protecting the welfare of current students and securing local and regional economies against shocks.

These reforms would therefore need to be supported by a clear, government-backed merger and bankruptcy regime. [176] This could be modelled on the Higher Education Restructuring Regime which operated during the Covid-19 pandemic, or upon the Post-16 Area Review Programme that took place in further education during the 2010s.[177] As part of the significant shrinkage of Higher Education entailed by this proposal, the Department for Education would support long-term restructures and mergers of institutions, including with Further Education Colleges, to protect current students, secure efficiencies and reorientate the sector to one more focused upon national needs. Ultimately this is likely to result in the merger or closure of some institutions, with only courses offering genuine value to the UK being preserved.

4.11 Childcare

The Government spends approximately £8 billion on subsidising childcare in England[178], almost triple the amount that it spent per child 15 years ago.[179] The UK has a larger subsidy as a share of net household income than either the EU average or the OECD average.[180]

This is primarily distributed through a number of free childcare entitlements:

- A universal entitlement of 15 hours a week[181] for three and four year olds.
- An entitlement of 15 hours a week for two year olds classed as disadvantaged.
- A 30 hours a week entitlement for all working families with children between 3 and 4 years.
- From September 2025 this 30 hours a week entitlement for

175. Policy Exchange, Education not Immigration, 2025, Link
176. Department of Education, 'Establishment of a Higher Education Restructuring Regime in Respond to COVID-19', July 2020, link.
177. House of Commons Library, 'Post-16 Area Review Programme', 2018, Link
178. Early Years Funding in England, House of Commons Library, 2024, Link
179. Public spending on the early years in England, NESTA, 2025, Link
180. Better Childcare, Policy Exchange, 2022, Link
181. All entitlements of 'per week' only apply for 38 weeks of the year.
174. Assuming students are taking a three year degree.

working families is being extended to all families with children between 9 months and 4 years.[182]

Other support for childcare is delivered through schemes such as the Government's new Breakfast Clubs scheme, through the tax-free childcare scheme[183] or, for those on Universal Credit, the Universal Credit childcare scheme.[184]

There has been a major shift in support given for young children towards childcare and away from other forms of support. Children's services programmes such as Sure Start – targeted at some of the more disadvantaged children – have faced significant cuts, while funding for childcare has increased. This disproportionately benefits (a) higher earning families;[185] and (b) families where both parents work, and who thus have a greater need for childcare. According to the Institute of Fiscal Studies, the expansion of 30 hours of childcare to children aged 9 months or above – at a cost of approximately £4 billion a year – will directly benefit "just a fifth of families earning less than £20,000 a year, but 80% of those with household incomes above £45,000."[186]

Yet the repeated expansion of 'free' hours has not delivered affordable or available childcare. The Department for Education's Annual Childcare Survey found that only 40% of parents with children aged 0 – 4 said the affordability of local childcare was 'good' or 'very good', with over a third saying it was 'difficult' or 'very difficult' to meet their childcare costs.[187]

For the last twenty years, the OECD has consistently found that the UK typically comes in the top two or three (behind the US and sometimes New Zealand) for the cost of childcare.[188] Only half of local authority areas say they have sufficient places for children under 2 who need them.[189] Childcare costs have also risen much faster than inflation, growing by twice as fast as average earnings or inflation between 2010 and 2020 – despite increased government subsidy.[190] Since 2020, childcare costs have often increased faster than average wage growth.[191]

The increased costs and reduced availability – alongside increased spending – have occurred due to the highly restricted regulatory burden placed upon childcare providers. Most importantly, the UK's childcare ratios are some of the most restrictive in Europe or the Anglosphere, despite a minor loosening in 2023. In addition, while some regulations regarding safeguarding and health and safety are necessary, the overall impact of regulation imposed upon not just nurseries but childminders – including the requirement to follow a burdensome Early Years Framework and submit to Ofsted inspections – has both increased costs and driven many providers to leave the sector. Half of childminders have left the profession over the last decade.[192] The overall result of these policies is to make the supply curve of child care relatively inelastic, so subsidies principally lead to an increase in prices.

The current situation is both costly for the taxpayer and not delivering either for working parents who need to find childcare or for those parents who would prefer to spend more time at home looking after young

182. Childcare Step-by-Step, gov.uk, Link
183. Tax free childcare, gov.uk, Link
184. Universal Credit childcare costs, Gov.uk, Link
185. Though the highest earning families, those where one parent earns over £100,000, lose this benefit, creating a cliff-edge in the tax system where someone who earns £101,000 with child-care eligible children will be worse off than if they earned £99,000.
186. Spring Budget 2023, Institute for Fiscal Studies, Link
187. Childcare and early years survey of parents: 2023, Department for Education, 2024, Link
188. OECD Data, Childcare as a proportion of net household income, Link
189. Coram Survey, 2023, Link
190. The Changing Cost of Childcare, Institute for Fiscal Studies, 2022, Link
191. The cost of childcare, NESTA, Link
192. Main findings: Childcare providers and inspections as at 31 August 2022, Ofsted, Updated 2023, Link

children. The Department for Education's Childcare and Early Years Survey of parents found that:

- 64% of working mothers[193] in families with children aged 0 to 4 years said that if they could afford it, they would work fewer hours so they could spend more time with their children.
- This includes 35% of working mothers of children aged 0-4 who wished they could give up work entirely; BUT
- 54% of *non-working* mothers of children aged 0-4 would like to start work, if only they had affordable childcare.

The system isn't delivering for either those who wish to work or those who wish to stay at home.

Rather than continuing to subsidise demand, the Government should reform the system, creating greater flexibility for parents and reducing the restrictions on childcare providers, allowing them to operate more flexibly and with less bureaucracy – without compromising safeguarding. Rather than the Government setting the price for 80% of the sector, a system of vouchers would allow parents to choose whether they wished to purchase more hours, at a lower rate, or to use them to support access to higher cost provision. Vouchers could also provide greater flexibility to reimburse family members providing childcare provision.

While there is a case for the universal provision of 15 hours of childcare for 3-4 year olds, for educational reasons, the Government should step back from the recently introduced 30 hour entitlement, which disproportionately benefits high earners. This would save approximately £5 billion annually. It should also reinvest some of the savings into a 'Sure Start' style programme focused on the vulnerable and disadvantaged.

In particular, the Government should:

- Align childcare ratios with those in France, increasing flexibility for childcare providers who wish to take advantage of them.[194]
- Remove regulatory requirements on childcare providers with the exception of those that relate to safeguarding and child protection.
- End Ofsted inspection of childminders – though childminders would continue to be required to have a Disclosure and Barring Service (DBC) check.
- Ofsted inspection of nurseries would be limited to inspecting safeguarding provisions.
- End the current system of free childcare entitlements, instead replacing it with a series of vouchers, that could be spent on any childcare provider, or with relatives who are providing childcare:
  - A universal entitlement for parents of 3 and 4 year olds, the total allocation equal in value to current spending on the current 15 hours per week entitlement for 3 and 4 year olds.
  - An entitlement for parents of disadvantaged 2 year olds, defined in the same way as the former entitlement for disadvantaged

193. The survey only asked the question of mothers.

194. The childcare ratios in France are 1:5 for 0-1 year olds, 1:8 for 2 year olds and no restrictions for 3-4 year olds.

2 year olds, the total allocation equal in value to current spending on the current 15 hours per week entitlement for disadvantaged 2-year-olds.

- Invest an additional £1 billion annually into 'Sure Start' style children's services, targeted at the vulnerable and disadvantaged.

Table 16: Savings from childcare

Annual Savings, £ billion[195]					
Year	**2026**	**2027**	**2028**	**2029**	**2030**
Abolish the current childcare system	8.8	9.0	9.1	9.3	9.5
Introduce universal vouchers for 3 and 4 year olds	(2.8)	(2.8)	(2.9)	(2.9)	(3.0)
Introduce vouchers for disadvantaged two-year olds	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)
New 'Sure Start' programme	(1.0)	(1.0)	(1.0)	(1.1)	(1.1)
Total Annual Savings	**4.4**	**4.5**	**4.6**	**4.7**	**4.8**

4.12 SEND

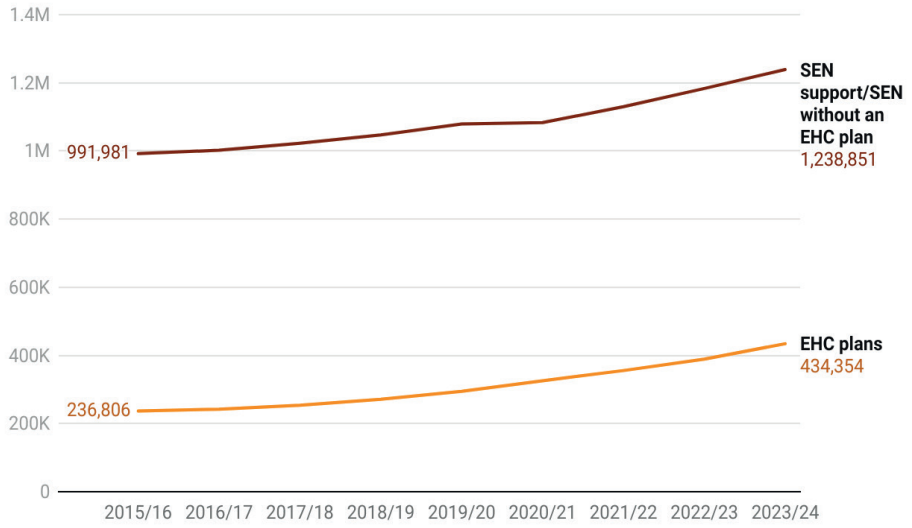
Special Educational Needs and Disabilities (SEND) is the term used in England for children and young people under the age of 25 who have a disability or '*a significantly greater difficulty in learning than the majority of others of the same age*'.[196] England's SEND system exists to provide additional support to these children so that they can access education and make progress comparable with their peers.

The number of children defined as requiring SEND Support increased by almost 25% over the nine-year period from 2015 to 2024. In the same period the number of children with SEND with severe needs who have Education, Health and Care Plans (EHCPs) has increased by 83%. EHCPs set out an individual entitlement to specific SEND provision which local authorities have a statutory obligation to provide. Over 1.6 million pupils in England are now diagnosed as having SEND, equivalent to almost one in five children in English schools. The growing level of SEND diagnosis has created significant pressure on the education and wider SEND system.

196. Special educational needs and disability code of practice: 0 to 25 years- Statutory Guidance, January 2015, Link.

195. Figures for the different components of childcare spending taken from Early years funding in England, House of Commons Library, 2025, Link and adjusted for inflation.

Figure 16: Number of SEND students in England with SEND support needs and EHCPs over time[197]



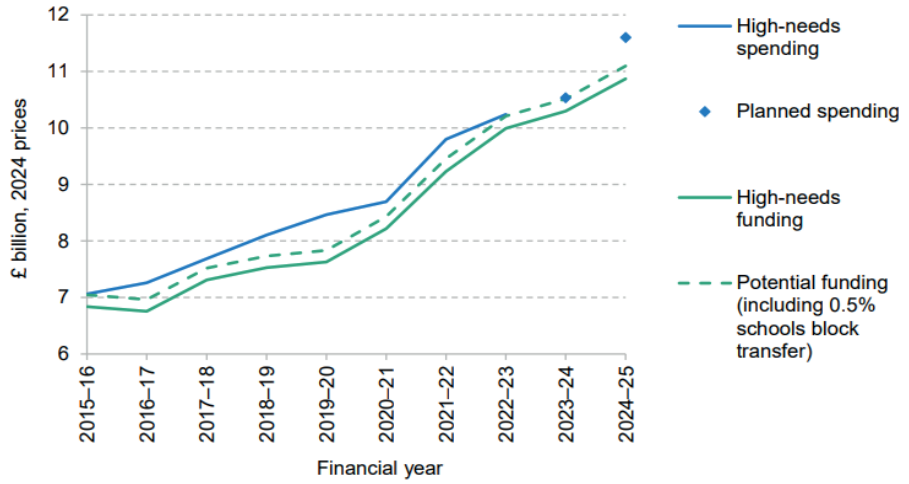
Source: Education statistics, gov.uk: https://explore-education-statistics.service.gov.uk/data-tables/special-educational-needs-in-england/2023-24?subjectId=cf208578-2aa2-43d5-7f09-08dc74d49ccd

Schools in England receive grant funding per pupil and also a notional SEND budget, which is calculated using an algorithm. From this, schools are expected to fund support for children with milder needs, known as SEND Support. Local authorities also receive 'higher needs block' funding from the government to support higher level and more costly needs. Most of this funding is spent on children with EHCPs, as under the Children and Families Act 2014 local authorities have a statutory duty to cover the cost of these plans, which are uncapped, although schools must fund the first £6000 of support.[198]

As the number of children with EHCPs has risen, the pressure of uncapped costs has dramatically increased SEND spending by local authorities. Between 2014/15 and 2024/25 SEND spending by local authorities increased to £10.7 billion – a real increase of 58%.[199] Yet the uncapped nature of EHCP funding means spending had outstripped funding, driving local authorities into debt. The County Councils Network estimated that almost three quarters of England's councils may have to declare bankruptcy in 2027 as a result of SEND spending.[200]

197. Special education needs in England, June 2024, Link.
198. Children and Families Act 2014, Link.
199. Support for children and young people with special educational needs, October 2024, Link.
200. Ibid.

Figure 17: High needs spending and estimated funding over time, 2024 prices[201]



In spite of this rapid increase in funding, England's SEND system performs poorly. Outcomes for those diagnosed with SEND are poor. Young people with EHCPs who turned 19 in 2015/16 were 6 percentage points more likely to have achieved Level 2 qualifications by 19 than those in the cohort that became 19 in 2022/23, despite the system spending roughly £3 billion more a year on support.[202] Evidence suggests that families and teachers have limited confidence in the SEND system. The Department for Education's 2023 SEND Review identified a '*vicious cycle*' of '*low confidence*' as one of the key challenges facing the system.[203]

Much of the support provided by England's SEND system is low quality and underpinned by limited evidence. A 2022 research report for the British Educational Research Association, found that, in schools studied, 67% of the interventions offered had no evidence to support them and 3% actually had published evidence to suggest they were ineffective.[204] A recent investigation by Schools Week, which submitted Freedom of Information requests to 25 councils in England in relation to the provision set out in Section F of SEND children's EHCPs, found several EHCPs explicitly set out entitlements to fidget toys and learning styles, despite neither approach having clear evidence of efficacy.[205]

The EHCP system and the funding it unlocks has also created escalatory incentives for SEND needs which has driven demand towards the upper end of the spectrum, increasing the overall cost of support. EHCPs often enable students to be passported into specialist settings where costs are significantly higher than in mainstream schools. Freedom of Information requests revealed that 97 councils spent more than £3.7 billion combined between 2021/22 and 2023/24 on educating children with SEND diagnoses at private schools.[206] Conversely there is not enough discretionary funding for early intervention to identify and address SEND early.

The current system is therefore both ineffective and fiscally unsustainable. England's SEND system should therefore transition from the current demand-led model, in which SEND spending is effectively

201. IFS, 'Spending on special needs: something has to change' (December 2024), Link
202. Ibid.
203. Special Educational Needs and Disabilities (SEND) and Alternative Provision (AP) Improvement Plan, March 2023, Link.
204. Pegram, J., Watkins, R. C., Hoerger, M., & Hughes, J. C. (2022). Assessing the range and evidence-base of interventions in a cluster of schools. *Review of Education*, Link.
205. Dickens J, 'Fidget spinners and learning styles: EHCPs' questionable interventions' *Schools Week*, March 2025, Link.
206. ITV News, April 2025, Link.

uncapped, to a budget-led model where schools and local authorities manage need based on the resources they have available.

To achieve this change to the current system, the Children and Families Act 2014 would need to be replaced. Schools would receive ringfenced SEND budgets from which they would be expected to meet the needs of their students. A non-statutory form of EHCP would be retained for those with the most severe needs as a means of passporting these children into special schools, but these specialist settings would now have flexibility over what provision to offer. Local authorities would be expected to cover the costs of such specialist education from a fixed budget, balancing resources based on need.

This system would empower professionals to manage resources and commission SEND provision flexibly in line with the needs they are presented with. To support good practice and prevent resources being wasted on low-quality or poorly evidenced provision, the Government should also create a new body to issue statutory guidelines on the kinds of SEND provision schools can commission, based on secure evidence and research, with tariffs and bands establishing acceptable costs. This will not only raise the quality of support that the system provides, but drive efficiency in resource use.

The new system could be phased in with a one-year initial implementation period followed by a three-year transition period to the new system. This would avoid a cliff edge in care and ensure, for example, that students with EHCPs currently studying GCSEs and A Levels would not see their support change during these vital years.

Under this system, the 'higher needs block' of SEND funding given to local authorities could be set 20% higher in real terms than local authority SEND funding in 2015 (£7.1 billion in 2025 prices). This uplift would account for increased demand for SEND since 2015 stemming from events such as the Covid-19 pandemic. SEND grants to local authorities would then be kept in line with inflation thereafter.[207]

By 2030, the first fully phased-in year of the scheme, this would mean that higher needs block funding to local authorities would equal £9.5 billion, £6.2 billion less than the £15.6 billion currently projected based on current annual growth in SEND spending by local authorities.[208]

Table 17: Savings from SEND

Annual Savings, £ billion					
Year	2026	2027	2028	2029	2030
Reformed SEND system	0.0	1.0	2.3	4.0	6.2

207. Spending on special educational needs in England: something has to change, IFS, December 2024, Link; Bank of England Inflation Calculator, Link.

208. We forecast high-needs funding by looking at historical DSG high-needs block funding figures and applying average growth figures from 2016/17 – 2024-25 (excluding 2021/22). These costings and projections are based on data from the high needs block of the Designated Schools Grant. Due to funding mechanisms within the wider SEND system it is not possible to accurately isolate or identify total expenditure by schools in England on SEND.

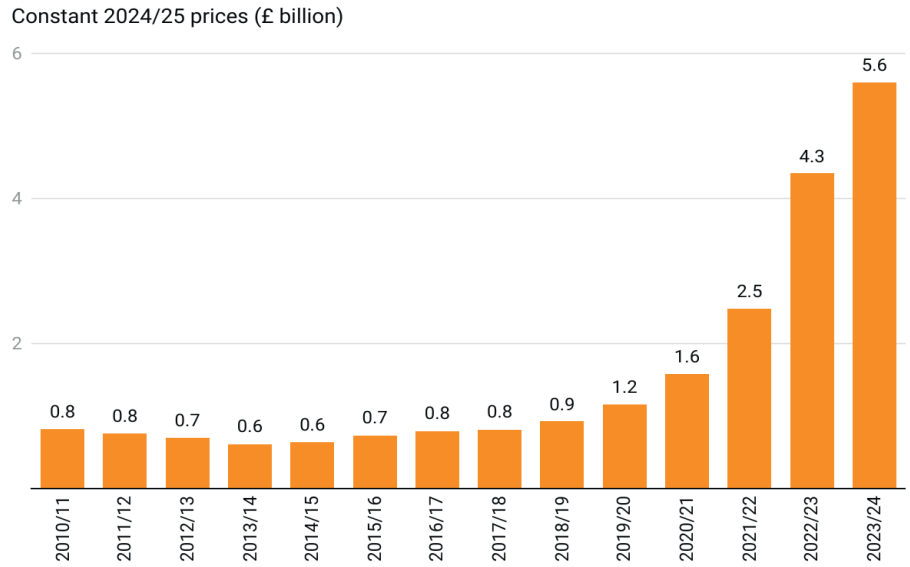
4.13 Small Boats and Asylum

Irregular migration primarily driven by potential asylum seekers is a topic which has received significant political and media attention in recent years. Successive Governments have attempted to stem the flow of irregular

migration and it is a priority of the current Government. There are also significant costs associated with the high levels of irregular migration and we will discuss these in this section.

The costs associated with dealing with irregular migration, including housing asylum seekers in hotels, providing financial assistance, and processing claims, came to approximately £5.4 billion in the 2023/24 financial year. Not only does this represent a significant cost to the public finances, but this has also increased in recent years as illustrated by the chart below. For example, the cost in the 2023/24 financial year was over twice as high as it was in 2021/22.[209]

Figure 18: Real annual cost of the UK's asylum system, 2010/11-2023/24



Source: Home Office, UK Visas and Immigration, Immigration Enforcement, Border Force and HM Passport Office, 'Immigration and protection data: Q1 2025'; HM Treasury, 'GDP deflators at market prices, and money GDP June 2025 (Quarterly National Accounts)'

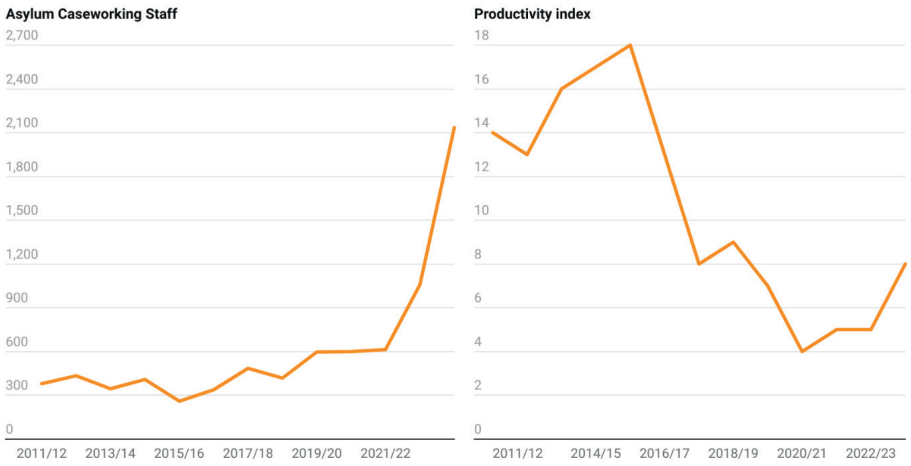
The biggest cost of the asylum system comes from housing asylum seekers in hotels. This currently stands at approximately £2.1 billion each year.[210]

Despite an increase in the number of asylum caseworkers hired by the Government, this has failed to bring down the waiting times for processing asylum claims. In fact, the productivity of asylum caseworkers decreased significantly and has only recently started to improve as illustrated by Figure 19. An increase in the asylum caseworker headcount coupled with a decrease in their productivity has exacerbated the asylum claim backlog and has so been a key driver of increased costs.[211]

209. The Migration Observatory: University of Oxford, 'The UK's asylum backlog', April 2025
210. Home Office Annual Accounts, 2025, Link
211. Cuibus, M., Walsh, P., & Sumption, M., 'The UK's Asylum Backlog', *University of Oxford*, April 2025

Figure 19: Number of asylum caseworking staff and productivity, 2011/12 – 2023/24

Productivity is measured as the average principal stages completed per month divided by the number of asylum caseworking staff

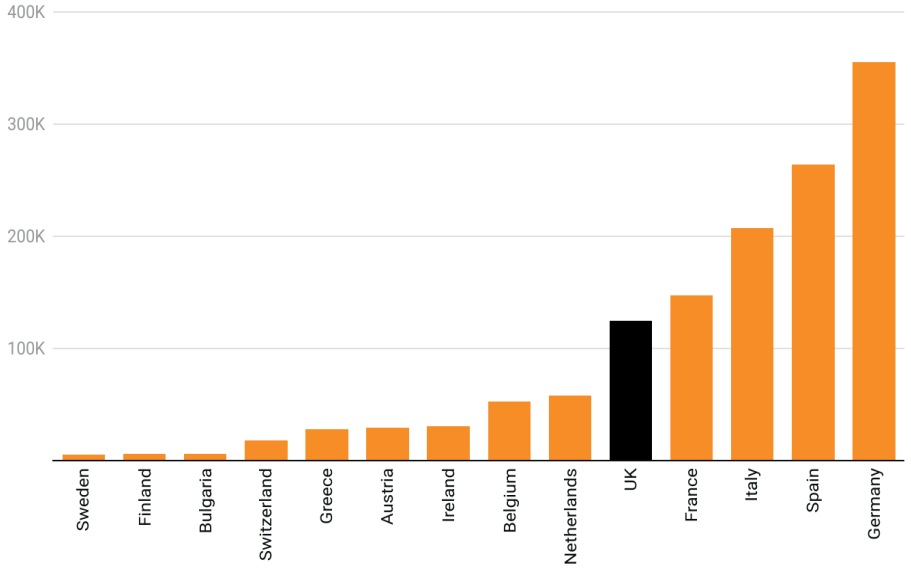


Source: Home Office, UK Visas and Immigration, Immigration Enforcement, Border Force and HM Passport Office, 'Immigration and protection data: Q1 2025'

The UK currently has the fifth largest asylum backlog in Europe with only France, Italy, Spain, and Germany being higher. Compared to the number of asylum claims it receives, the UK's asylum backlog is higher than France, Switzerland, Greece, Austria, Bulgaria, and Sweden.[212]

Figure 20: Asylum backlogs in the UK and other European countries, December 2024

Number of people awaiting an initial decision on their asylum case



Source: The Migration Observatory, The UK's asylum backlog. Data may not be directly comparable since each country's is collected by its national statistical agency.

It is clear that there are fundamental issues with the asylum system in the UK. This has brought significant costs to taxpayers which are projected to increase. While it will not be possible to completely eliminate spending on asylum, an effective system of deterrence, an end to housing asylum

212. Sturge, G., Barton, C., & Stiebahl, S., 'Asylum Statistics'. *House of Commons Library*, May 2025

seekers in hotels, and significant increases in efficiency and productivity within the asylum system workforce has the potential to bring savings of at least £3 billion each year. How to achieve this has been discussed further in a wide range of other papers by Policy Exchange, including *Stopping the Small Boats: a "Plan B."*[213]

Our savings model a linear decrease in spending to achieve the total annual savings of £3 billion in 2030.

Table 18: Savings from small boats and asylum

Annual Savings, £ billion Year	2026	2027	2028	2029	2030
Small boats and asylum savings	0.6	1.2	1.8	2.4	3

4.14 Housing Benefits

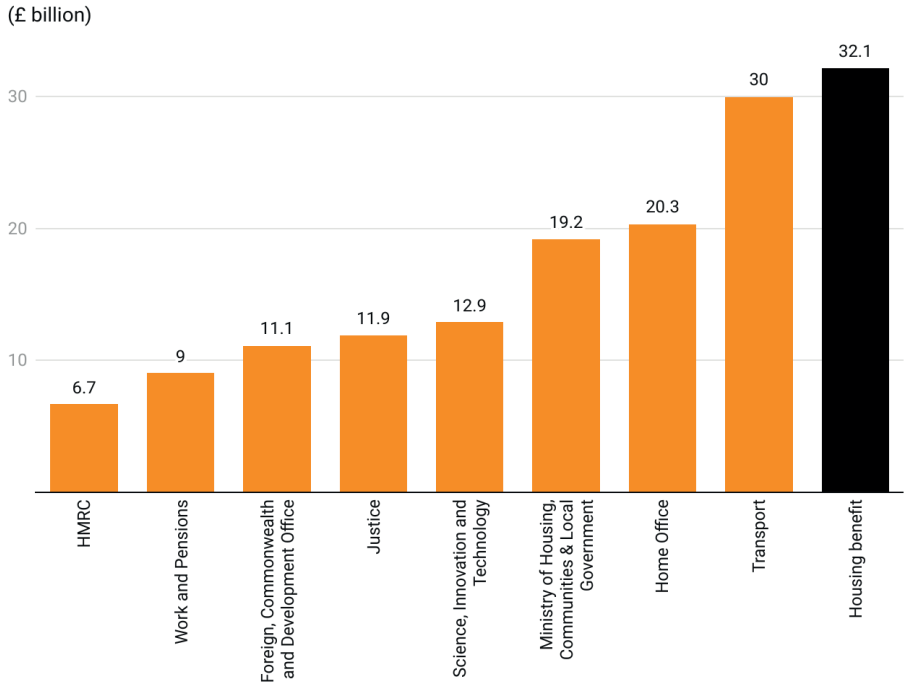
In this chapter, 'Housing Benefit' refers both to Housing Benefit, the legacy benefit, and to support for housing costs delivered through Universal Credit (the current principal means by which people of working age receive support for housing costs). Both of these provide support for people on low income to pay rent.

As the name suggests, Housing Benefit provides a subsidy to people on low incomes towards their housing costs. It is administered by local councils and can help with rent payments for both council tenants and those renting from private landlords or housing associations. The amount awarded is based on individual circumstances, including income, savings, rent, and other factors.[214]

The annual cost to the Government of Housing Benefit is approximately £30 billion. While the Government has announced plans to freeze housing benefit payments, the cost is still set to rise to £35 billion by 2028.[215] The current and projected spend on Housing Benefit is higher than the annual budgets for several Government departments and is more than is spent on the police.[216] (See Figure 21.)

213. Stopping the Small Boats: a "Plan B", Policy Exchange, 2022, Link
214. UK Government, 'Housing Benefit'
215. Seddon, P., 'Housing benefit payments to be frozen next year', *BBC*, October 2024
216. Johnson, P., 'Doubling of the housing benefit bill is sign of something deeply wrong', *IFS*, March 2019

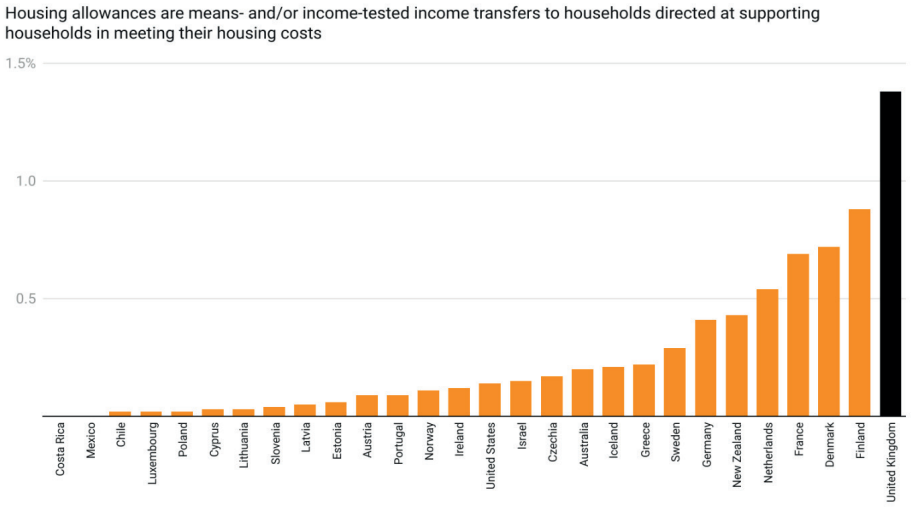
Figure 21: UK expenditure on housing benefit relative to various government departments, 2023/24



Source: Department for Work and Pensions, Benefit expenditure and caseload tables 2025; HM Treasury, Public spending statistics: February 2025

Moreover, the UK is also an international outlier in terms of the amount spent on Housing Benefit. For example, the UK spends considerably more as a proportion of GDP on subsidising the housing costs of low income households than other highly advanced economies.[217] (See Figure 22.)

Figure 22: Government expenditure on housing allowance in OECD countries (% of GDP), 2022 or latest year



Source: OECD, Affordable Housing Database

217. Zolyomi, E., & Hollan, K., 'Affordable housing for low-income families', *European Centre for Social Welfare Policy and Research*, March 2018

Despite the amount spent on Housing Benefit, there is evidence to suggest that recipients of it are still facing financial hardship due to the benefits cap and the high cost of living.[218] As such, despite being expensive, Housing Benefit is failing to adequately fulfil its function.

The reason why Housing Benefit is so expensive and is projected to increase further is largely the result of the fact that rents have increased.[219] The primary cause of this has been that supply has failed to keep up with demand due to the difficulty and increased costs associated with development as a result of the country's relatively restrictive planning system. One way in which the Housing Benefit bill could be reduced is if the planning system was liberalised and more homes were built as a result, thereby increasing supply and subsequently reducing rental prices.

However, while this would lower rents and so lead to a reduction in the size of the Housing Benefit bill, these savings would not be realised for a number of years. Other policy proposals should also be considered.

For example, geographical restrictions could be placed upon the claiming of Housing Benefit. A significant proportion of claimants live in locations where rental costs are higher than average such as in and around city centres and other areas where there is relatively high demand. The Government could insist that people would not be able to claim Housing Benefit in order to subsidise their rent in more expensive areas. For households who are already resident in an area, they would be required to move to a more affordable region of their town or city. They could be given a three month notice period in which to do so and receive assistance from their local authority to help them relocate to a more affordable area.

Further possibilities could include tightening the eligibility for housing benefit, either by restricting the ability of non-UK citizens to claim housing benefits, reducing the savings threshold required to qualify, or other such means. Alternatively, the Government could reduce the income ceiling required to qualify, or it could reduce Local Housing Allowance rates, either by freezing them, or by pegging them to a lower percentile of the typical private sector housing rents.

A reduction in spending on Housing Benefit by one third would still result in an annual saving of approximately £10 billion, demonstrating the potential gains in this area. Our savings model a linear decrease in spending to achieve the total annual savings of £10 billion in 2030 (adjusted for inflation), although in practice these could either be front-loaded or backloaded.

Table 19: Savings from housing benefits

Annual Savings, £ billion					
Year	2026	2027	2028	2029	2030
Housing benefits	2.0	4.1	6.3	8.6	11.0

218. Berry, C., 'Nowhere left to go', *Shelter*, June 2023

219. Johnson, P., 'Doubling of the housing benefit bill is sign of something deeply wrong', *IFS*, March 2019

5. Going Further?

There is a good case for going further and reducing the ratio of government spending to GDP to 30%, which would be slightly lower than Switzerland's ratio but still miles higher than Singapore's, which is at just over 15%.

In order to reduce our spending ratio to 30% of GDP, in addition to the measures outlined above, we would need to fundamentally rethink public sector spending across the whole of the economy and to reshape the state in a way that is considerably more radical than is set out in this paper.

In this paper we have examined public expenditure in Sweden, Japan, the United States, Switzerland, Singapore and Australia (see Annex C). Although there are differences between all of these countries and the UK, they are all highly advanced economies, share similar cultures and customs, and are generally regarded as open and internationalist in outlook. As such, one can at these countries in order to gauge the spectrum of potential options for the UK.

The difference between the UK and our comparator countries in regards spending on public services can, in part, be explained by political choices based upon the preferences of the electorate and the politicians elected to represent them. Japan, for example, spends 1.6% of GDP less on education as a proportion of GDP than the UK, while the United States spends 7.5% less of its Federal Budget than the UK as a proportion of GDP on social protection. Australian public spending on health is more than 1% of GDP less than the UK's, while Singapore spends considerably less cross almost all budget areas. Conversely, Sweden spends considerably more than the UK in several areas such as education (2.5%), transport (1.7%) and welfare (3.5%), but less on health (1.3%).

Switzerland's public spending as a proportion of GDP is over 13 percentage lower than that of the UK. It achieves this while still maintaining high levels of satisfaction among the public. Switzerland has one of the lowest rates of public employment as a percentage of total employment (11.2%), which is seven percentage points below the OECD average. It achieves this through its relatively decentralised system of governance which grants significant fiscal power to its various Cantons.

What can we learn from all of this? The first lesson is that public spending is about political choices. The Government can simply choose to cut spending in some areas if it chooses to and, although this may not be politically popular, it is possible to achieve.

For the UK, under a 30% scenario, questions that would need to come into consideration include the universal provision of the state pension and the more fundamental nature of our current non-contributory welfare

system. It would require a shift to a system in which welfare was a genuine safety net of last resort for those in most need, and without other options, and where the contributions of those who had put into the system were taken into account when considering what they would receive in times of hardship.

It would require a wholesale re-evaluation of the generosity of the welfare state and public services to immigrants. both illegal and legal, to move to a system where the right to come to the UK to work or study did not entail the right to access services or benefits free of charge.

Most importantly, if one looks at international comparators, there are two major areas that mark out those in which public sector spending accounts for a much lower proportion of GDP.

The first is public services, which in these countries are less likely to be wholly funded and delivered via the public sector. In the UK, this would mean a greater move to co-payments and a social insurance model, particularly in the NHS. While some public services would continue to need to be funded by taxation, these would need to become significantly more efficient, adopting the best private sector practices on staffing, accountability and delivery while deploying the latest in technologies to drive both savings and higher performance.

Secondly, it is clear from our comparator countries that the amount spent on servicing the national debt is important. While these countries all have different priorities and so make spending choices based on these, they do spend less as a proportion of GDP on debt servicing.

For the UK, cutting the amount spent on debt interest from £111 billion to, say, £20 billion would at a stroke reduce public sector spending by approximately 3% of GDP. This emphasises the fact that the savings identified in this report would help to create a virtuous cycle, in which reduced debt interest payments freed up additional funds that could be used either for tax cuts or public services.

Finally, in addition to public service reform, delivering continued falls in public spending as a share of GDP would be significantly easier if there is a return to meaningful economic growth. Productivity increases are the only sure foundation for delivering a richer society.

How this can be done is at the heart of Policy Exchange's Programme for Prosperity. As set out in the first paper in this series, *Economic Transformation: Lessons From History*[220], there is no silver bullet for this – but there are lessons we can learn from other countries, and from the UK's own history.

For the UK at the current time, this must include greater levels of investment, particularly from the private sector; wholesale reform of the sclerotic planning system, for both housing and infrastructure; a reduction in the regulatory burdens upon business; and a lower burden of taxation, particularly upon businesses and job creation – which, in turn, can only be delivered by a reduction in public sector spending.

220.Economic Transformation: Lessons from History, Policy Exchange, 2025. Link

Annex A: A Short history of British Public Spending 1800 – Present:

The 19th Century

As the OBR's historical public finances dataset shows, the government in Britain had a highly limited role in the economy through the nineteenth century.[221] The two main exceptions concerned defence expenditure and debt interest.

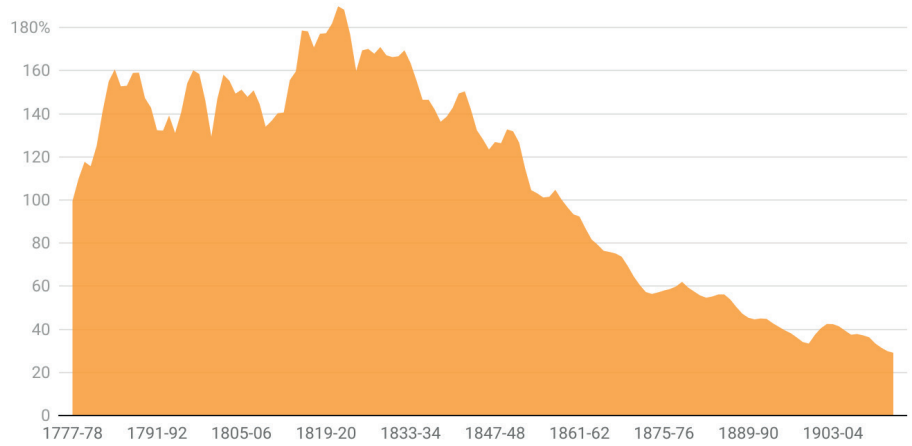
The prolonged conflict with Revolutionary and later Napoleonic France saw considerable outlays on the Royal Navy and a standing army, the size of which swelled over the course of the war. Defence spending peaked at about 15 per cent of GDP in 1797-98, before subsiding and rising sharply again to 13.7 per cent at the time of the Battle of Waterloo. Britain borrowed heavily to finance its war effort, and servicing costs rose as a result. Debt interest payments as a proportion of GDP averaged 3.2 per cent from 1700-01 to1789-90. From 1790-91 to 1843-44, they rose to an average of 5.4 per cent. Public Sector Net Debt (PSND) peaked at 190 per cent of GDP in 1821-1822.

After this point, however, the British state engaged upon a prolonged period of fiscal consolidation. Throughout the nineteenth century, and with the exception of a few spikes, public expenditure was steady at around 10 per cent of annual GDP, there was a preponderance of budget surpluses, and debt fell persistently.

The Boer War precipitated a relatively large increase in government outlays, but even then, Britain entered the twentieth century with public expenditure comprising a relatively small proportion of its economic output. In 1914, total public spending amounted to around 14 per cent of GDP, with about 6 per cent of GDP spent on defence, and a further 0.8 per cent on debt servicing. PSND itself was on a long-term downward trajectory, from around 100 per cent in the mid-1800s to around 29 per cent in 1914.

221. OBR, "300 Years of Public Finance Data", 2023. Link. All figures used in Annex A come from this source unless otherwise referenced.

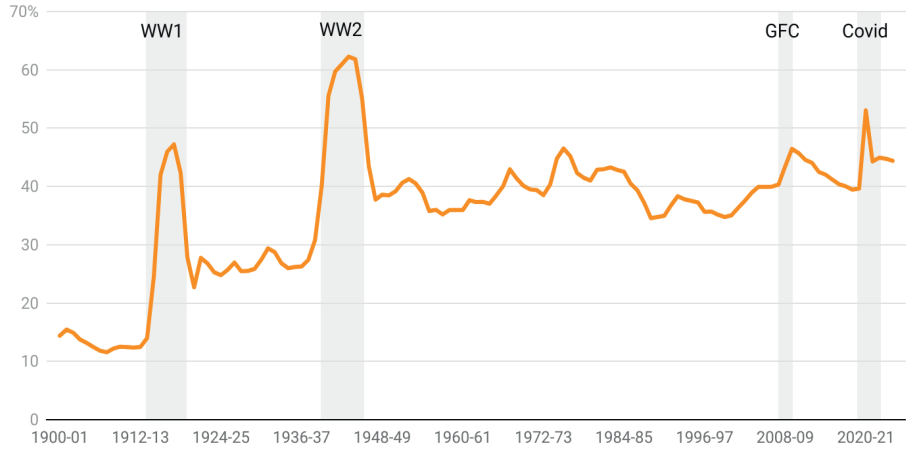
Figure 23: UK public sector net debt (% of GDP) 1777/78 – 1913/14



Source: OBR, 300 years of UK public finance data

By contrast, the fiscal story of the twentieth century is one of profound transformation, both quantitatively and qualitatively: from a state that consumed between one and two tenths of the economy, to one that consumes around a half of it, and from a government focused on providing for the defence of the realm to one heavily involved in redistribution and the provision of welfare and social security.

Figure 24: Government expenditure in the United Kingdom (% of GDP), 1900/01 – 2024/25



Source: Office for Budget Responsibility, Data

The Great War and its aftermath

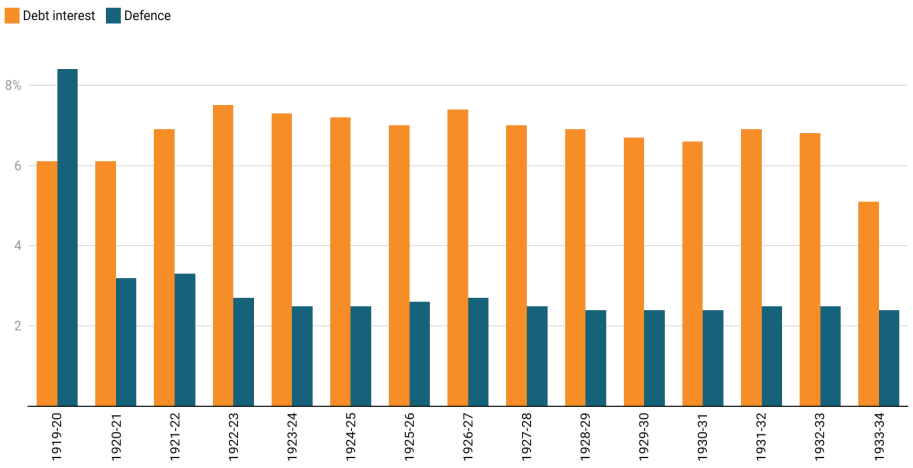
This transformation began with the Great War of 1914 to 1918. Over the course of the conflict, public spending more than tripled to about 62 per cent of annual product, almost entirely due to increases in spending on the Army and Navy. At the war's conclusion, total public expenditure did fall, but as a share of GDP remained at a permanently higher level compared to the prewar years, averaging around 25-26 per cent in the interwar years.

At least at first, the increased size of the state in the postwar economy is partly explained by the UK's subdued economic performance. Levels of output failed to return to prewar levels until around 1925, and GDP per capita did not recover until 1927.[222] Unemployment, the baleful effects of Spanish flu which killed some 200,000 people in Britain, strikes, and monetary policy decisions meant that the economy did not start meaningfully growing again until 1932, after which it expanded by around 25% up to 1939.[223]

Yet even when the economy recovered, government expenditure constituted a now higher overall proportion of total economic output. Notably, this development occurred even at a time of falling defence expenditure – which dropped to 2.5 per cent of GDP by 1923-24. The principal drivers of higher spending were debt payments, and the expanded remit of state-delivered services.

Britain's war effort during the First World War had largely been financed through borrowing, rather than tax revenues. Between 1915 and 1918, her borrowing amounted to about thirty per cent of GDP per annum, and her total stock of debt reached 185.5 per cent of GDP in 1922-23. The annual cost of servicing that debt rose appreciably. Debt interest payments averaged 7 per cent of GDP between 1919-20 and 1930-31.

Figure 25: Defence and debt interest spending in the UK (% of GDP), 1919/20 – 1933/34



Source: OBR, 300 years of UK public finance data

Even more significant, however, was the decided increase in expenditure on a range of new competencies which had been assumed by government in this period. This was driven by social legislation. In 1908, the Old Age Pensions Act provided for the first means-tested pension – administered by the Post Office, paid at five shillings a week, and with a retirement age of 70 (considerably higher than today, and with life expectancy at a lower level). The National Insurance Act of 1911 provided for statutory sick pay and healthcare costs for particular workers, as well as unemployment benefits.

222. Our World in Data, Link.

223. History of government, gov.uk, Link.; Our World in Data, Link.

The scope of these programmes expanded in the postwar period as demobilised troops returned home, often needing support with employment or disabilities. Spending on health and education increased: a Ministry of Health was established in 1919, and the 1918 Education Act raised the school leaving age to 14 and introduced compulsory part time education from 14 to 18. Although the latter proposals were postponed, the 1918 Act accelerated the shift away from a voluntary and local schooling system to a centralised and compulsory one.

These legislative developments were reflected in the fiscal numbers. After 1918, the settled size of government expenditure as a percentage of GDP was roughly double what it was in the period 1900-1914. In the fourteen years prior to the outbreak of the Great War, non-defence expenditure averaged about 70 per cent of all spending. For the period 1920-21 to 1934-35, this rose to 90 per cent.

The Second World War and the advent of the Welfare State

Public sector spending was fairly stable until 1939 at around the 25 per cent mark, with a small jump in 1930-31. Once again, however, war exercised a "ratcheting" effect on the role of the state in the economy. Defence spending increased from 5 per cent of GDP in 1937-38 to 50 per cent by 1942-43, driving overall expenditure up from 27 per cent of GDP to 61 per cent over the same period.

Postwar, Britain followed a similar pattern as it did after 1918; defence expenditure fell, even while overall government spending settled at a higher level. Debt once again soared to almost 250 per cent of the economy by the war's conclusion. Indeed, debt would be on a long term downward trajectory until the Great Financial Crisis because the economy was growing.

The size of the state in the economy was now of a different order of magnitude. Of course, the development of minimal levels of government social provision in the first quarter of the twentieth century led to a generally larger public sector than was the historical norm. But its extent remained circumscribed, with only piecemeal changes to the coverage of existing state provision. The state pension age, for example, was reduced to 65 in 1925. The reforms delivered by the Attlee Government after 1945, by contrast, fundamentally altered the nature of the state, widening and deepening its activities.

William Beveridge's famous 1942 report *Social Insurance and Allied Services* propounded a clear argument: that the state should now be involved in the care of individuals "from the cradle to the grave".[224] Beveridge envisaged a comprehensive and integrated system of social services to tackle the five principal challenges or "giants" of postwar reconstruction: want, disease, ignorance, squalour and idleness.

The state would centralise and standardise services for people's health and welfare, assuming competencies previously delivered locally and often

224.Sir William Beveridge, Social Insurance and Allied Services, Link.

voluntarily or privately, and financing them through general taxation. Labour delivered this vision through the creation of the National Health Service, universal National Insurance and sickness and unemployment benefit.

Beveridge himself had imagined a strong continued role for the voluntary and charitable sectors, but in practice, the diversity implied by non-state provision butted up against the commitment to equality held by most of the political architects of the welfare state. State-run social services have thus almost entirely replaced voluntary ones, transferring the financial burden from individuals and their savings through to the taxpayer.

From the mid-1950s to the end of the 1970s, government expenditure grew more or less consistently as a proportion of GDP, even as the economy itself expanded. Between 1955-66 and 1975-76, the share of government spending in the economy increased by almost a third from 36.5 per cent to 46.4 per cent. In that time, defence spending as a proportion of GDP fell by more than 40 per cent, while spending on health increased by 50 per cent as a proportion of GDP and social security spending rose by around 60 per cent as a proportion of GDP. Besides social service provision, the government became increasingly involved in the economy, from delivering council housing to running nationalised industries. In the 1950s, as many as one in four workers was employed by the state.[225]

Some key economic aspects of the post-war world enabled this ever-increasing share of government spending in the economy. Most importantly, for most of the period economic growth was strong and interest rates were relatively low. This enabled those countries that were saddled with high debt burdens, principally the United Kingdom and the United States, to work those debt burdens down. It also meant that other countries which didn't start with these huge debt burdens were able to increase their spending without driving up the debt ratio very much.

There was also a distinct demographic component to this ability. For most of the post-war period, most western countries enjoyed a demographic dividend, in the shape of a rise in the working population as a percentage of the total.

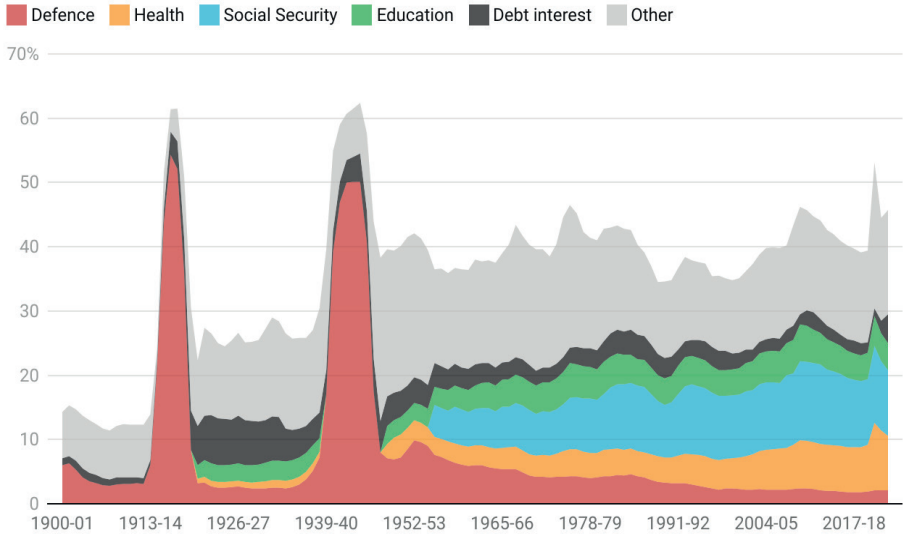
Moreover, until recently, the costs of high rates of taxation were not as obvious as they subsequently became. This is partly to do with the level of marginal tax rates but also to do with the emergence of competition from a number of low tax countries around the world. In the early post-war years this wasn't a factor, with Singapore and the Gulf States being severely under-developed. But this has now changed dramatically. These places are now super-competitive and highly attractive to millions of successful and wealthy people.

As Figure 26 below shows, the British state has been transformed over the last two hundred years into a welfare and healthcare provider of first resort, even as its traditionally significant levels of defence spending have fallen. Unfortunately, the OBR dataset on which Figure 26 is based does not itemise the components which make up "other public sector spending"

225. Public Services debate, November 1975, Hansard, Link.

(in fact, it is a residual of total spending minus the other categories). But it includes everything from social care and transport to overseas aid and housing.

Figure 26: Components of public sector spending (% of GDP), 1900/01- 2022/23



Source: OBR, 300 years of UK public finance data

The Thatcher Years and beyond

Between the late 1970s and the turn of the twentieth century, the UK managed to reverse the continual upward trajectory in public spending. Margaret Thatcher's governments of the 1980s played a critical role in effecting this change in direction, with the size of the state in the economy falling from 41.4 per cent the year she became Prime Minister to 34.5 per cent in 1988-89, a level that has not been achieved again since.

Largely, however, she did not achieve this by cash terms reductions in expenditure. Instead, she largely held public sector spending steady, while improving the growth rate of the economy. Social security was indexed to prices rather than the higher of wages or prices, slowing the rate at which it increased year on year. At the same time, a significant transfer of state-owned assets to the public - from industry to housing - was achieved, exerting a downward pressure on day-to-day expenditure on housing benefits as well as public sector wages. Public sector employment, for example, fell from 28 per cent of the workforce to 22 per cent by 1990.[226] As a result, in today's prices, total public spending increased from some £520 billion in 1979-80 to approximately £590 billion in 1990-91 – about 13 per cent over the period. The economy, however, grew by about 30 per cent.[227]

If Thatcher had a considerable impact on the relative levels of government spending, she did little to change the broader shifts initiated by the mid-century welfare reforms in the composition of that expenditure. Defence expenditure continued to fall as a share of GDP through the Thatcher

226. Long-term trends in UK employment: 1861 to 2018, ONS, Link.

227. Gross Domestic Product: chained volume measures: Seasonally adjusted £m - Office for National Statistics, Link.

years, and it was actually during her administration that spending on the NHS outstripped defence spending as a proportion of GDP. By the time she left office, the UK spent 3.2 per cent of GDP on defence, 4 per cent on health and 8.6 per cent on social security.

Major's government largely sustained the fiscal status quo secured in the 1980s. But with the election of a Labour Government in May 1997, the upward creep in government spending as a proportion of GDP recommenced, albeit with many of Thatcher's economic reforms largely left untouched. Over the Blair and Brown Governments, healthcare spending as a proportion of GDP increased from 4.6 per cent to 7.5 per cent, and social security spending increased from 10.3 per cent to 12.3 per cent. The NHS budget more than doubled in real terms over the period – from approximately £86 billion to £187 billion. Social security spending grew from £191 billion to £308 billion in today's prices.[228]

The Coalition and Conservative Governments

When the Conservatives were returned to government in 2010 at the head of a coalition with the Liberal Democrats, total public spending was roughly 46 per cent of GDP – the highest since the 1970s. But their stated aim was not a reduction in the level of public spending as such, but to tackle the deficit – which had reached over 10 per cent of GDP by 2010.[229] A concerted policy programme of fiscal retrenchment was undertaken which brought public spending down to just over 39 per cent in 2018-19. As with Thatcher's attempts at getting a grip on the size of government, the Cameron-Osborne attempts at spending control did little to alter the trajectory towards welfare and social security and away from defence spending which continued to fall as a share of GDP. Indeed, the introduction of the triple lock during the Coalition's first budget in 2010, which reversed the Thatcher Government's policy on the indexation of social security to prices, has ensured an inexorable upward shift in the generosity of the state pension.

In the last five years, three factors have led to a sizeable spike in the size of the state: firstly, the number of people applying for a range of benefits - and most significantly disability and incapacity support - has exploded since 2020; secondly, debt has increased to around 100 per cent of GDP, due to the energy crisis and public borrowing during the COVID-19 pandemic. The cost of servicing that debt has also risen.[230] Finally, the annual costs of running the NHS have risen steeply. The result is that as of 2024, over 8 per cent of GDP is now spent on healthcare, 12 per cent on social security and 4 per cent on debt servicing costs.[231] Defence spending by contrast hovers just about 2 per cent, and less than 2 per cent is spent on policing, public order and safety.

What should be clear from this brief history of the last century and a quarter of public spending is that exogenous factors have played a critical role in the changing scope and nature of government activity. Two global conflicts, economic downturns and public health crises have had a bearing on the state's involvement in the economy. Additionally, Britain's

228. OBR historic fiscal data, uprated with BoE inflation calculator.

229. UK government debt and deficit: June 2016, ONS, Link.

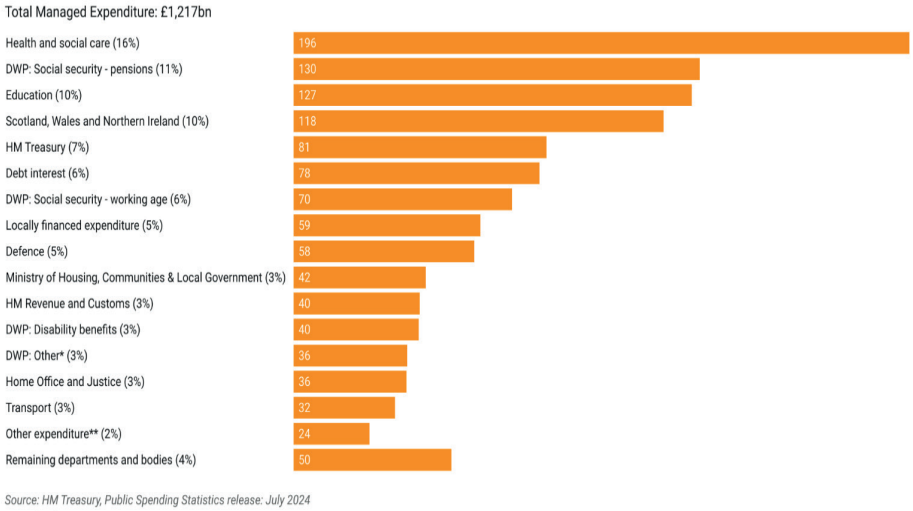
230. Debt interest, OBR, Link.

231. 'What does the government spend money on?', IFS Tax Lab, Link.

ageing population has undoubtedly placed pressure on both healthcare expenditure and the state pension.

But save for the dramatic rises in defence expenditure in the context of war, it is important to recognise that there was nothing inevitable about these trends. The permanently higher level of state spending in peacetime is largely the result of a changed consensus about the role of government in securing people "from the cradle to the grave" funded out of general taxation. And while there have been successful efforts to check the inexorable upward trend in expenditure, neither the Thatcher nor Cameron Governments successfully re-conceived the role of the state when it comes to social provision.

Figure 27: UK Government Total Managed Expenditure (TME) (£bn) (2023-2024)[232]



NB: Health and social care cost is England only. Percentages refer to the proportion of TME.

**The figure quoted for "DWP– Other" is slightly lower than in the National Audit Office report due to slight variations in the figures from different sources.*

*** Includes locally finances expenditure, depreciation, net transfers to the EU, public corporations' own-financed capital spend and accounting adjustments.*

232. Sources: HM Treasury (2024), Public Spending Statistics release: July 2024 National Audit Office (2024), An Overview of the Department for Work & Pensions for the new Parliament 2023-24

Annex B: Public Spending Reductions in Focus:

The Thatcher Years

When the Conservatives re-entered government in 1979, high levels of public spending represented a key part of their diagnosis of Britain's economic malaise. "The State takes too much of the nation's income; its share must be steadily reduced", said the 1979 Conservative Manifesto. "Public expenditure", declared a 1979 Treasury White Paper, "is at the heart of Britain's present economic difficulties". [233]

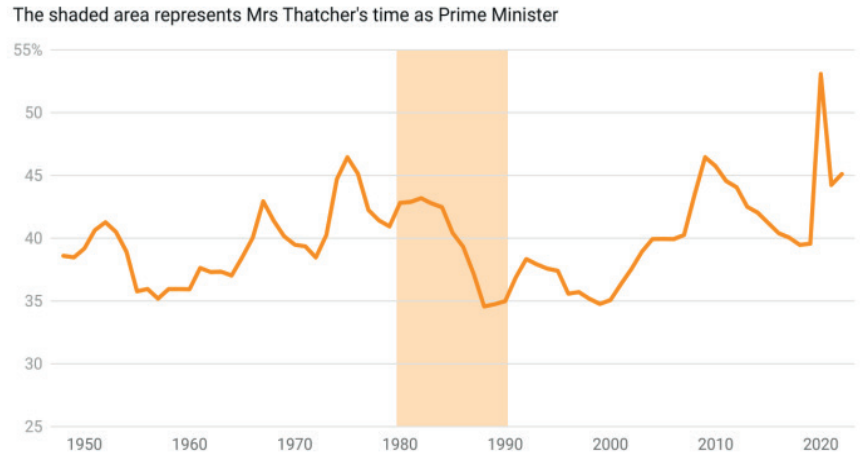
Partly, the assessment was an economic one. A vast transfer of resources, in the Thatcherite conception, had taken place from the private, wealth generating private sector of the economy to the wealth-consuming public sector. This lay behind the "British Disease" of high inflation, low productivity, and a declining share of world trade, as an expanding state crowded out private enterprise. However, there was a powerful moral dimension to the Thatcherite case too; that a bigger state implied a reduction in personal responsibility, and that expanded state provision promoted a dependency that reduced the capacity of people to thrive and prosper.[234]

Yet the evolution of Britain's fiscal position through the 1980s is complex. As can be seen in Figure 28, public spending as a proportion of GDP rose by around two percentage points in the first years of Thatcher's administration, before falling consistently from 1982-83 to 1989-90 from 43.3 per cent to 34.7 per cent. A significant part of the explanation for this is on the "denominator" side of the spending to GDP ratio: the British economy experienced recession between 1980 and 1982 but then entered a prolonged period of growth through the rest of the decade.

233. Malcom Dean, 'Margaret Thatcher's policies hit the poor hardest – and it's happening again', The Guardian, April 2013, Link.

234. See Shirley Letwin, *The Anatomy of Thatcherism*.

Figure 28: UK government expenditure (% of GDP), 1948 - 2022



Nevertheless, and as Thatcher's second Chancellor Nigel Lawson reflected in his memoirs, economic growth was "by no means the whole story", and other developed economies which experienced economic growth in the 1980s did not secure similar reductions in public spending.[235] The Thatcher governments had a clear strategy for how to reduce public spending and a sense of how to deliver those reductions tactically. In this section, a few key aspects of their reform agenda will be considered, including the rules that the Treasury introduced to hold down spending, as well as changes to specific areas of state provision.

Table 20: Composition of UK government expenditure before and after the Thatcher years (% of GDP), 1978/79 – 1989/90

Category	1978-79	1989-90	Difference
Social security	8.5%	8.2%	−0.3%
Of which pensioners	*5.0%*	*4.6%*	*−0.3%*
Of which non-pensioners	*3.5%*	*3.6%*	*0.0%*
Health	3.9%	3.9%	0.0%
Education	4.9%	4.1%	−0.8%
Defence	4.0%	3.3%	−0.7%
Public order and safety	1.4%	1.6%	0.3%
Transport	1.5%	1.2%	−0.3%
Housing and community amenities	2.6%	0.8%	−1.8%
Overseas aid	0.4%	0.2%	−0.2%
Public sector net debt interest	3.5%	2.3%	−1.2%
Total Managed Expenditure	**41.5%**	**34.7%**	**−6.8%**

Source: IFS TaxLAB, IFS spending composition sheet; OBR, Public finances databank – July 2025. TME figure comes from OBR databank.

235. Nigel Lawson, The View from Number Eleven, p.724.

Expenditure Targets and 'Funny Money'

When the Conservative entered office in 1979, they had a stated aim of reducing the deficit, then known as the Public Sector Borrowing Requirement (PSBR), from 5.25 per cent of GDP to 4.5% of GDP in its first year. This implied a £3 billion reduction in spending, but with the cuts to the higher and basic rates of income tax from 83 per cent to 60 per cent and from 33 per cent to 30 per cent respectively, the Government actually needed to find some £7 billion in overall savings. Partly this was achieved through increases in indirect taxation, but a large chunk was to be secured through spending cuts – specifically, reductions in "industrial support", asset disposals (like the sale of UK government shares in British Petroleum) and a three per cent reduction in staffing budgets.[236]

Nevertheless, even with these reductions, spending continued to rise in the first years of Thatcher's government. It was broadly accepted that any enduring change in the relative size of the state in the economy was ultimately only likely to be achieved over the medium term which meant setting out some clear measures of and objectives for the trajectory of public expenditure.

Firstly, the Government shifted from setting government spending in "volumes" to setting it in cash terms. In the case of the former, departments did not have to allow for inflation when planning their budgets; the additional cost would be automatically covered by the Treasury. From the 1981 Budget onwards, departmental budgets were agreed in cash terms, and additional funding requirements had to be justified and agreed.

More generally, in 1983 the Treasury shifted from its previous position of seeking to fund tax cuts with real spending reductions - "a policy formulation", as Lawson put it, "designed more to create a badly needed new climate than as a prosaic description of the likely outcome" – to an objective to hold the level of public spending steady as the economy grew. This was later refined to securing a slower rate of growth in public spending than GDP growth, which would result in public expenditure as a proportion of the economy falling over time.

Welfare: from universal entitlement to means-testing

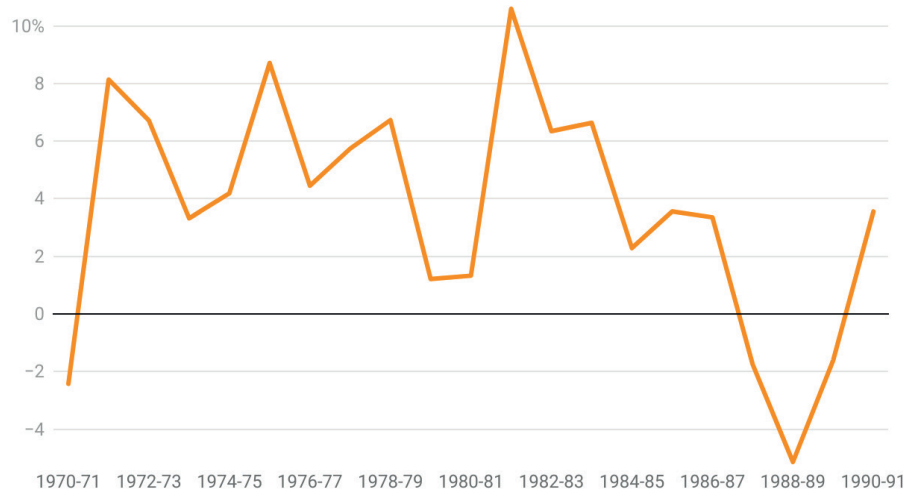
One of the practical ways in which these objectives were achieved was through a broad shift in welfare policy away from universal provision and towards targeted poverty reduction. And in this, the government was successful. For social security in the round, means tested benefits accounted for 15 per cent of spending in 1979-80. By 1995, this had increased to 30 per cent.[237]

Universal Child Benefit, for example, was frozen in real terms, while a new means-tested Family Credit was introduced which took on a greater proportion of the welfare burden over time. School meals and school milk were made means-tested benefits. The earnings-related supplement for Unemployment and Sickness Benefit was scrapped in 1980.

236. Lawson, The View from Number Eleven

237. John Hills, 'Thatcherism, New Labour and the Welfare State', LSE, August 1998, Link.

Figure 29: Real annual growth of social security expenditure, 1970/71 – 1990/91



Source: OBR, 300 years of UK public finance data; HM Treasury, GDP deflators at market prices, and money GDP June 2025 (Quarterly National Accounts)

Pensions

A number of people inside the Conservative Governments of the 1980s wanted radical reforms to the structure of pension provision – some arguing for compulsory private pension schemes, others for an increase in the retirement age (Thatcher was unsupportive), others still for the abolition of the State Earnings Related Pensions Scheme (SERPS) – a supplementary entitlement introduced by Labour in 1975 over and above the state pension. In the end, however, some significant but less transformative reforms to the existing systems of provision were agreed.

Firstly, in the 1979 Budget, Geoffrey Howe changed the formula by which the state pension was to be uprated each year. Instead of rising in line with the higher of prices or wages, the pension would henceforth simply rise in line with prices. Secondly, the generosity of SERPS entitlement was reduced from 25 per cent of someone's best ten years of earnings to 20 per cent of their lifetime earnings, and the proportion passing to a widow or widower was reduced by 50 per cent in 1985. Together, these measures helped check the growth in spending on pension-aged benefits.[238]

Housing Benefits

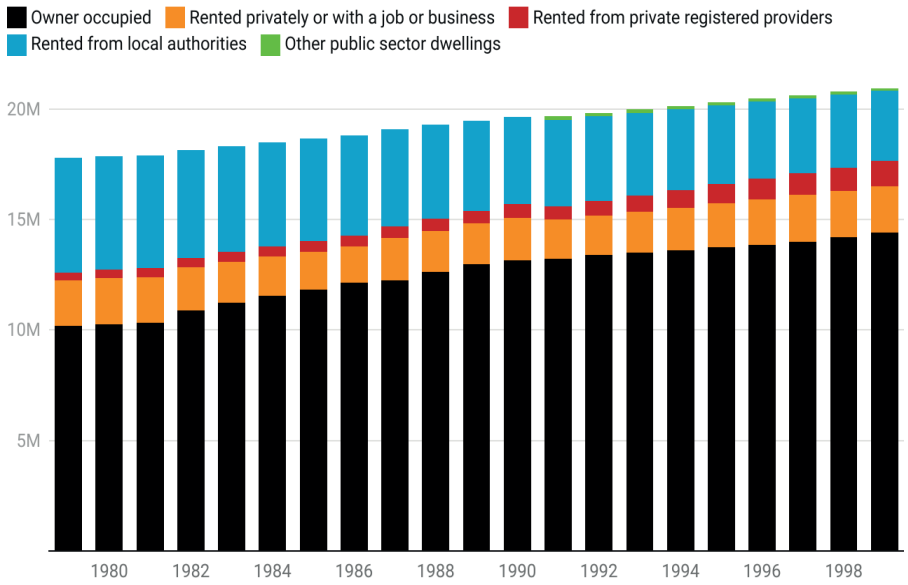
Another key area of reform was the level of state support related to housing. The Thatcher governments sought a broad shift "from bricks and mortar to people", by reducing state housebuilding, selling the considerable number of state-owned homes to their tenants, and providing for people who needed support through the means-tested Housing Benefit. As such, even though housing benefit increased, overall public spending on housing decreased, from 2.6 per cent of GDP in 1979-80 to a low of 0.7 per cent in 1988-89.[239] Key in this transition was the government's totemic Right to Buy policy. Between 1981 and 1995, around 1.7 million homes were passed into the ownership of former tenants at a discount. In 1979, 42 per

238. Lawson, Op Cit

239. Public Expenditure: Statistical Supplement to the Financial Statement and Budget Report 1994-95, Link.

cent of people lived in social housing; by 1995, 23 per cent did.[240]

Figure 30: Housing stock by tenure, 1979 - 1999



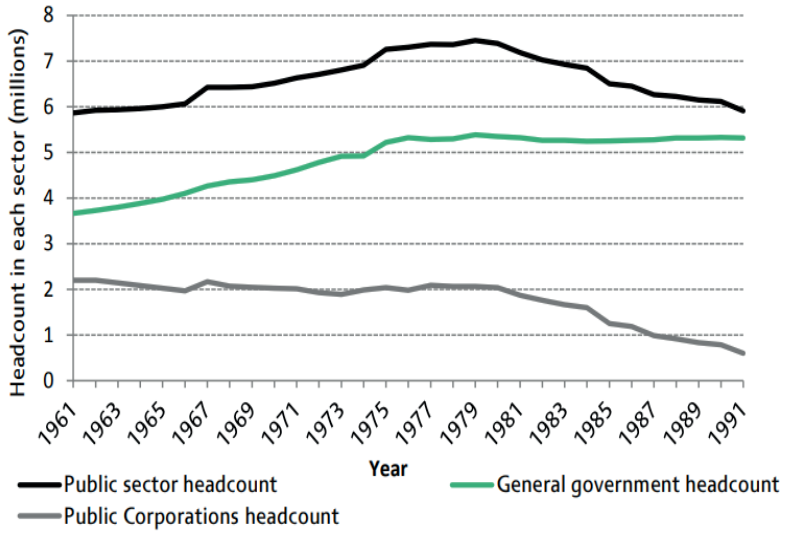
Source: Ministry of Housing, Communities and Local Government, Ministry of Housing, Communities & Local Government (2018 to 2021) and Department for Levelling Up, Housing and Communities Published 10 November 2012, 'Live tables on dwelling stock (including vacants)'

Public Sector Employment

The Thatcher administrations managed to secure reductions to the overall scale of public sector employment too. In the late 1970s, the civil service headcount stood at around 732,000; within her first four years, that number had fallen to 630,000. By 1990 it had fallen to 565,000, a reduction of over one fifth over a decade, through a mixture of privatisation (for example of government-owned laboratories) and cost savings.[241] This coincided with a wider reduction in public sector employment, as privatisation in particular had a pronounced effect on the labour market. The share of the public sector in total employment fell from 30% in 1977 to below 23% in 1991, in large part due to privatisation.[242]

240. John Hills, 'Thatcherism, New Labour and the Welfare State', LSE, August 1998, Link.
241. Staff Numbers debate, March 1990, Link.
242. Institute for Fiscal Studies, 'The public sector workforce: past, present and future' IFS Briefing Note BN145, February (2014) Link, p.7.

Figure 31: Size of the public sector workforce, 1961-91 (IFS)[243]



Source: Authors' calculations using 'Economic Trends Annual Supplement 2004', table 3.9, Office for National Statistics.
Notes: Headcount is measured at mid-year. Community Programme employees, who were in the public sector from 1983 to 1988 before being transferred from general government to the private sector in 1988Q3, are excluded. Polytechnic staff were transferred out of general government into the private sector in 1988, but are included in general government from 1989 to 1991 to remove this discontinuity. Total employment measured using ONS series MGRZ.

Countervailing trends: Defence and Health

As discussed earlier, one of the defining trends of the postwar period was the fall in defence expenditure as a proportion of the economy. This continued throughout the 1980s, dropping from 4 per cent of annual output to about 3 per cent by 1993. Again, partly these trends are explained by the denominator effect of GDP growth; defence spending increased as a proportion of the economy during the recession years at the start of the 1980s, and fell later.

But it is also explained by policy changes. In particular, a NATO pledge to increase defence spending by 3 per cent per year in real terms was dropped in the 1983 election, and came to an end in 1985-86. Additionally, changes were made to the relationship between the Treasury and Ministry of Defence. Previously, Defence had operated a "block budget", in which the Treasury could negotiate the overall envelope of funding, but not individual items of expenditure. From 1986, when George Younger replaced Michael Heseltine as Defence Secretary, discussions over the expenditure rounds were to be conducted on an item-by-item basis.[244]

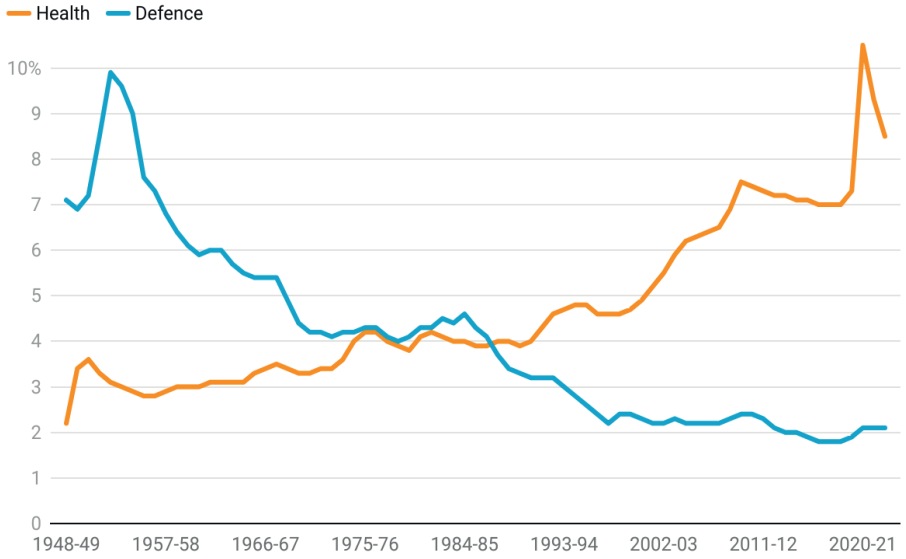
Offsetting these considerable savings, however, was a vast expansion in the expenditure on healthcare, particularly under John Major. Thatcher herself managed to hold NHS spending roughly steady as a proportion of the economy over the 1980s. Spending on the National Health Service increased in real terms by about 30 per cent between 1979 and 1990, but this was largely offset by improved economic performance. The introduction of the internal market, competitive tendering and hospital

243. Institute for Fiscal Studies, 'The public sector workforce: past, present and future' IFS Briefing Note BN145, February (2014) Link, p.8.

244. John Hills, 'Thatcherism, New Labour and the Welfare State', LSE, August 1998, Link.

trusts all took place largely after Thatcher left office, but these did not secure significant spending reductions. Indeed, fiscal restraint was loosened in the 1990s, and by the time of Labour's election victory in 1997, health-related public spending summed to 4.8 per cent of the economy.

Figure 32: Government expenditure on health and defence (% of GDP), 1948/49 – 2022/23



Source: OBR, 300 years of UK public finance data

The Cameron Governments 2010-16

The 2010 election occurred in the wake of the 2008 financial crisis. The economy was recovering but public sector net borrowing sat at 10.3% of GDP – the highest in decades.[245] The Conservative-led coalition faced a mammoth task to stabilise the public finances.

The Coalition Agreement stated that 'the most urgent task facing this coalition is to tackle our record debts, because without sound finances, none of our ambitions will be deliverable'.[246] To this end, Chancellor of the Exchequer George Osborne set himself two tasks: that the structural current deficit should be in balance in the final year of the five-year forecast period and that national debt as a percentage of GDP should be falling before the end of the Parliament.

Public sector spending as a percentage of GDP fell from its 34-year peak of 46.3% in 2009-10 to 41.1% by 2015-16 and to its 15-year low of 39.4% by 2018-19.[247] The scale of these cuts makes them the greatest display of fiscal restraint since the Thatcher era. Table 21 shows how the composition and scale of government expenditure evolved over this period.

245. Office for Budget Responsibility data, Link.
246. The Coalition: Our Programme for Government (2010), Link
247. Office for Budget Responsibility data, Link.

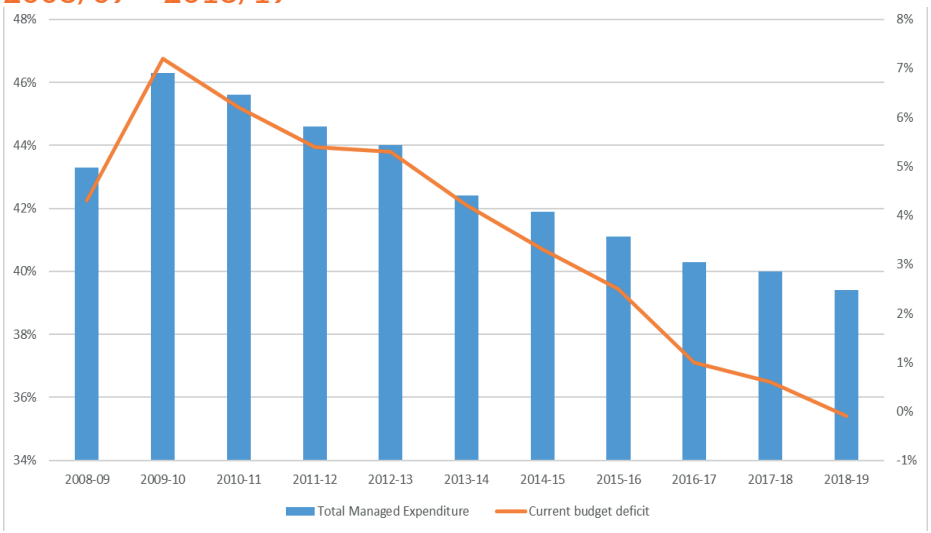
Table 21: Composition of UK government expenditure before an dafter the Coalition years (% of GDP), 2009/10 and 2018/19

Category	2009-10	2018-19	Difference
Social security	12.3%	10.3%	−2.0%
Of which pensioners	*6.4%*	*5.8%*	*−0.6%*
Of which non-pensioners	*6.0%*	*4.5%*	*−1.4%*
Health	7.5%	7.0%	−0.5%
Education	5.7%	4.0%	−1.6%
Defence	2.4%	1.8%	−0.6%
Public order and safety	2.2%	1.5%	−0.7%
Transport	1.5%	1.5%	0.0%
Housing and Community amenities	1.0%	0.6%	−0.5%
Overseas aid	0.5%	0.7%	0.2%
Public sector net debt interest	1.9%	1.6%	−0.3%
Total Managed Expenditure	**46.3%**	**39.4%**	**−6.9%**

Source: IFS TaxLAB, IFS spending composition sheet; OBR, Public finances databank – July 2025. TME figure comes from OBR databank.

These savings were mostly driven by reforms to welfare and pensions, in addition to cuts in departmental expenditure limits.

Figure 33: TME (left) and Budget Deficit (right), (% of GDP), 2008/09 – 2018/19[248]



Source: *OBR, Public finances databank – September 2025*

248.OBR public finances data, Link

Welfare and Pensions

Welfare

As the consistently largest part of government spending and one of the most contentious aspects, welfare expenditure became a major focus of fiscal consolidation. Expenditure on UK social security and tax credits was £218.4 billion in 2016-17, 28.3% of TME.[249] In 2016-17 changes to welfare spending saved around £26 billion a year for the Exchequer (or approximately 10% of what welfare spending might otherwise have been).

The switching to CPI indexation for benefits, tax credits and public service pensions from 2011-12 was estimated to save £7.8 billion in 2015-16 in the 2011 Budget, although this estimate was lowered to £4.3 billion in 2015.[250] The 1% increase cap on working age discretionary benefits and tax credits for three years from 2013-14 was estimated to have saved £2.6 billion a year by 2017-18.[251] However, due to higher-than-expected inflation, by 2020 the freeze saved the Exchequer £4.7 billion.[252]

The Treasury also made significant but controversial changes to housing benefits. These included the recalculation of the local housing allowance (LHA), extending the shared accommodation rate for single people under 35, and the introduction of the underoccupancy penalty ('bedroom tax'), that saved £470 million a year through a 25% reduction in housing benefits for those with more bedrooms than 'needed'.[253] The Welfare Reform and Work Act 2016 also required "registered providers of social housing in England to reduce social housing rents by 1% a year for 4 years from a frozen 2015 to 2016 baseline,"[254] ultimately saving the government £1.4 billion a year by 2020-21, via reductions in housing benefit.

Pensions

The Coalition made a number of changes to the state pension and public sector pensions, although many of the savings were offset by the introduction of the triple lock.

The 2011 Pensions Act accelerated the Pensions Act 1995 in bringing forward the equalisation of the retirement age to November 2018; it also further legislated the state pension age (SPA) rise from 65 to 66 by October 2020. The combination of the 1995 and 2011 Acts saved approximately £215 billion between 2010/11 and 2025/26.[255] Further, the Pensions Act 2014 brought forward the increase to 67 between April 2026 and March 2028, which will reduce annual costs by £10.5 billion in 2029-30.[256]

Public sector pension reforms changed indexation from RPI to CPI, linked the normal pension age to the SPA (except for 'uniformed services'), and replaced existing final salary pension schemes with average salary pension schemes. Gross expenditure on public service pensions will subsequently fall from its peak in 2022-23 of 2.1% of GDP, to around 1.5% of GDP from 2064-65 onwards.[257] Additionally, increasing member contributions by an average of 3.2 percentage points over the 3 years up

249. House of Commons Library, Welfare savings 2010-11 to 2020-21, 2016, Link
250. IFS and Nuffield Foundation, Benefit Spending and Reforms: The Coalition Government's Record, 2015, Link
251. House of Commons Library, Welfare Benefits Uprating Bill, 2013, Link
252. Hansard, Working-age Benefits, 2017, Link
253. Wintour, P., Labour commits to abolishing bedroom tax, The Guardian, 2013, Link
254. Welfare Reform and Work Act 2016, Link
255. DWP, Analysis relating to State Pension age changes from the 1995 and 2011 Pensions Acts, 2019, Link
256. OBR, The fiscal impact of increases in the state pension age, Link
257. House of Commons Library, Public service pensions – the 2015 reforms, 2021, Link

to 2015, saved £1.2 billion in 2012-13, £2.3 billion in 2013-14 and £2.8 billion in 2014-15.[258]

In addition, the automatic enrolment of employees into workplace pensions, a scheme devised by the Behavioural Insights Team at the Cabinet Office – whose aim was to generate ten times their running costs government savings or be shut down in two years - shifted the burden of social welfare onto the individual. This policy saw 58,000 employers enrol an additional 5.4 million workers between 2012 and 2015, only costing DWP £1 billion in expenses to enact.[259] Although its ultimate success will be determined by its ability to boost private retirement savings and thus reduce the burden placed upon the state pension.

An area where the government did increase spending was the decision to implement the 'triple lock' in 2010. The state pension was now to be uprated each year by the highest of earnings growth, inflation, or 2.5%. This is estimated to cost approximately an additional £10 billion a year, rising potentially up to £45 billion a year by 2050.

Departmental Spending

Departmental cuts

In addition to Welfare and Pension changes some of the most significant cuts occurred within departmental budgets. Total departmental expenditure limits (DEL) fell 15% in real terms between 2009-10 and 2015-16.[260] Certain departments were impacted by very significant cuts: communities and local government, work and pensions, and justice had their DELs slashed between 2009-10 and 2015-16 by 62%, 57% and 32% respectively. These periods of spending reductions also included sharp decline within tight periods, such as between 2009-10 and 2012-13 where MHCLG (Housing and Communities) fell 24%, 48%, and 32% year-over-year, or the 13% cut to the FCDO's DEL in one year between 2013-14 and 2014-15.[261]

Decisions were made to protect certain departments to some extent: health, education and international development. George Osborne in 2010 pledged to increase the NHS budget in England YOY in real terms; between 2010-11 and 2015-16 the NHS budget increased by 5.0% in real terms. The schools budget was also protected, though the Department for Education as a whole was not. The government also subscribed to the 0.7% of GNI commitment to foreign aid, first hitting the target in 2013 and being enshrined into law by 2015. Subsequently between 2009-10 and 2015-16 the department for international development saw its real-terms DEL appreciate by 27%.

Staffing

Staffing costs account for a majority of spending across most public services. The two significant aims of the 2010 and 2013 spending reviews regarding staff were an overall reduction in headcount and wage restraint. In 2013, total public sector pay was £164 billion or 23% of UK public

258. HM Treasury, Public Service Pension reforms, 2013, Link

259. HM Treasury, Treasury Minutes Progress Report, 2017, Link

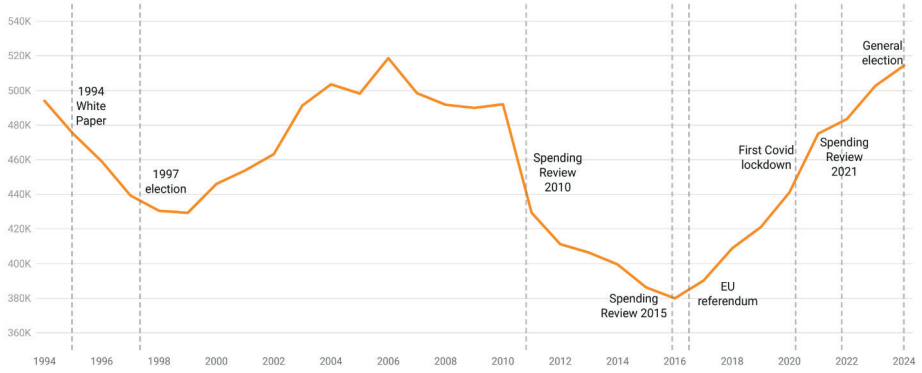
260. UK Housing Review, Table 16 Departmental Expenditure Limits (DEL) and Total Managed Expenditure (AME), Link; HM Treasury, GDP deflators at market prices, and money GDP September 2025 (Quarterly National Accounts), 2025, Link

261. Ibid.

spending.[262] As staffing constitutes a significant proportion of departmental spending, pay restraint and headcount reductions became central to the austerity agenda. The implementation of a two-year pay freeze between 2011 and 2013 plus a 1% average pay cap between 2013 and 2017 was estimated to have saved between £10 and £20 billion annually from 2017 onwards.[263]

There was also an attempt to decrease the total staffing numbers employed by government departments and their arms-length bodies. Between April 2010 and May 2013, the NHS cut the number of managers from 38,300 to a low of 26,000.[264] The Prison Service reduced officer numbers by 30% between 2010 and 2013. Later Conservative governments have returned headcount to pre-2010 level in all areas. except NHS senior managers.

Figure 34: Number of civil service staff, 1994 - 2024



Source: ONS, Public sector employment; Cabinet Office, Civil Service statistics.

Programmes

As part of departmental spending cuts, a number of programmes and services provided by the government were suspended or axed altogether.[265] These included (at 2010/11 prices):

- The rollout of the Future Jobs Fund – axed (£290 million).
- Extension of the Young Person's Guarantee to 2011/12 - axed (£450 million).
- Two Years Jobseeker's Guarantee - axed (£515 million).

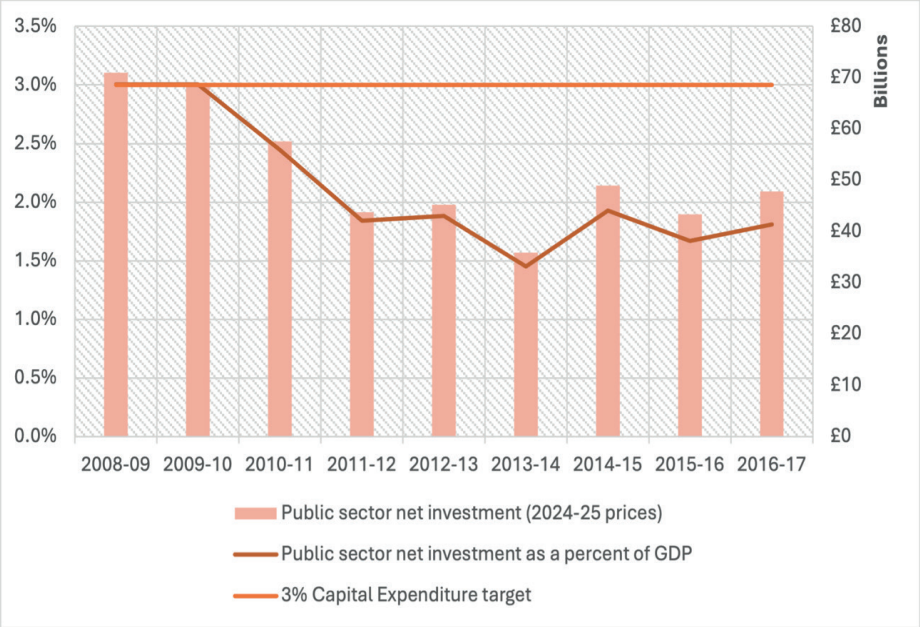
Capital Expenditure

In 2010-11, capital expenditure accounted for 7.4% of total managed expenditure and almost 60% of total spending in some departments (transport).[266] Public sector net investment fell over the four years from 2009-10 to 2013-14 from 3% of GDP to 1.5% of GDP.

Compared to if public sector net investment had continued at its 2009-10 rate of 3% of GDP from 2010-11 to 2016-17, the government saved approximately £200 billion in cumulative capital expenditure (in today's prices).[267] During the Cameron years public sector net investment exceeded 2% once (2010-11) whereas in the eight years since, it has only twice been below that same threshold (2019-20, 2022-23).[268]

262. National Audit Office, Central government staff costs, 2015, Link
263. Institute for Government, Performance Tracker 2023: Cross-service analysis, 2023, Link
264. The Health Foundation, Strengthening NHS management and leadership, 2022, Link
265. BBC News, In Full: The projects axed or suspended by government, 2010, Link
266. Parliament, Department for Transport estimate memorandum: Main Estimate 2011–12, 2012, Link
267. IFS, Public investment: what you need to know, 2024, Link; ONS, Gross Domestic Product: chained volume measures: Seasonally adjusted £m, Link
268. IFS, Public investment: what you need to know, 2024, Link

Figure 35: Public sector net investment[269]



Secondary Effects

Certain spending cuts caused unintended side-effects, increasing costs for other parts of government. Between 2009-10 and 2017-18, Sure Start's budget decreased from £1.8 billion to £576 million. Spending on the Supporting People programme initially had a £1.8 billion ringfenced budget but this was decreased to £1.64 billion in 2010-11 and to £1.59 billion in 2014-15.[270]

However, over the same period (2009-10 to 2017-18) real children's social care spending increased by some 16%[271] while homelessness services increased by 113% in real terms between 2010-11 and 2022-23.[272] While not inherently causal, in some cases it may be that cost savings in one department increased expenses in another, often more acute and crisis-driven.

National government's cost cutting occasionally has an *off-loading* effect upon local government. The reduction of social sector rents by 1% each year for 4 years from 2016-17 is a key case. This amounted to cutting the funds provided to local councils and housing associations (funded by local councils) for council house provision, acting as a stealth tax upon local government.

One of the most heavily affected budget lines was local government funding. From 2010-11 to 2019-20 this funding fell by some 20% in real terms.[273] Much of this was absorbed in the form of efficiency savings or reductions in services.

Determination of success

The first stated aim of the programme of fiscal restriction from 2010-2016 overseen by George Osborne was to "achieve [a] cyclically-adjusted current balance by the end of the rolling, five-year forecast period". The

269. OBR public finances data, Link
270. House of Commons Library, The Supporting People programme, 2012, Link
271. Institute for Government, Performance Tracker 2023: Children's social care, Link
272. National Audit Office, The effectiveness of government in tackling homelessness, 2024, Link
273. IFS, The 2025-26 English Local Government Finance Settlement explained, 2024, Link

second, was that debt as a percentage of GDP should be falling by the end of the parliament. On the former, the cyclically-adjusted current budget deficit fell from 5.4% of GDP in 2009-10 to 2.3% in 2015-16 and 0.9% in 2016-17.[274] Meanwhile, public sector net borrowing was reduced from 10.3% of GDP in 2009-10 to 2.8% in 2016-17. Net debt as a percentage of GDP rose from 70.9% in 2010 to 83.3% in 2016/17.

While neither of the aims were hit, Cameron and Osborne did achieve large and historic spending cuts and returned the deficit from an unsustainable to manageable (although still significant) level.

Milei's Government Spending Cuts in Argentina

Previous sections of this paper have demonstrated how Governments in the UK have reduced public spending. In this section we examine a contemporary example, the Administration of Javier Milei in Argentina.

It should be noted that the overall verdict on Argentina's reforms is not yet in. Initially promising economic results, including significant falls in inflation, have more recently been followed by a currency crisis, when an electoral defeat in Buenos Aires sparked concerns that his reforms might be losing public support. The ultimate outcome remains to be seen.

Table 22 shows how the size and composition of government expenditure in Argentina has changed in a short timeframe, from 2023 to 2024.

Table 22: Composition of Argentina's government expenditure (% of GDP), 2023 and 2024

Expenditure category	2023	2024	Difference
Social security	16.7%	16.2%	−0.5%
Public debt service	3.5%	3.3%	−0.1%
Health	1.4%	1.5%	0.2%
Education and culture	2.7%	1.7%	−1.0%
Energy, fuels and mining	3.2%	2.3%	−0.9%
Transport	1.7%	0.9%	−0.8%
Public safety, order and judicial	1.6%	1.5%	−0.2%
Defence	0.6%	0.6%	0.0%
Science, technology and innovation	0.6%	0.4%	−0.1%
Housing and urban planning	0.3%	0.1%	−0.3%
Other	5.5%	2.8%	−2.7%
Total	**37.8%**	**31.4%**	**−6.4%**

Sources: Ministry of Finance, Open Budget; IMF, World Economic Outlook Database. We have combined relative proportions of expenditure based on budget data with the IMF's government expenditure as a % of GDP data to reach these figures

274.OBR, Data, Link

When Milei took office in November 2023 Argentina had the highest rate of inflation in the world with its annual rate standing at 211.4%. Rampant inflation in Argentina was largely caused by the Central Bank of Argentina being forced to print Pesos in order to fund the Government's spending commitments. Very high levels of public spending funded by borrowing and money printing had been an issue in Argentina for over a century, leaving its public finances in a parlous state and resulting in the country running an annual fiscal deficit for 123 years.[275]

Milei's Government introduced substantial cuts and has significantly reduced public spending. One of the primary ways this has been achieved has been through a reduction in the size of the State. For example, it has closed down 13 Government departments. Moreover, it has abolished 100 secretariats and sub-secretariats in addition to 200 lower-level departments. In doing so it reduced the civil service headcount by 37,000 which is the equivalent of 10% of the Government workforce.[276]

The Government departments which remained faced significant cuts to their budgets. For example, the Secretariat of Science, Technology, and Innovation saw its funding reduced by over 98% while the Ministry of Infrastructure had its budget cut by over 73%.[277]

Table 23: Departmental budget cuts in Argentina under President Milei

Department	Size of budget cut (%)
Secretariat of Science, Technology, and Innovation	98.2
Ministry of Infrastructure	73.6
National Secretariat for Children, Youth, and Family	59.6
Secretariat of Education	52.1
Ministry of Health	28.1
Ministry of Security	22.3
Office of the President	13.3

Source: CEPA–SIDIF

The largest area of Government expenditure in Argentina was on Social Security which stood at 52% of the total, with 60% of this being on pensions.[278] The Milei Administration has introduced reforms to the State Pension system. For example, while there was an uplift to the State Pension in order to take account of the increase in the cost of living, the Government temporarily severed the link with inflation which slowed the growth of pension spending.

Furthermore, it abolished the previous Government's *moratorios* or amnesties which had allowed people to claim the State Earnings Related Pension who had not made the requisite 30 years of contributions. Given

275. Garcia, F., & Venturi, L., 'Argentina under a new government: what are the big economic challenges?' *Economics Observatory*, May 2024, Link

276. Buenos Aires Times, 'Milei's chainsaw cut nearly 35,000 public sector jobs in 2024', December 2024, Link

277. Molina, F., Centenera, M., & Lorca, J., 'Milei is taking a chainsaw to the state', *El Pais*, October 2024, Link

278. *Ibid*

that 73% of new beneficiaries in 2024 were in receipt of the State Earnings Related Pension due to these amnesties, it was having a significant impact on the Social Security Budget. The abolition of these amnesties means that those without 30 years of contributions are now only eligible to claim the less generous means tested State Pension.[279]

The Government has also reduced public spending in other areas. For example, it cut energy subsidies, resulting in $2.7 billion in savings.[280]

The Milei Government has, so far, had a dramatic impact on the country's economy and the health of its public finances. In addition, the economy has recovered, despite the dire predictions of many economists and commentators who at the time argued that the Milei Government's cuts to public spending would have a negative impact on growth.[281]

The fiscal deficit has been eliminated for the first time in over a century with a modest surplus being achieved. Furthermore, the money spent on servicing the National Debt has decreased by 11%.[282]

Economic optimism has also increased in Argentina. For example, the percentage of people who think that the economic conditions in the area they live in and their standard of living is getting better has increased.[283]

Finally, while the response from the public has been mixed, the Milei Government is relatively popular. The Government is less unpopular than the one which preceded it and has moderately strong support among people aged 16 to 24 and among those aged over 60.[284] However, a recent electoral loss in Buenos Aires, followed by a number of defeats in Congress, have led some to conclude that Milei's popularity is waning – and has sparked a currency crisis that threatens the broader success of his reforms.

Lessons for the UK

While the UK is not in a comparable position to Argentina as inflation and borrowing did not reach the same heights, there are still lessons to be learned. As has been discussed in previous sections of this paper, high borrowing by UK Governments has significantly increased the size of the National Debt which is projected to reach an unsustainable level over the next 50 years. To reduce the deficit, radical steps must be taken by the Government to cut public spending.

The example of the Milei Administration shows that Governments can bring public spending down to more sustainable levels by drastically reducing the size of the state, eliminating subsidies, and reforming the pension system. However, it is important to ensure that sufficient popular support is maintained, for if the markets lose confidence that reforms can be sustained, this may provoke a backlash.

279. Dixon, P., 'Argentina's Economy Under the Reforms of Javier Milei', *Market Research*, May 2025, Link

280. Paque, K., & Holtzmann, H., 'Argentina: One year of Javier Milei's Economic Policy', *Friedrich Naumann Foundation*, November 2024, Link

281. Goni, U., & Phillips, T., 'Economists warn electing far-right Milei would spell devastation for Argentina', *The Guardian*, November 2023, Link

282. Ventura, L., 'Milei Ends Argentina's Deficit After 123 Years', *Global Finance*, January 2025, Link

283. Vigers, B., 'Javier Milei's Argentina in 6 Charts', *Gallup*, December 2024, Link

284. Ibid

Annex C: International Comparisons

Throughout Annex C we use UK government expenditure from the OECD.[285]

Singapore

Singapore's fiscal policies are carefully constructed with a view to the long-term, in order to facilitate economic growth, maintain macroeconomic stability and promote social equity.[286] Relative to the UK, the Singapore government spends around 30% of GDP less by limiting expenditure on social security transfers, healthcare, and education. Adhering to its strict fiscal rules has also allowed Singapore to become a net creditor, building up large reserves which can supplement annual budgets.

Across advanced economies, its government expenditure as a share of GDP is among the lowest, enabling a low fiscal burden on Singaporean taxpayers. Despite its relatively low spending, it performs excellently on various measures including health, education and crime outcomes.

In which areas does Singapore minimise its government expenditure?

Table 24 shows the various areas of expenditure for both the UK and Singapore. It is worth bearing in mind that Singapore's productivity, as measured by GDP per capita, is significantly higher than the UK's, and so each percentage point of GDP holds more absolute value in Singapore. This means that, compared to the UK, it can produce more in *absolute* per capita terms while consuming the same (or even somewhat lower) proportion of its GDP. Despite this, the figures in Table 24 indicate the level of strain placed on the economy by each component of government spending.

285. This may lead to discrepancies with figures used in the rest of the paper which utilise other sources. OECD data has been used here given its utility for making international comparisons of different categories of expenditure.

286. Ministry of Finance, Singapore's Fiscal Policy, Link

Table 24: Areas of government expenditure in the UK and Singapore (% of GDP), 2023 and 2023-24[287]

Expenditure category	UK, 2023	Singapore, 2023-24	Difference (UK minus Singapore)	
General public services	6.4%	0.6%	5.8%	Includes some core/admin departmental spending, aid, debt interest etc.
Of which public debt interest	4.5%*	0.0% (NIRC gives a budget supplement of 3.3%)	4.5%	The Net Investment Returns Contribution (NIRC) gives investment income of 3.3% of GDP, this is not counted as expenditure here. This 3.3% does not equal Singapore's **total** net investment income.
Of which foreign aid	0.6%	0.1%	0.5%	The Singapore figure is for 'foreign affairs' while UK figure includes aid. Singapore does not provide Official Development Assistance meaning overseas aid is negligible.
Defence	2.2%	2.9%	-0.6%	
Public order and safety	2.2%	1.2%	1%	
Economic affairs	4.9%	3.2%	1.7%	Includes labour affairs, agriculture, fuel, transport and other industries.
Of which transport	1.7%*	1.9%	-0.2%	
Environmental protection	0.7%	0.5%	0.2%	
Housing and community amenities	0.9%	1.2%	-0.3%	
Health	8.7%	2.6%	6.1%	
Recreation, culture and religion	0.6%	0.4%	0.2%	
Education	4.8%	2%	2.8%	Singapore's system is highly centralised, cost efficient and avoids many social service offerings that the UK provides.
Social protection	15.4%	0.8%	14.7%	The Singapore figure represents the value of social transfers to individuals. There may be some overlap between this figure and other categories. UK figure adheres to the standard 'COFOG' definition developed by the OECD for social protection.
Of which pensions	4.6%*	0.1%	4.5%	UK figure corresponds to GB state pension spend. Singapore does not provide a state pension. Individuals save through the CPF. The Singapore figure corresponds to 'Silver Support scheme', its support scheme for pensioners who had low incomes during working years.
Other	0.0%	0.2%	-0.2%	
Total	**46.9%**	**15.5%**	**31.4%**	

**2023-24 figure*

Notes: Discrepancies in 'Difference' column are due to rounding.

287. Figures for Singapore should be taken as estimates since it does not report expenditure figures using the same COFOG framework as the UK.

Source: UK - OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; HM Treasury, Public Expenditure Statistical Analyses 2024; House of Commons Library, UK aid: spending reductions since 2020 and outlook from 2024/25; Department for Work and Pensions, Benefit expenditure and case-load tables 2023; ONS, Gross Domestic Product at market prices: Current price: Seasonally adjusted £m; Singapore - Ministry of Finance, Analysis of Revenue and Expenditure Financial Year 2024; Telescope, Reviewing Qualifying Criteria So That Silver Support Scheme Benefits More Needy Seniors; Department of Statistics Singapore, National Accounts

Table 24 shows that Singapore's government expenditure is some 30% of GDP lower than the UK's. The key areas in which Singapore is able to limit its government expenditure are social protection and pensions, debt interest, health and education. These are discussed in turn below.

Social protection and pensions

For many countries, welfare spending is a significant component of government spending. This is not the case in Singapore, which refuses to be a redistributive welfare state. While the government does provide some social support, it is highly targeted and limited in its scope and carefully designed to avoid dependency on such schemes.

Data on welfare spending breakdowns in Singapore is limited, but analysis released alongside the 2024 Budget shows that the total value of 'Social transfers to Individuals' was only around £3 billion, or 0.8% of its GDP.[288]

Social security programmes are designed to be inadequate and, until recently, Singapore did not provide benefits for the unemployed. Aimed towards low and middle-income workers, a new scheme offers involuntarily unemployed workers up to 6,000 Singaporean dollars (£3,500) over a six month period, subject to various conditions.[289] This represents an apparent shift in policy, although it should be noted that support is modest, means-tested and short-term.

Singapore also does not have a traditional state pension system like that of the UK and other nations. Rather, it has the Central Provident Fund (CPF) which is a compulsory comprehensive savings and pension plan which employees and employers are expected to contribute a combined 37% of wages to, until the age of 55 when the rate begins to decrease.[290] In 2023, 4.5 million people were registered on the CPF with a cumulative balance of S$560 billion (£320 billion).[291] By funding through the CPF, Singapore keeps government spending on pensions to a minimum.

Debt interest

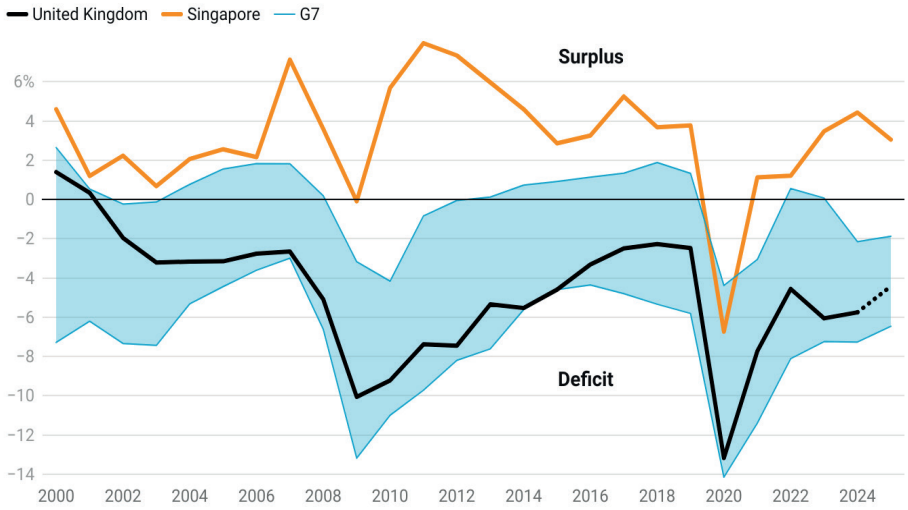
Singapore's fiscal prudence and cost-effective spending have allowed it to consistently achieve budget surpluses. (See Figure 36.) As a result, it does not have net debt. Rather, it has reserves which are invested and can be used as a financial buffer in a crisis, to supplement the budget and to secure macroeconomic stability.[292] In fact, while some 74% of government revenue comes from taxes, about 18% comes from the Net

288. Ministry of Finance, Analysis of Revenue and Expenditure Financial Year 2024; original figure is around 5.2 billion Singaporean dollars
289. MyCareersFuture, What is the SkillsFuture Jobseeker Support scheme?, Link
290. Central Provident Fund, Government of Singapore, How much CPF contributions to pay , Link
291. Expatica, The Singapore pension system, Link
292. Ministry of Finance, What Are The Reserves Used For?, Link

Investment Returns Contribution (NIRC) which is generated from its reserve investments.[293] The government is only allowed to allocate up to 50% of investment returns to the NIRC, with the rest being used to continue to grow the reserves.

Singapore does not report on precisely how large its reserves are, but in 2023-24 the NIRC contributed around 3.3% of GDP towards the budget. This represents a marked difference compared to the UK's situation, in which some 10% of government spending goes towards paying debt interest.

Figure 36: Government budget balance in the UK, Singapore and G7 (% of GDP), 2000 - 2005



Source: IMF World Economic Outlook Database. This metric is 'net lending (+)/borrowing (-) and is calculated as revenue minus expenditure. Forecasted values have been used for 2025 for G7 countries.

Health

Singapore achieves impressive health outcomes while spending a much lower proportion of its GDP on government-financed healthcare than most developed countries. Current government health expenditure sits at about 2.6% of GDP, a fraction of that spent by the UK government (8.7%). By financing healthcare through multiple streams, Singapore is able to keep government expenditure and the tax burden low, incentivise citizens to take care of their health, and provide subsidised care for those on lower incomes.

Singapore's public health insurance system, MediShield Life, is mandatory for all citizens and provides basic healthcare, protecting citizens from large bills arising from hospitals and certain outpatient treatments.[294] Citizens pay premiums, deductibles, coinsurance and any costs above claim limits, and MediShield Life often does not cover primary or outpatient care, nor prescription costs. Some 70% of Singapore residents also purchase private insurance to supplement the basic plan offered through MediShield.

To help citizens afford treatment when it is required, Singapore employs

293. Government of Singapore, Where does Government revenue come from?, Link
294. The Commonwealth Fund, International Health Care System Profiles; Singapore, Link

a compulsory savings scheme, MediSave. Employees and employers contribute a proportion of their salary (8-10.5%, age dependent) towards tax-exempt, interest-earning accounts which can be used to cover individual or family health payments.

Finally, the Singaporean government provides a safety net, through MediFund, for citizens who still face financial difficulties after these measures.

For more detail on Singapore's impressive health system and outcomes, see Policy Exchange's previous release in the *Policy Programme for Prosperity*, 'The NHS – a Suitable Case for Treatment?'.[295]

Education

Singapore's education system is highly centralised which contributes towards cost efficiency. It also mainly focuses on core academic outcomes. This is different to the UK, where our system takes on somewhat of a social care role, through the provision of free school meals to low-income families, school nurses and pastoral staff, and mental health support. The UK also spends a considerable amount on Special Educational Needs and Disabilities (SEND). Indeed, central government funding for special needs is as high as £11 billion.[296]

While Singapore does subsidise higher education, it is not to the same extent as in the UK. Given the design of student loans in the UK, many graduates never fully repay their loan which means that the government bears this burden. The UK also provides maintenance loans and grants to support higher education students which also adds to this expenditure.

How does Singapore's government expenditure compare internationally?

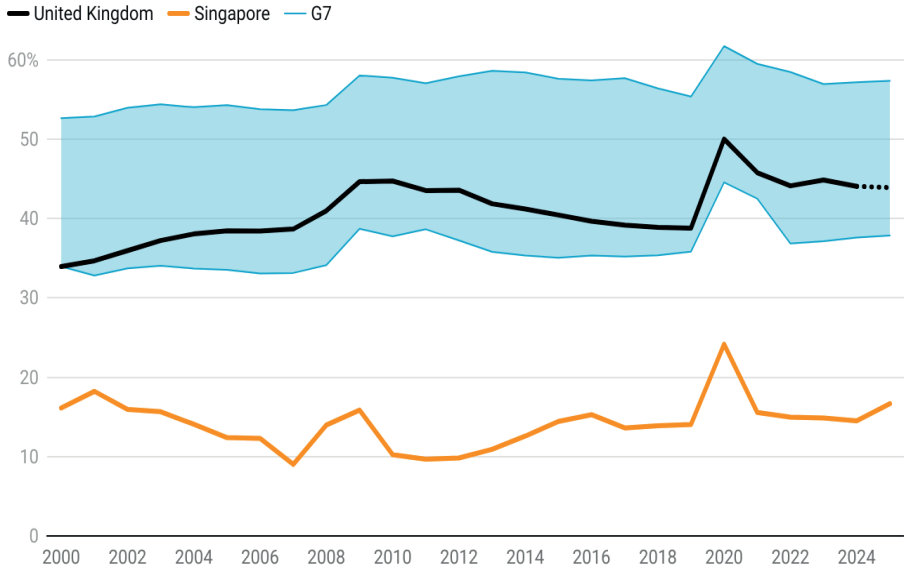
Singapore's government expenditure as a proportion of GDP has consistently been among the lowest across developed nations. The International Monetary Fund reports Singapore's government spending to be as low as 16.7% of GDP in 2025, significantly lower than all G7 countries and well under half of the equivalent UK figure (44% in 2024).[297] (See Figure 37).

295. Bootle, R., Ramanauskas, B. and Sweetman, B. 'The NHS – a Suitable Case for Treatment?' Policy Exchange, Link

296. IFS, Spending on special educational needs in England: something has to change, December 2024, Link

297. These data do not line up with Table 24 because they represent figures from more recent years.

Figure 37: Government expenditure in the UK, Singapore, and G7 (% of GDP), 2000 - 2005



Source: IMF World Economic Outlook Database. Forecasted values have been used for 2025 for G7 countries.

Critically, it has been very rare for government expenditure to exceed government revenues in Singapore. There are strict fiscal rules, including the inability to spend budget surpluses accumulated in previous terms without the President's approval, which is only likely to be given in times of real need, or during the pandemic.

Indeed, over the 26-year period shown in Figure 36, there have only been two years in which Singapore has run a budget deficit (2009 and 2020). This is in stark contrast to the UK over this period, for which there are only two years in which it has managed to run a surplus (2000 and 2001).

Conclusion

By placing a high value on personal responsibility and mandating that citizens save a proportion of their incomes to put towards healthcare and pension needs, Singapore's government spending remains restricted and the tax burden is kept low. Fiscal prudence has facilitated a net positive asset position, unlike many other developed nations. The Central Provident Fund acts as the equivalent of many nations' welfare transfer systems, benefits are strictly means-tested and designed to limit dependency, and the population has strong family and community values which means that the state only intervenes as a last resort.

Switzerland

Switzerland's government is significantly leaner than the UK, spending about 33% of GDP compared to the UK's 47%. It achieves this by spending significantly less on healthcare, social security transfers and national security, and by maintaining relatively low levels of debt.

In which areas does Switzerland minimise its government expenditure?

Table 25 shows the different areas of government expenditure in the UK and Switzerland. Switzerland's productivity is significantly higher than in the UK. In fact, the GDP per capita of Switzerland is roughly double that of the UK. Compared to the UK then, it can produce more in *absolute* per capita terms while consuming a similar (or even a notably lower) proportion of its GDP. Table 25 gives an indication of the level of strain placed on the economy by each component of government spending.

Table 25: Areas of government expenditure in the UK and Switzerland (% of GDP), 2023

Expenditure category	UK	Switzerland	Difference (UK minus Switzerland)
General public services	6.4%	4.2%	2.2%
Of which public debt interest	4.5%*	0.3%	4.2%
Of which foreign aid	0.6%	0.6%	-0.1%
Defence	2.2%	0.9%	1.4%
Public order and safety	2.2%	1.6%	0.5%
Economic affairs	4.9%	3.9%	1%
Of which transport	1.7%*	1.1%	0.6%
Environmental protection	0.7%	0.5%	0.2%
Housing and community amenities	0.9%	0.2%	0.7%
Health	8.7%	2.2%	6.5%
Recreation, culture and religion	0.6%	1%	-0.4%
Education	4.8%	5.6%	-0.8%
Social protection	15.4%	13.1%	2.4%
Of which pensions	4.6%*	5.1%	-0.5%
Total	46.9%	33.2%	13.7%

**2023-24 figure*

Notes: UK pension figure corresponds to Great Britain spending on state pension. Switzerland pension figure comes from 2019. Discrepancies in 'Difference' column are due to rounding.

Source: UK - OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; HM Treasury, Public Expenditure Statistical Analyses 2024; House of Commons Library, UK aid: spending reductions since 2020 and outlook from 2024/25; Department for Work and Pensions, Benefit expenditure and case-load tables 2023; ONS, Gross Domestic Product at market prices: Current price: Seasonally adjusted £m; Switzerland – OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; IMF, Interest paid on public debt, percent of GDP; Swiss Agency for Development and Cooperation SDC, Switzerland's official development assistance; Transport Policy Volume 158, "How much should public

transport services be expanded, and who should pay? Experimental evidence from Switzerland"; House of Commons Library, Pensions: International comparisons; SECO, Gross domestic product quarterly data

Table 25 shows that Switzerland is able to spend 13.7% of GDP less than the UK by spending less on health (by 6.5% of GDP), debt interest (by 4.2%), social protection (2.4%) and defence (1.4%). These are each discussed in turn below.

Health

Switzerland has a highly decentralised universal healthcare system, where residents are required to purchase insurance from private insurers.[298] Employing various charges for its healthcare system, including deductibles and coinsurance (with an annual cap) allows government spending to remain minimal. An important part of the government's role is to provide a safety net to those on lower incomes through subsidising premiums.

Each canton is responsible for licensing health providers, coordinating hospital services, disease prevention, and subsidising premiums. Meanwhile, the federal government regulates the financing of the system, ensures the quality of pharmaceuticals, manages public health initiatives and promotes training and research schemes.[299]

The main reason that Switzerland's government is able to spend so much less than the UK's is because of differences in funding systems. Switzerland spends around 11.8% of GDP on health across its whole economy, with 2.7% coming from government[300], 5.3% from compulsory insurance schemes, 1.1% from voluntary insurance schemes and 1.8% through out-of-pocket payments.[301] Meanwhile, the UK spends some 11% of GDP in total, with 9% coming through the tax-funded NHS and 2% coming from other private funding.

Switzerland faces relatively high out-of-pocket payments compared to comparable nations which might suggest that compulsory insurance coverage does not always fully cover the needs of citizens.

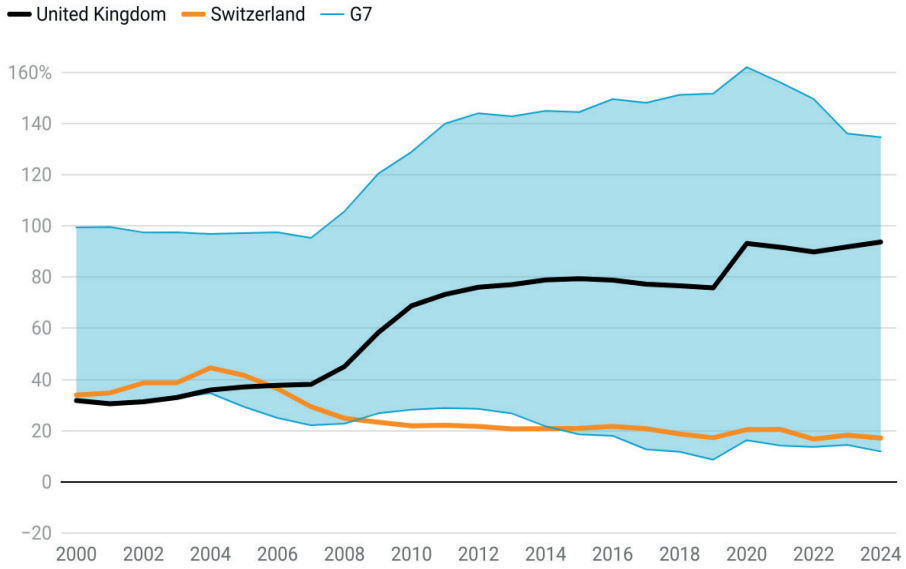
Debt interest

At the end of 2024, Switzerland's net debt stood at about 17% of GDP, which is very low relative to comparable countries.[302] It credits the 'debt brake' for this. [303] Introduced in 2003, the debt brake sets a ceiling for total expenditure based on expected receipts, with the principle that receipts and expenditure should be kept in balance at all times, and a design that prevents chronic deficits.

The debt brake gathered initial strong support in 2001, when 85% of voters approved of it, and continues to be supported by the general population and Parliament, despite it limiting opportunities for politicians to spend. This has allowed Switzerland to lower net debt from about 39% in 2002 to 17% in 2024. (See Figure 38.)

298. The Commonwealth Fund, International Health Care Systems Profiles; Switzerland, Link
299. Ibid
300. Slight discrepancy with Table 25 due to differences in sources/definitions
301. OECD Data Explorer, Health expenditure and financing, Link
302. IMF, World Economic Outlook Database, Link
303. Swiss Federal Authorities, Debt brake, April 2024, Link

Figure 38: Government net debt in the UK, Switzerland and G7 (% of GDP), 2000 - 2024



Source: IMF World Economic Outlook Database.

Social protection

Switzerland's social transfers are 2.4% of GDP lower than the UK's, despite spending slightly more on public pensions. Welfare benefits are designed to cover only the bare necessities in Switzerland, and is available only for people living below the poverty line.[304] Those receiving social assistance are helped by budget advisors in order to improve their financial situations, and there is an expectation for these people to be searching for a job.

There are also some restrictions on welfare transfers; housing must be the cheapest available in the area otherwise you may be told to move out, if you're under 25 years old you are expected to live with your parents or to share a flat, and there is no budget for a car unless completely necessary. Switzerland's policy led to 50% of welfare recipients being independent within a year, with 20% needing assistance for another year or two, as of 2020.[305]

Switzerland's pension system has three 'pillars', the first of which is made of up of the old-age and survivors' insurance, and the invalidity insurance scheme. These are financed by salary contributions from employees and employers. The second pillar is a compulsory occupational pension scheme paid by employees with earnings over a certain threshold. Finally, private savings operate as an optional third pillar. Contributions to these enjoy tax benefits to encourage uptake. Public pension expenditure as a % of GDP is slightly higher in Switzerland than the UK.

Defence

Switzerland's defence spending lags far behind many other developed European countries. While NATO has encouraged members to spend a minimum of 2%, Switzerland currently spends just under half of this, at

304. Misicka, S. How Swiss welfare works, February 2025, Link

305. Ibid

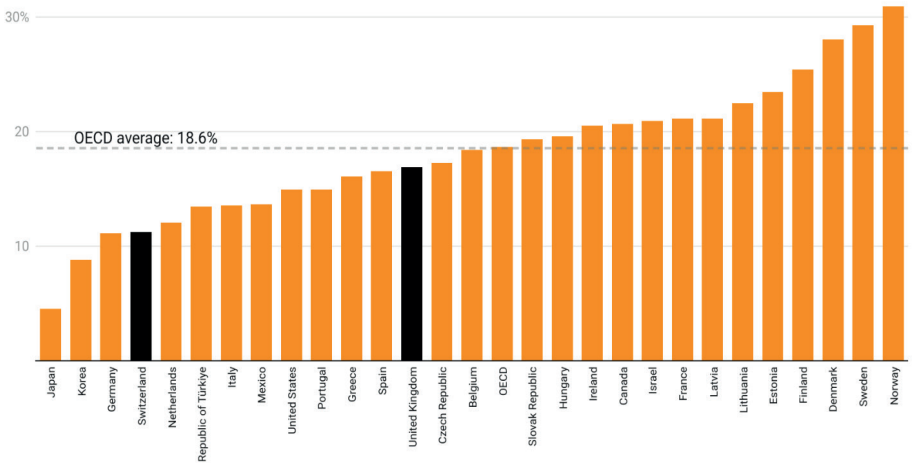
0.9%, with an eventual goal of 1% of GDP.

Given the context of war in Ukraine as well as NATO and the US calling for greater defence spending, Switzerland's neutrality policy has been under some scrutiny, with leading German politicians labelling the 1% of GDP target 'a joke'. But it is worth noting that given the strength of Switzerland's economy, 1% of GDP is worth more per capita than in many other economies.

Civil Service and Administration costs

Relative to most OECD countries, Switzerland has a low proportion of its workforce employed in the public sector. Indeed, only 11.2% of its workforce are publicly employed compared to 18.6% in the OECD.[306] (See Figure 39.) Given the relatively small size of the state in Switzerland, it follows that public employment is proportionally low. It also follows that Switzerland spends a relatively low amount on public administration, that is spending concerned with the day-to-day operations of public services and running of government departments.[307]

Figure 39: Employment in government as a percentage of total employment (%), 2021



Source: OECD, Public employment and management

How does Switzerland's government expenditure compare internationally?

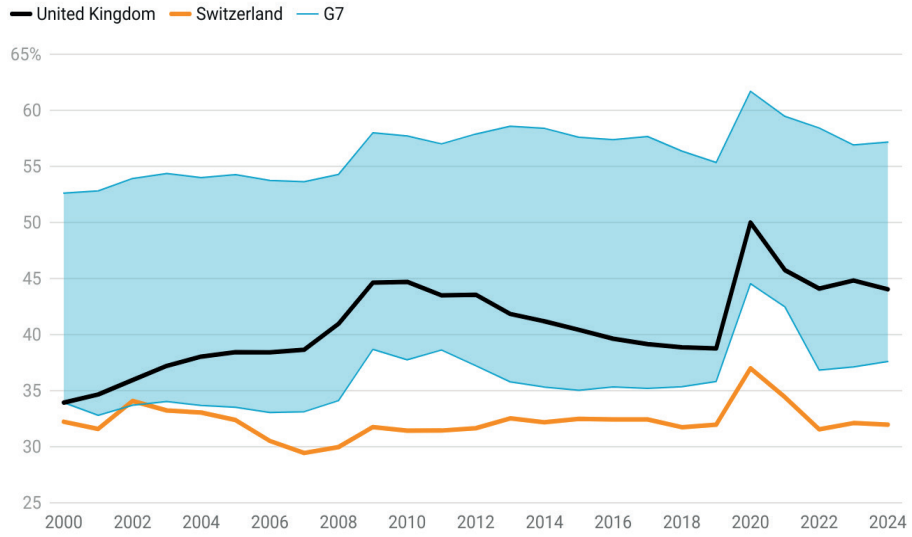
Figure 40 shows that government expenditure in Switzerland is significantly lower than the UK and all countries within the G7. Since 2000, it has consistently remained between around 31-33% of GDP while the UK has seen an increase from 34% to 44% in 2024.[308]

306. OECD, Government at a Glance 2023: Switzerland, Link

307. In 2022, Switzerland spent about 11.3% of total government spend on 'General, administrative and operating expenditure'. This represents about 3.8% of GDP

308. There is a slight discrepancy in this UK figure compared to others used in our paper due to differences in sources

Figure 40: Government expenditure in the UK, Switzerland and G7 (% of GDP), 2000 - 2024



Source: IMF World Economic Outlook Database.

Conclusion

Through its compulsory health insurance system, strict fiscal approach, neutral foreign policy and limited benefit generosity, Switzerland is able to limit spending on health, debt interest, defence and social security respectively, allowing it to maintain a relatively low level of government expenditure as a proportion of GDP.

Australia

While not as large as in Singapore and Switzerland, the difference in government spending as a proportion of GDP between Australia and the UK is still significant. In 2023, while the UK government spent about 47% of GDP, the Australian government only spent some 40%, having seen some increases over the last 20 years. Key areas where Australia spends less as a proportion of GDP are social transfers, debt interest and health.

In which areas does Australia minimise its government expenditure?

Table 26 shows different areas of government expenditure in the UK and Australia. Australia's productivity, captured by GDP per capita, is somewhat higher than in the UK, and so it can produce more in absolute per capita terms while consuming a similar proportion of its GDP. Table 26 shows the level of strain placed on the economy by each component of government spending.

Table 26: Areas of government expenditure in the UK and Australia, (% of GDP), 2023

Expenditure category	UK	Australia	Difference (UK minus Australia)
General public services	6.4%	4.3%	2.1%
Of which public debt interest	4.5%*	1.6%	2.9%
Of which foreign aid	0.6%	0.2%	0.4%
Defence	2.2%	2.3%	-0.1%
Public order and safety	2.2%	2%	0.2%
Economic affairs	4.9%	5.3%	-0.4%
Of which transport	1.7%*	0.7%	1.1%
Environmental protection	0.7%	0.9%	-0.2%
Housing and community amenities	0.9%	0.6%	0.3%
Health	8.7%	7.6%	1.1%
Recreation, culture and religion	0.6%	0.9%	-0.3%
Education	4.8%	5.7%	-0.9%
Social protection	15.4%	10.6%	4.8%
Of which pensions	4.6%*	3.6%	1.0%
Total	46.9%	40.2%	6.7%

**2023-24 figure*

Notes: Discrepancies in 'Difference' column are due to rounding. Australia pension figure is 'Assistance to the aged' found in the cited Budget Analysis and the transport figure is 'Transport and communication' spending.

Source: UK - OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; HM Treasury, Public Expenditure Statistical Analyses 2024; House of Commons Library, UK aid: spending reductions since 2020 and outlook from 2024/25; Department for Work and Pensions, Benefit expenditure and caseload tables 2023; ONS, Gross Domestic Product at market prices: Current price: Seasonally adjusted £m; Australia – OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; IMF, Interest paid on public debt, percent of GDP; Australian Government, Department of Foreign Affairs and Trade, Australia's Official Development Assistance Budget Summary 2023-24; Parliamentary Budget Office, 2024-25 Budget Snapshot; Australian Bureau of Statistics, Australian System of National Accounts

Table 26 shows that the main areas in which Australia is able to minimise spending are social transfers (4.8% of GDP difference between Australia and UK), debt interest (2.9% difference), transport (1.1%) and health (1.1%). Some of these components are discussed further below.

Social transfers and pensions

Table 26 shows that Australia spends 10.6% of GDP on social protection, compared to the UK's 15.4%. These welfare transfers are therefore the area of spending in which Australia's government saves the most. It keeps spending low through its targeted, heavily means-tested approach.

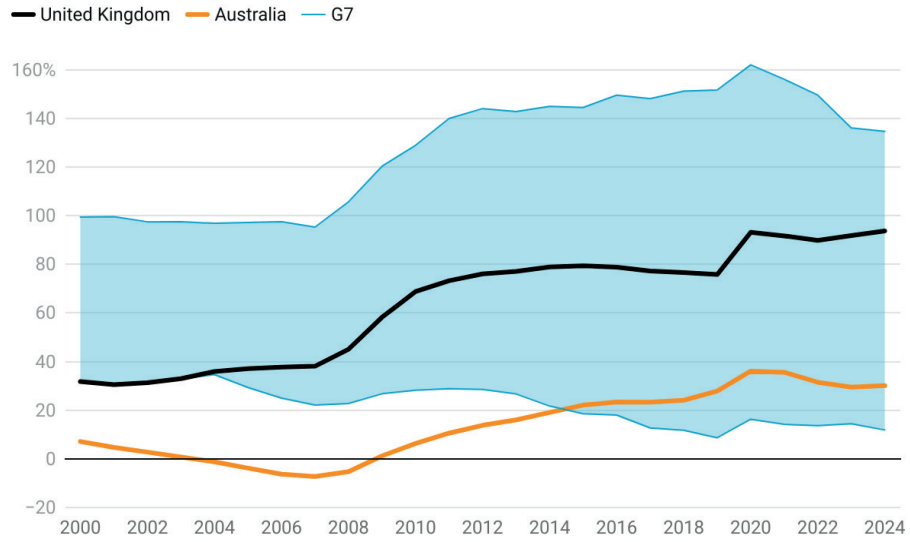
For example, the Age Pension in Australia is means tested and depends on citizens' assets as well as their homeownership and relationship status.[309] The UK, on the other hand, offers several benefits which are independent of means, such as Child Benefit and the State Pension. There is also a greater reliance on private retirement savings in Australia. While employees do not have to contribute into their pensions, employers are required to pay 12% of workers' wages and there are some tax incentives for employees to supplement this. This means that Australia's government spends 1% of GDP less than the UK on pensions.[310]

More generally, the UK state plays a larger universal welfare role while the Australian system acts as a safety net for those in need, designed to prevent poverty. Unemployment benefits in Australia are relatively low compared to many developed countries, and it has drawn criticism from those who believe it is insufficient to alleviate poverty. In fact, a study of 33 OECD countries argued that Australia could increase these significantly without major disincentive impacts on working.[311] The Australian government maintains that its low payments are needed in order to incentivise employment.

Debt interest

While Australia's government net debt has grown as a proportion of GDP since 2000, it currently finds itself in a relatively favourable position. (See Figure 41.) At 30% of GDP, it is over a third lower than in the UK proportionally and fares well when compared to the debt positions of many G7 countries.

Figure 41: Government net debt in the UK, Australia, and G7 (% of GDP), 2000 - 2024



Source: IMF World Economic Outlook Database.

This debt position has not been achieved strictly by fiscal prudence, as is shown in Figure 42. While generally often operating a *lower* budget deficit

309. Australian Government, Assets test, Link

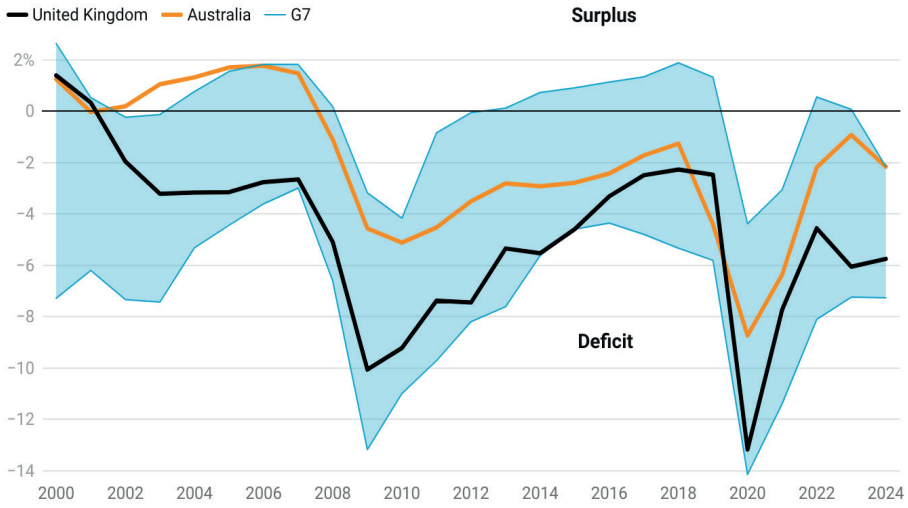
310. The figure used for pension spending is under the category 'Assistance to the Aged' which could suggest Australia's pension scheme costs slightly less than the reported 3.6% in Table 26.

311. The Australia Institute, Unemployment payments and work incentives: An international comparison, Link

than the UK, Australia's government has still been in deficit since 2008. It is therefore also partially a result of Australia's superior GDP growth that has allowed it to keep the debt ratio from growing unsustainably, as it has in the UK.

Australia's low level of net debt leads to relatively low interest payments. Indeed, while the UK spent 4.5% of GDP on these in 2023-24, it was as low as 1.6% in Australia in 2023.

Figure 42: Government budget balance in the UK, Australia, and G7 (% of GDP), 2000 - 2024



Source: IMF World Economic Outlook Database. This metric is 'net lending (+)/borrowing (-) and is calculated as revenue minus expenditure.

Health

Australia operates a universal, tax-funded healthcare system called Medicare which citizens are automatically enrolled onto. Medicare covers public hospitals, subsidised out-of-hospital services as well as subsidised prescription medicines.[312] It also provides safety nets for costs above the Medicare Benefit Schedule over the annual threshold. Unlike the UK, Australia's model combines both the public and private sector. In fact, roughly half of Australians purchase supplementary insurance in order to pay for services such as private hospitals and dental care, giving them greater choice and faster access to non-emergency services.[313]

The government encourages private health insurance through tax rebates (8.5-33.9% depending on age and income), as well as an income-based penalty (1-1.5%) for not having private insurance which applies to single people and families with incomes over a certain threshold. By encouraging people to purchase private insurance, this takes some pressure off of the public system and allows the government to spend a lower proportion of GDP on health.

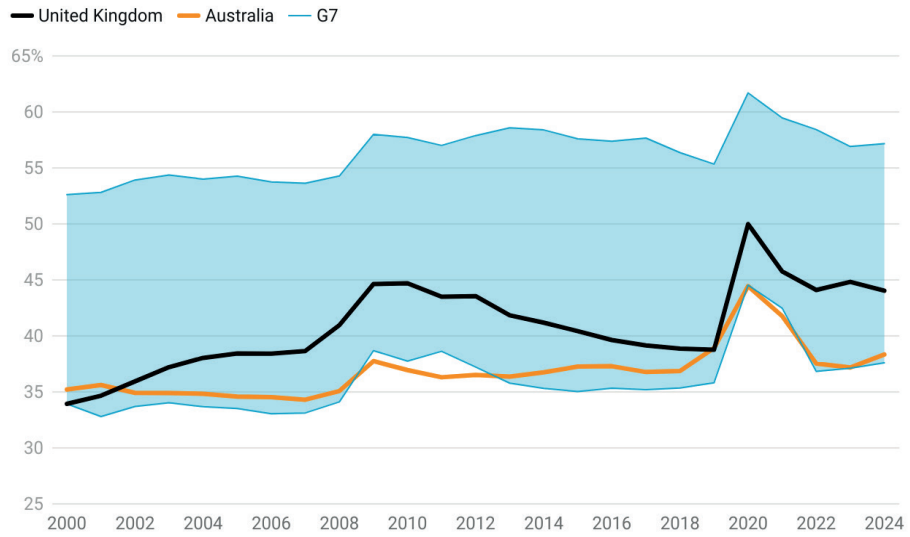
312. Bootle, R., Ramanauskas, B., & Sweetman, B., 'The NHS - A Suitable Case for Treatment?', *Policy Exchange*, July 2025, Link

313. The Commonwealth Fund, International Health Care System Profiles; Australia, Link

How does Australia's government expenditure compare internationally?

When compared to other G7 countries, Australia's government expenditure is relatively low. (See Figure 43.) The IMF gives expenditure at 38.3% of GDP in 2024, with the US representing the only G7 country with a lower figure (37.6%). Australia's 38.3% of GDP is about 6 percentage points lower than the equivalent UK figure (44% in 2024).[314]

Figure 43: Government expenditure in the UK, Australia and G7, (% of GDP), 2000 - 2024



Source: IMF World Economic Outlook Database.

Conclusion

Australia's comparably low government expenditure on social transfers, debt interest payments, transport and healthcare allow spending to remain lower than in many developed countries. The most significant of these factors is certainly social transfers. By means testing various benefits including its pension scheme, and by offering relatively ungenerous unemployment support, Australia maintains low social security spending.

USA

The United States spends approximately 8% of GDP less than the UK, most of which is a result of spending less on social protection and welfare.

In which areas does the USA minimise its government expenditure?

Table 27 shows different areas of Government expenditure in the UK and the United States. The USA's productivity, captured by GDP per capita, is somewhat higher than in the UK, and so it can produce more in absolute per capita terms while consuming a similar proportion of its GDP. Table 27 shows the level of strain placed on the economy by each component of Government spending.

314. Figures here are slightly different to those reported in Table 26 due to a different period and source being used.

Table 27: Areas of government expenditure in the UK and USA, (% of GDP), 2023

Expenditure category	UK	USA	Difference (UK minus US)
General public services	6.4%	6.9%	- -0.5%
Of which public debt interest	4.5%*	3.9%	0.6%
Of which foreign aid	0.6%	0.2%**	0.3%
Defence	2.2%	3%	-0.8%
Public order and safety	2.2%	1.9%	0.3%
Economic affairs	4.9%	3.2%	1.7%
Of which transport	1.7%*	1.7%	0%
Environmental protection	0.7%	0%	0.7%
Housing and community amenities	0.9%	0.5%	0.4%
Health	8.7%	1 0.1%	- -1.4%
Recreation, culture and religion	0.6%	0.2%	0.4%
Education	4.8%	5.4%	- -0.6%
Social protection	15.4%	7.9%	7.5%
Of which pensions	4.6%*	5.2%	-0.6%
Total	46.9%	39.1%	7.8%

**2023-24 figure. **2024 figure*

Notes: *Discrepancies in 'Difference' column are due to rounding.*

Source: *UK - OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; HM Treasury, Public Expenditure Statistical Analyses 2024; House of Commons Library, UK aid: spending reductions since 2020 and outlook from 2024/25; Department for Work and Pensions, Benefit expenditure and caseload tables 2023; ONS, Gross Domestic Product at market prices: Current price: Seasonally adjusted £m; USA - OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; World Bank, World Development Indicators; OECD, Official development assistance (ODA); U.S. Department of Transportation, Transportation Public Finance Statistics (TPFS); THE 2023 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS*

As illustrated by Table 27, the most significant difference between the US and the UK is spending on social protection. The US spends 7.5% less on social protection relative to GDP than the UK.

There is also the example of environmental protection. As demonstrated by Table 27, the UK spends 0.7% of GDP on protecting the environment. Although a small sum in terms of a proportion of GDP, this is still significantly higher than the amount spent by the United States which now spends 0% of GDP on environmental protection.

Finally, there is the issue of foreign aid. As Table 27 demonstrates, the UK spends more of a proportion of its GDP on foreign aid than the US. As with many of the other items of US Government expenditure, this is in flux. Regardless, it still does highlight the difference in spending between the two nations

Japan

Japan's government expenditure was around 40% of GDP in 2023, 7% of GDP lower than in the UK which is substantial. The main areas of difference are in debt interest payments, education and defence.

In which areas does Japan minimise its government expenditure?

Table 28 shows different areas of government expenditure in the UK and Japan. Unlike our other case study countries, Japan's productivity, captured by GDP per capita, is somewhat lower than that of the UK, and so it cannot produce as much in absolute per capita terms while consuming a similar proportion of its GDP. Table 28 shows the level of strain placed on the economy by each component of government spending.

Table 28: Areas of government expenditure in the UK and Japan, (% of GDP), 2023

Expenditure category	UK	Japan	Difference (UK minus Japan)
General public services	6.4%	3.6%	2.8%
Of which public debt interest	4.5%*	1.2%	3.3%
Of which foreign aid	0.6%	0.4%**	0.2%
Defence	2.2%	1.1%	1.1%
Public order and safety	2.2%	1.2%	1%
Economic affairs	4.9%	4.9%	0%
Of which transport	1.7%*	1.4%***	0.3%
Environmental protection	0.7%	1.1%	-0.4%
Housing and community amenities	0.9%	0.6%	0.3%
Health	8.7%	8.1%	0.6%
Recreation, culture and religion	0.6%	0.4%	0.2%
Education	4.8%	3.2%	1.6%
Social protection	15.4%	16.1%	-0.7%
Of which pensions	4.6%*	8.9%****	-4.3%
Total	46.9%	40.4%	6.5%

**2023-24 figure. **2024 figure. ***2022 figure. ****2019 figure.*

Notes: Discrepancies in 'Difference' column are due to rounding.

Source: UK - OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; HM Treasury, Public Expenditure Statistical Analyses 2024; House of Commons Library, UK aid: spending reductions since 2020 and outlook from 2024/25; Department for Work and Pensions, Benefit expenditure and caseload tables 2023; ONS, Gross Domestic Product at market prices: Current price: Seasonally adjusted £m; Japan – OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; IMF, Interest paid on public debt, percent of GDP; OECD, Official development assistance (ODA); IMF, Government Finance Statistics; House of Commons Library, Pensions: International Comparisons

As illustrated by Table 28, the Japanese Government has lower levels of public spending than the UK in several areas.

For example, it spends less as a proportion of GDP on servicing its National Debt than the UK. This is despite the National Debt of the UK being lower as a proportion of GDP than Japan's.

Japan also spends less on education than the United Kingdom. This is accounted for by lower spending on relatively lower spending on all levels of education including pre-school, primary, secondary, post-16, and post-18.

Finally, Japan also spends less on public order and safety than the UK. Spending on this area is 1% less in Japan as a proportion of its GDP than in the UK.

Sweden

Unlike our other case studies, Sweden's government spends more than the UK as a proportion of GDP. The main areas in which it spends more are education, social protection and transport.

In which areas does Sweden minimise its government expenditure?

Table 29 shows different areas of government expenditure in the UK and Sweden. Sweden's productivity, captured by GDP per capita, is slightly higher than in the UK, so it can produce more in absolute per capita terms while consuming a similar proportion of its GDP. Table 29 shows the level of strain placed on the economy by each component of government spending.

Table 29: Areas of government expenditure in the UK and Sweden, (% of GDP), 2023

Expenditure category	UK	Sweden	Difference (UK minus Sweden)
General public services	6.4%	5.3%	1.1%
Of which public debt interest	4.5%*	0.7%	3.8%
Of which foreign aid	0.6%	0.8%**	- -0.3%
Defence	2.2%	1.8%	0.5%
Public order and safety	2.2%	1.5%	0.7%

Economic affairs	4.9%	5.1%	-0.2%
Of which transport	1.7%*	3.4%***	-1.7%
Environmental protection	0.7%	0.6%	0.1%
Housing and community and amenities	0.9%	0.8%	0.1%
Health	8.7%	7.4%	1.3%
Recreation, culture and religion	0.6%	1.4%	-0.8%
Education	4.8%	7.3%	-2.5%
Social protection	15.4%	18.9%	-3.5%
Of which pensions	4.6%*	5.4%****	-0.8%
Total	46.9%	50%	-3.1%

**2023-24 figure. **2024 figure. ***2022 figure. ****2019 figure.*

Notes: Discrepancies in 'Difference' column are due to rounding.

Source: UK - OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; HM Treasury, Public Expenditure Statistical Analyses 2024; House of Commons Library, UK aid: spending reductions since 2020 and outlook from 2024/25; Department for Work and Pensions, Benefit expenditure and caseload tables 2023; ONS, Gross Domestic Product at market prices: Current price: Seasonally adjusted £m; Sweden - OECD Data Explorer, NAAG Chapter 6A: Government expenditure by function; IMF, Interest paid on public debt, percent of GDP; OECD, Official development assistance (ODA); IMF, Government Finance Statistics; World Bank, World Development Indicators; House of Commons Library, Pensions: International Comparisons

As illustrated by Table 29, Sweden spends significantly more than the UK on social protection (by 3.5% of GDP). This is primarily due to the comparatively large amount spent in Sweden on out work benefits, childcare, and provision for the elderly.

Sweden also spends considerably more on education (2.5%) than the UK. This includes spending on all stages of education including pre-school, primary, secondary, post-16, and university.

Sweden spends considerably more as a proportion of its GDP on transport than the UK. This is primarily due to Sweden's relatively generous subsidy systems.

A final metric to illustrate the difference between the UK and Sweden is provided by the amount spent by the two countries on servicing its National Debt as Sweden spends considerably less than the UK on debt interest payments.

Common Themes

What are the common themes behind why the UK spends more as a proportion of GDP than other highly developed economies?

The main area in which the UK Government spends more than similar

countries is on healthcare. While total healthcare spending in the UK is around the OECD average, the UK is relatively unique among our comparator nations in that the overwhelming majority of this is funded directly by Government spending whereas the majority of the countries discussed in this report fund healthcare through a combination of taxation, insurance, and co-payments. The exception to this is Sweden, which is similar to the UK both in terms of funding model and spending levels.

The UK also spends more on welfare as a proportion of GDP compared to many of our comparator nations. Singapore, for example, has developed a culture of discouraging a dependency culture and so has a rigorous system of means-testing in place for benefits.

Spending on welfare in Switzerland is 2.4% of GDP lower than the UK with requirements for claimants to be searching for paid employment and strict restrictions on the equivalent of Housing Benefit meaning that claimants must live in the cheapest housing available in the area.

Australia also spends less than the UK on welfare – 10.6% of GDP compared to the UK's 15.4%. Taking a similar approach to that of Switzerland, Australia keeps welfare spending low through means-testing.

A further common theme which emerges when analysing our comparator countries is that the majority of them spend significantly less as a proportion of GDP than the UK on debt interest payments.

The commonality here among our comparator countries is that they have lower debt to GDP ratios than the UK. Even Sweden – which has considerably higher public spending on education and welfare than the UK – spends far less than the UK on servicing its debt. It has a debt to GDP ratio of approximately 33.5% compared to the UK's ratio of over 96%. And although Japan has a higher debt to GDP ratio than the UK, it spends less as a proportion of GDP on servicing its debt than the UK because it is able to borrow at lower rates.

There are other examples of where the UK differs from other highly developed nations in terms of public spending. For example, Japan spends far less than the UK on transport. Switzerland spends less on its civil service as it is considerably smaller than the UK's. The US spends significantly less on environmental protection and international aid as a proportion of GDP while spending more on healthcare than any other country.

However, these are often unique to individual nations rather than representing common themes. The three main areas where UK public spending is considerably higher than its peers are healthcare, welfare, and debt interest.

Annex D: The Burden of Debt

The bill for debt interest is forecast to be £111.2 billion in 2025-26, amounting to about 8% of overall government spending.[315] This is the third largest category of spending in the overall total after health and welfare. Indeed, it accounts for most of the government's budget deficit. In other words, we are borrowing more money to pay the interest on past borrowing. And the amounts are constantly rising. This is unsustainable. One item of government spending that we should be aiming to reduce markedly is debt interest. But this is more easily said than done.

The determinants of debt interest

The dynamics of debt interest are extremely powerful and potentially extremely dangerous. They are governed by a formula which links the ratio of debt to GDP, the growth rate of GDP, the public deficit as a percentage of GDP and the interest rate on government debt.

The following equation shows how debt as a share of GDP will evolve over time:

$$\frac{D_t}{Y_t} = \frac{(1+r)D_{t-1}}{(1+g)Y_{t-1}} + b_t$$

Where D t is government debt at time t, Y t is GDP at time t, r is the nominal interest rate, g is the nominal growth rate of GDP and b t is the primary budget balance as a share of GDP at time t.

Note that the rate of inflation does not figure directly in this equation. It is there, though, indirectly, through the nominal growth rate of GDP. For any given real growth rate, higher inflation will bring a higher growth rate of nominal GDP. And inflation will influence, although not mechanistically determine, the rate of interest at which the government can borrow.

Let us assume that the primary budget (i.e. excluding interest payments) is kept in balance. If nominal interest rates on government debt exceed the nominal growth of GDP, then debt servicing costs and the overall debt will continue to increase as a share of GDP. This is potentially explosive. And once markets react to the deterioration by increasing the rates at which they will lend to the government, then the deterioration accelerates. This is known in the markets as "the debt trap." Plenty of emerging market economies have found themselves facing this trap. Once in it, usually the

315.OBR (2025), Economic and fiscal outlook – March 2025, Link. These are the forecast figures for 2025-26.

only feasible ways out are default or inflation, which is default by the back door.

If a government wants to stop the upward move of the debt ratio and avoid the debt trap it must tighten fiscal policy so as to run a primary budget surplus. The higher the initial debt ratio, the bigger the primary surplus needs to be to stabilise the debt ratio.

If the nominal interest rate on debt is lower than the nominal growth rate then, with a balanced budget, the debt ratio will fall over time.

The UK currently has a debt ratio of about 100% of GDP and its budget deficit is currently just above 5% of GDP, of which around 3-4% is represented by interest payments, meaning that the primary deficit is just over 2% of GDP. Within the G7, our deficit is the third highest, behind the US and France.

Remarkably given that our real growth rate is so low, the growth rate of nominal GDP exceeds the nominal interest on debt by about 0.3%. This means that we can potentially run a primary budget deficit of just over 1% of GDP and still stabilise the debt ratio.

This is a bit misleading because the average interest rate that the government pays on its debt is heavily influenced by the legacy of considerable amounts of debt issued at low interest rates. In time, this debt will run off, to be replaced by debt carrying a higher rate of interest.

The options

There are six broad ways of getting the debt interest burden lower:

(i) Grow the economy.

(ii) Default on part or all of the debt.

(iii) Engineer a burst of higher inflation which will reduce the real value of the debt and lower the debt to GDP ratio.

(iv) Compel or encourage financial institutions to hold government debt, thereby reducing the rate of interest that the government has to pay to borrow. (This is known as financial repression.)

(v) Benefit from lower market interest rates.

(vi) Reduce the debt though fiscal restraint.

Growing the economy is the painless way and it has been a major element in reducing the debt on the two occasions that we have engineered a huge debt reduction, namely during the 19th century after the Napoleonic Wars and in the 20th century after the Second World War. But it is not under the government's direct control.

Default is not something that modern British governments have ever done. (Medieval monarchs are a different matter.) It is what failed states do in the emerging market world. And default has long lasting effects on the reputation and status of a country that goes down this route. It is not

remotely on the British policy agenda now – nor should it be.

Inflation is the way that debt burdens are often liquidated and it played a key role in the reduction of UK debt after the Second World War. But this is not a magic wand. Most importantly, inflation is a source of inefficiency in the economy and unfairness in society. It is something that we should aim to avoid or minimise. That is, after all, why we have the 2% inflation target. Once inflation is in the system it is devilishly difficult and expensive in terms of lost output to squeeze it out.

Moreover, the extent to which inflation can now be used to liquidate debt is circumscribed by the high proportion of index-linked debt in the total (about one third), the shortening of the maturity of the debt, and the greater sensitivity of the markets to the prospect of higher inflation.

Financial repression was employed in both the US and the UK during the post Second World War period to reduce the burden of debt servicing costs. You could say that the policy of Quantitative Easing (QE) was a recent example of financial repression in that it replaced market finance with finance through the central bank. This would ordinarily be much cheaper but given that the Bank of England has chosen to pay interest on commercial banks' deposits with it, the saving will have been small. (See below for a discussion of the payment of interest on commercial banks' deposits at the Bank.)

Apart from QE, financial repression is out of fashion. The idea of forcing financial institutions to hold government debt for other than prudential reasons is regarded as a distortion of financial markets. In any case, the decline of defined benefit pension schemes, which are constrained to hold large amounts of debt, will have the result that the natural demand for gilts from UK institutions will tend to fall over time. in today's open capital markets it is difficult to see much scope for financial repression to reduce the debt servicing cost.

Benefiting from lower market interest rates? At the time of going to publication, the British government borrows expensively: ten-year yields are at 4.59%, compared with 2.61% for Germany and 4.04% for the United States.[316] If the UK were to be able to borrow at a 1% lower rate then this would reduce debt interest payments by around £28 billion per annum. This effect would build up gradually as the stock of debt became due for refinancing.

But to a large extent this is outside the control of the government, although there are some things that can be done by governments to encourage a lower cost of finance. (See below.)

So we come to fiscal restraint. If we reduced the total debt by 10% then, other things equal, we would eventually reduce the debt interest burden by 10%. Once the debt ratio had stabilised, then to reduce the debt burden by 10% you would have to reduce the budget deficit by about 1% of GDP for 10 years.

316.Bloomberg, accessed on 14 October 2025, Link

The way forward

You can see the beginnings of a painful, though highly effective, policy mix, that would both reduce the debt burden over time and engineer a more favourable macroeconomic balance in the UK economy. The first requirement is to tighten fiscal policy to a significant degree, allowing the debt ratio to start to fall.

Because the fiscal tightening would reduce aggregate demand, the Bank of England would typically respond by reducing short-term interest rates. Such a reduction would directly reduce the cost of the government's short-term borrowing and the effect would tend to filter down the yield curve, thereby reducing the interest rate on 10-year bonds and beyond.

So you could envisage a virtuous circle in fiscal policy whereby initially painful actions improve the debt dynamic: fiscal tightening reduces the deficit and thereby, after a while, the amount of debt; this reduces the amount of debt interest that needs to be paid; this improvement in the fiscal position allows the government to borrow on more favourable terms, thereby adding to a downward pressure on borrowing costs; and these effects are compounded by the ability of the Bank of England to set lower interest rates, which then reduces the costs of borrowing.

One likely side effect of such a policy would be to reduce the pound's value on the foreign exchanges, thereby giving a boost the UK's net exports. Given that the UK is running a very large current account deficit and that its net international asset position is accordingly deteriorating year by year, this would be welcome. Of course, there would be temporary upward pressure on inflation which would for a time inhibit the Bank's ability to reduce interest rates. But after an initial upward blip, inflation should return to its previous path.

Annex E: Ending Interest Payments on Bank Reserves

One further possible way of reducing the burden of debt interest would be for the Bank of England to stop paying interest on commercial banks' deposits with it. This has not been formally included in the paper's recommendations for three reasons:

- It is temporary, with the savings falling rapidly over the period as deposits are reduced.
- It Is economically distortionary.
- It is functionally equivalent to a tax on the banks, which is firstly undesirable and, secondly, if it were thought to be desirable, could be implemented more cleanly by simply taxing them directly.

One criticism of this measure is that it would cause the Bank of England to lose control of monetary policy as banks would react to the loss of interest by concluding that they must sharply reduce their cash holdings by buying assets and lending money, while bidding down for deposits.

But this objection is easily answered. The Bank would simply have to impose Reserve Requirements or Special Deposits to be held with itself equal to just a bit less than the banks' current holdings with it, the difference to constitute the banks' operating assets and liquid reserves. Special Deposits were part of the Bank's monetary policy armoury for much of the post-war period and the Bank only began paying interest on bank reserves in 2005. Moreover, some other central banks already follow this practice. The ECB operates a tiering policy under which some of the banks' reserves are not paid interest.

The policy of not paying interest has been supported by, amongst others, two former deputy Governors of the Bank, Sir Paul Tucker and Sir Charles Bean, a former adviser to the Governor, Charles Goodhart and Lord Adair Turner. Given all this, the argument that the policy would be unworkable just does not stand up.

There are nevertheless downsides. Failing to pay interest would amount to a sort of tax on the banks. Some of this might be borne by the banks themselves but most of it would be passed on to their customers in the form of higher lending rates and lower deposit rates so this would amount to a tax on ordinary people (and companies) who deal with banks. That said, it is doubtful that many people would notice the difference and, if they did, doubtful that this would change their behaviour much, if at all.

It would, however, risk diverting financial flows into other channels outside the banking system which could give rise to prudential worries.

And the large gains from this measure would be temporary. They are currently as large as they are because of the huge expansion of the Bank's balance sheet which occurred because of the policy of Quantitative Easing. As the Bank's balance sheet runs down, or is made to run down through the policy of Quantitative Tightening, then the amount of banks' deposits will fall back and with it the amount of interest saved -- similarly if and when interest rates fall.

After all, before 2022, total interest paid by the Bank to the banks never exceeded £3 billion per annum and was sometimes less than £1 billion. We will, eventually, return to that sort of position.

The upshot is that this is not a first best measure. But it is worth considering, as is the alternate proposal of simply introducing a levy on the banks based on their profits or total assets. Both would have significant risks, but the current fiscal situation obliges us not to rule them out.

How much could this save?

The OBR's Economic and Fiscal outlook presents a forecast for the total number of gilts within the Asset Purchase Facility (APF - this is the value of the gilts purchased by the Bank of England as part of the Quantitative Easing programme) to 2029-30, as the Bank of England continues its Quantitative Tightening programme.[317] If we assume that the total value of reserves at the Bank will fall by the amount that the APF is forecast to fall, and that the Bank Rate falls to 3.5% by mid-2026 and remains at that level, we can estimate interest payments for the next five years.

If the Bank of England were no longer to pay interest on these reserves, it would therefore save the Treasury a cumulative £72 billion by 2030 – though as the table below shows, the annual saving diminishes significantly towards the end of this period.

Table 30: Savings from ending interest payments on bank reserves

Year	2026	2027	2028	2029	2030
Annual Savings, £ billion	20.0	17.2	14.5	11.6	8.8

These savings could be even larger if, as has been suggested by the Reform UK Party, the Bank of England were to stop its Quantitative Tightening programme altogether.

317. OBR, Economic and Fiscal Outlook March 2025, Link

List of figures and tables

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