

No. 418 December 2010

## **Britain's Borrowed-Time Bomb**

*By Eamonn Butler*

21 December 2010

Britain has managed to preserve its AAA credit rating during the world financial crisis, but its luck will run out unless it gets to grips with the spiralling costs of its welfare state. Its obligations to future pensioners, the cost of free medical care to an aging population and scores of other state benefits are imposing a growing burden that Britain's next generation may prove unable to afford. It might take 10 or 20 years to get to that point, according to analyst Miles Saltiel in his report "On Borrowed Time," published by the Adam Smith Institute. But there is every prospect of Britain then facing a fiscal crisis that will make Ireland's woes appear insignificant by comparison.

The trouble is that Britain's national debt, which the Treasury expects to peak at about 70% of GDP in 2013-2014, does not tell the whole story. Indeed it barely tells half the story. Alongside those strictly financial obligations to its creditors, Britain has also promised itself a huge raft of social benefits that it hopes its children will be good enough to pay for. And like someone ordering an expense-account lunch, it has inclined to be generous with other people's money.

On top of that, British baby boomers are now reaching retirement, and seemingly doing their best to live forever. New figures published last month showed that men at the retirement age of 65 can now expect to live until 87, and women to 90. In other words, members of this bulging generation look to be living on taxpayer-funded pensions for at least the next quarter of a century. The cost of state pensions has already risen by a quarter in the last 15 years. Some of that is due to Gordon Brown's expansion of the public-sector workforce, which has particularly generous pensions terms. But more is due to the sheer numbers coming through. Today, over-80s account for one in 25 British people; 50 years from now, they will be one in eight. Without reform, this giant Ponzi scheme is bound to collapse.

Along with pensions, older people use a lot more health care—another expense-account lunch, through Britain's National Health Service system. Since 1947, health-care spending has risen to 16.5% of GDP from 2%. The NHS budget increased by 40% under

the Brown years alone. Health-care costs will be just as big a strain on future public finances as pensions. Older people rely on other social services too, which the shrinking minority of younger workers are also expected to pay for.

Bodies such as the University of Munich and the Bank for International Settlements have already expressed alarm at the volume of these so-called "intergenerational obligations." Standard & Poor's reckons that U.K. debt could hit 100% of GDP by 2013, from just 30% a decade ago, and many leading economists agree. That is the point at which ratings agencies start putting you on credit watch. Certainly, Britain has a mature debt profile. But if gilt ratings did get downgraded below A, they would be expelled from the indexes of top-rated sovereign debt, and promptly dumped by bond funds, accelerating the problem even further.

The new Adam Smith Institute report looks at three scenarios. One is that the government's planned spending "cuts"—which are actually only reductions in the rate of increase of public spending—carry on until 2015 and then future economic growth (rather generously assumed at 2.5% per year) goes wholly into public spending. Britain's public debt would then hit 100% of GDP as early as 2019. If the proceeds of economic growth are shared 50-50 between higher spending and debt reduction, the crunch will still come, but 12 years later, in 2031. If future growth were devoted entirely to debt reduction—which would amount to unimaginable and unprecedented self-restraint by politicians—Britain would still be in the red until 2041.

It is plain that Britain cannot continue in this way. So what is to be done?

The first task is to get a handle on the scale of the problem. The U.K. welfare state has grown up through a long series of political initiatives, with no real thought given to its future cost. If we are to avoid collapse we need to know how deep that black hole really is. Politicians must also admit the long-term costs of the benefits they generously vote us today. Any policy that shifts costs onto future generations should come with that price tag attached, so we know how much of a burden we are loading onto our children.

Second, we need to adjust our benefits now in order to keep them affordable in the future. The government already plans to raise the pension age by a year, to 66; but with life expectancy rising two years every decade, the threshold should be nearer to 70.

Third, we ought to be paying more of our own bills—investing in our own pensions, insuring our own health. It's time we own up to the fact that expecting our children to pay for our comfort is not just risky, it is utterly immoral.

Mr. Butler is director of the Adam Smith Institute and author of "The Rotten State of Britain," (Gibson Square Books, 2009).

[Click here to read article.](#)

This article was published by [The Wall Street Journal](#) on 14 December 2010.

To subscribe to our free perspectives series please email us your contact details by [clicking here](#)

## **Related studies and commentary:**

### **The Global Fiscal Crisis and the Future of Public Spending**

A speech delivered to the Rotary Club of Wellington

1 February 2010

By Roger Kerr

[\[Full text\]](#)

### **Naive Keynesianism and Other Fallacies**

An article first published in the *New Zealand Centre for Political Research Weekly*

10 June 2009

By Roger Kerr

[\[Full Text\]](#)

### **Should Keynes have a seat at the G20 table?**

An article first published in the *Australian Financial Review*

28 March 2009

By Stephen Kirchner

[\[Full Text\]](#)

### **Submission on the Budget Policy Statement 2009**

A submission by the New Zealand Business Roundtable

January 2009

[\[Full text\]](#)

### **The Dilemma of Public Sector Spending: Getting the Quantity and Quality Right**

A Speech delivered to the 10<sup>th</sup> Public Sector Finance Forum in Wellington

19 September 2006

By Roger Kerr

[\[Full text\]](#)

### **Restraining Leviathan – A Review of the Fiscal Responsibility Act 1994**

A book published by the New Zealand Business Roundtable

November 2004

By Bryce Wilkinson

[\[Full text\]](#)