Without further reform efforts to bring the public finances under control in this Parliament will be undone

*While the Chancellor's Autumn Statement attracted much discussion of its immediate political significance, **Kimberley Trewhitt** suggests that it was a missed opportunity to address much longer term problems. She argues that projections for spending on health and pensions should worry us greatly and that much needed reform will only become more difficult with time.*

Last week's Autumn Statement demonstrated that the Government is struggling to stay the course of rescuing the public finances. Yet the current challenges will pale in comparison to those governments may face in the future if there is not radical reform of the areas where spending is projected to grow the most: health and pensions. The Spending Review for 2015-16, which George Osborne committed the Government to announcing in the first half of next year, provides an opportunity for the Chancellor to set out a new direction.

The welfare and health budgets are by far the largest items of public expenditure. In 2010-11, the Government spent more than £100 billion on health and more than £160 billion on welfare. Spending by the Department for Work and Pensions over the period was greater than that of the Department for Business, the Department for Education, the Ministry of Defence and the Department for Communities and Local Government put together. Health and welfare are also the two public service areas that will be put under the most pressure in the future as a result of demographic change. More people will live longer and live in old age with complicated health conditions. The Office for Budget Responsibility (OBR) has projected that over the next forty years government spending on health will increase from 8.1 per cent of GDP to 8.7 per cent of GDP and spending on state pensions will rise from 5.7 per cent of GDP to 7.3 per cent of GDP.

The Government's current austerity plans fail to address this long-term unsustainability. The health budget is ring-fenced and the Government is unwilling to renege on manifesto promises to pensioners such as the Winter Fuel Allowance. The introduction of the triple lock indexation on the state pension and plans to introduce a single tier pension also have significant cost implications. The Government needs to take action now otherwise the public sector debt will be on an upward trajectory again from the 2030s. The OBR has projected that it will reach almost 90 per cent of GDP by 2060. Efforts to bring the public finances under control in this Parliament will be undone. Furthermore, the costs of tackling the challenge will be greater further down the line. Not only will financial costs be higher, but politically reform will be more difficult; by 2020 45 per cent of voters will be aged over 55.

In the Autumn Statement the Chancellor re-confirmed the status of the NHS as a protected budget in 2015-16. Instead, George Osborne should open up the health budget for negotiation. So far in this Parliament, the best examples of innovation and improvements in the delivery of public services have been in those services with the budgets that are most under pressure, such as local government, the police and the criminal justice system. These improvements go further than finding efficiency savings; there has been transformation of public service delivery. The scope for achieving this while cutting spending is there because so much spending in the past was poor quality.

In health the Government has continued to measure success by an increase in the number of doctors. However, the quality of care depends on the quality rather than the quantity of staff. As the Home Secretary has argued in relation to the police: "What matters is not the total number of officers employed, but the total number deployed, and how effectively they are deployed". Inconsistency can also be seen in national pay and conditions. The Autumn Statement announced the introduction of performance related pay for teachers. This should be extended to other services including the NHS.

Giving managers this greater flexibility can improve the quality and productivity of care, as shown in recent Reform research on the health workforce. In the long term, individuals may also need to take more responsibility for the costs of healthcare themselves. Paying for some health services and greater use of private insurance would reflect health systems in other developed counties, such as fees for GPs in New Zealand and the take up of health insurance in Australia.

The second key part of reform will be a fundamental redesign of the welfare system. In the Autumn Statement, George Osborne set out changes to the uprating of benefits, which are estimated to save around £3.6 billion. This is a drop in the ocean compared to the scale of the challenge. The area where the greatest costs lie remains untouched: pensions account for the single greatest part of the welfare budget. The structure of the population has changed drastically since the State Pension was introduced. Life expectancy in the UK is around 20 years higher than the retirement age and by 2050 almost one in four people will be aged over 65. As a result, the budget will be subject to enormous pressure. At the same time, the working age population (which typically funds pensions and old-age transfers) is set to shrink as a proportion of the population by 10 per cent. Levers such as lifting the state pension age in line with longevity will be insufficient to overcome the challenge. Tax hikes on the working age population would also be unsustainable in the long term.

The state pension system must therefore focus on helping those who need it most. This means that many individuals should contribute more to the costs of their retirement and that a stronger private pillar should be developed. It also means that supplementary pension benefits should be better targeted at those in need. This includes programmes such as the Winter Fuel Allowance, free bus passes and TV licences, which represent poor value for money. The Winter Fuel Allowance costs more than £2 billion a year and 90 per cent of recipients are not in need of the payment. To put this into context, Lord Alan Sugar, ranked among the top 100 of the Sunday Times Rich List, tweeted this week: "Government debt is £1,078,450,095,062. I tried to give back my £100 fuel allowance they have no system to accept it. Giving it to charity."

Commitment to reforming public services and tackling unsustainable spending areas to put the public finances on a sound footing is the only way to ensure economic stability and growth in the long run. The Autumn Statement was a missed opportunity in this sense.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting.

About the author

Kimberley Trewhitt *is a researcher at the independent think tank Reform. Kimberley joined Reform in 2010 and focuses on economic and fiscal policy, the business environment and welfare.*

You may also be interested in the following posts (automatically generated):

1. Book Review: Personalising Public Services: Understanding the Personalisation Narrative by Catherine Needham (10.6)
2. Autumn Statement 2012: There are bigger challenges awaiting George Osborne (7.5)
3. Poorly targeted short term initiatives to revive the UK's flagging growth rates are likely to make things worse. Consistency in economic policy is key in delivering long-term growth. (6.9)
4. If the economic outlook continues to worsen, George Osborne will have to relax the pace of deficit reduction and take measures to increase demand in the economy. (6.3)