Sharper Axes, Lower Taxes: Big Steps to a Smaller State

SUMMARY

- Government spending is over 50 per cent of national income. Spending grew steadily in the twentieth century and then experienced very rapid growth from the beginning of the 21st century.
- Much government spending discourages economic activity and prevents innovation and competition in crucial sectors such as health and education. Furthermore, government intervention is incoherent. For example, government spending and implicit subsidies strongly encourage certain carbon-intensive activities; other forms of government spending are then used to try to reduce carbon-intensive energy generation.
- The recent Comprehensive Spending Review was anything but comprehensive. Certain departments were omitted from the review altogether. Most other areas of spending were 'salami sliced'. No coherent, bottom-up analysis of government functions has taken place. The government could achieve its main public policy objectives at much lower levels of spending if there were to be a radical review of all aspects of spending.
- Even if the coalition achieves its objectives, there will be only modest reductions in government spending. Nominal spending will rise, real spending will be cut by less than 1 per cent per annum and spending as a proportion of national income will fall back only to 2007 levels.
- A complete review of government functions could, as a first step, lead to cuts in underlying government spending of £242 billion in addition to the government's proposed cuts. Using the

government's definitions of government spending and national income this would amount to a cut of £215 billion to around 29 per cent of national income.
- Government spending – even in areas such as research and development, investment and education – has little or no beneficial effect on economic growth. The taxation necessary to fund government spending, however, seriously and adversely affects economic growth. A reduction in government spending of the order suggested by our authors would lead to economic growth increasing by more than 0.75 per cent per annum: this would mean that national income would grow by an extra 20 per cent every 25 years.
- The current welfare system discriminates strongly against work, family formation and saving. Welfare should be completely reformed to provide income supplements through a negative income tax with household tax allowances. Furthermore, welfare claimants without jobs and who are of working age should be required to undertake work as a condition of receiving benefits. Reforming welfare and related changes to pensions would save £46.5 billion a year.
- The National Health Service should be replaced by health savings accounts with insurance for catastrophic risks. Experience from other countries suggests that this can lead to better outcomes, lower costs and much stronger incentives for health promotion. This reform would save £44 billion a year. More radical reform of education to save over £15 billion is required: reforms should include parents making some contribution to the cost of their children's education.
- Policy in areas such as defence and foreign aid should be strategically reviewed. Foreign aid should be cut entirely except for emergency aid: the evidence suggests that growth in poor countries will come about only as a result of the adoption of market economies and through private investment. Aid probably hinders

growth in the poorest countries. Reforms to defence and foreign aid should lead to spending reductions of £29 billion a year.
- Much government-owned infrastructure can be privatised; market-based solutions to transport urgently need to be adopted with a consequent elimination of government subsidies; and climate change policy is currently incoherent. Huge savings in government spending are possible in the field of climate change policy even if the government wishes to retain incentives to reduce carbon emissions. Over £80 billion a year could be available for tax decreases from the proposals made in these areas.