

2136.3	2136.5	3761.3	1402.5
1801.7	1081.2	3731.4	2011.8
909.2	909.6	893.2	3671.1
2011.4	2101.6	4610.6	1081.2
3415.9	3541.8	5131.4	6951.3
1904.7	1904.2	2011.8	1081.2
1468.4	4168.6	3671.1	2011.4

In case of emergency, break glass

What to do if the UK faces a sovereign debt crisis

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Foreword

The Right Honourable Sir John Redwood PC, MA, DPhil, FCSI

This is a very important contribution to the UK economic debate. The authors warn of the dangers of the UK continuing to borrow too much and ending up unable to finance new debt at realistic interest rates. Such a crisis would force emergency measures on spending and taxation that no government should wish to experience. It would be similar to the pains of the 1974-79 Labour government forced into spending cuts and tax rises by the need to borrow from the IMF when its spending was excessive. This time round it could be a strike of the bond lenders domestically forcing remedial action.

This work sets out the measures that would be needed if the UK were to face a debt crisis, while showing how taking many of these steps now could also help head off such a crisis and restore the UK to faster growth and better balance in its economy.

As I write this, there is a respite in the markets for UK government debt, brought on by a worldwide move to lower rates and by a pause in the upwards move of UK inflation. Nonetheless, UK debt is too high and rising, which leaves the country at risk of higher state borrowing rates, higher taxes and less growth - a lethal combination. This work is right not to scaremonger. The government would be right to take it seriously and implement its recommendations. That would get state borrowing rates down and remove the current serious doubts from markets about future deficits and the ability of the government to control spending.

The UK political background to the economy and public spending

The UK government is spending too much, which also means it is taxing too much and borrowing too much. To most people paying their taxes, seeking to control their own costs and to compete in private sector jobs and businesses, the government has an overspending problem which needs addressing urgently.

To left wing parties, public sector management and much of the media in the UK debate, the UK is still suffering from alleged austerity in the public sector. They think the rich and better off are not taxed enough, so it is high time they were made to pay more to boost public output. The problem with this approach is further tax rises could damage growth more, leaving the Treasury short of tax revenue with growth more elusive. The reaction to the government's first tax-raising budget damaged growth, led to some investment being cancelled and more well-off investors going elsewhere.

The Labour government wants to boost economic growth to increase tax revenues and pay for more public service without raising tax rates and new taxes. It promised not to raise the three main taxes to get elected, and its first budget with higher taxes on employment, business,

farms, and savings did damage, pushing up unemployment and inflation. Its own flawed fiscal rules tell it to raise more tax in the meantime, which duly impedes the very growth they see as their salvation. There are now rumours that the government may have to break its promise and raise Income tax to cut the deficit.

The right-of-centre opposition parties stress the need for tax cuts to boost growth. The Conservatives have set out an initial £37bn of cost reductions, part paying for deficit reduction and part for lower taxes. Reform has offered a chainsaw-style assault on public spending in the councils it is now controlling and in the national government with a view to lower tax.

Much of the debate is locked into disputes around the central assumption for the left-inclining media and parties that more public spending will deliver more and better public service, with a general reluctance to explore the details where wasteful, less desirable or inefficient public spending could profitably be reduced or eliminated. The expected larger deficit will likely come from a lower forecast of productivity growth. A big part of this revision reflects the collapse of public sector productivity after 2019 and its current level still well below six years ago.

The UK economic policy control framework

Whilst in the EU, the UK had to adopt the EU semester debt and deficit controls as its fiscal framework even though it was not a member of the Euro where that was mandatory and enforceable by fines and sanctions. It was required to keep its running deficit to under 3% of GDP in any given year, and to reduce state debt to GDP to a maximum of 60%. For most of the later years under this regime, the UK, like other member states, allowed debt as a percentage of GDP to rise well above 60%, and in some years exceeded the 3% annual control.

Under Rishi Sunak as Chancellor, a reform of the fiscal rules was undertaken, but it still retained EU Maastricht Treaty-style debt and deficit driven controls. Attention turned to requiring the government to set budgets, whereby the fifth year of the forecast UK state debt was falling as a percentage of GDP, in recognition of the longer term need to bring the ratio down. Rachel Reeves relaxed this rule giving more room to borrow to invest, whilst saying she would eliminate the current deficit by year five. So far, these fiscal rules have not prevented deficits and debt percentages continuing to rise.

This publication sets out sensible spending reductions

There is plenty of evidence that taxes are too high in the UK. Individual taxes like CGT and spirits tax are bringing in less revenue after recent rises. UK corporation tax at double the Irish rate brings in just one third the Irish amount per head. The government is being warned off more wealth taxes, as many millionaires and billionaires are leaving to avoid the current levels of tax.

All this year, the UK government has paid a higher price for longer term borrowings than other advanced countries, and has paid a higher price than the one-day peak of rates under Liz Truss which so alarmed Labour and commentators at the time. Debt interest at over £100bn a year is

now a big item in the budget. The UK is having to borrow to pay the interest on past borrowings, which is not a good position to be in.

The answer is therefore spending reductions. The Labour government tried a couple of these in its first budget, only to choose cuts to benefits which were unacceptable to many people. They were forced to drop them by their own MPs. As this work shows, there was no need to choose such contentious items.

All political parties agree more people should be in work and not on unemployment benefits. The last government did well in getting unemployment down from 7.8% to 4% over its years in office. It has now risen to 4.8%. There are a number of measures to promote more work for people already settled here. This can also be linked to fewer low pay and no pay migrants coming into the country on visas. This will help save large sums on benefits and subsidised housing that new people will otherwise need.

Most agree the surge in sick notes for life in the last couple of years is also avoidable. Granting younger people with milder mental health conditions, with no requirement to seek work, is bad for them as well as for the state. There needs to be tightening of the rules for new grants of ill-health benefits.

The Bank of England, according to official forecasts, is in the middle of losing taxpayers £257bn by selling and holding bonds at large losses. This is a cost of more than £20bn a year to taxpayers who have to send the Bank cash as it records the losses. Stopping selling any bonds in the market and adjusting Bank lending and borrowing rates to provide a modest spread between the two would save more than £10bn a year.

UK public sector productivity is still down by more than 4% on 2019 levels. Simply getting back to that old benchmark would save more than £25bn a year, before adding more productivity gains to make up for the lost years since then and to incorporate the great skills and capacities of modern computers into the clerical and administrative activities of modern government.

The UK has done more than other leading countries to drive its CO₂ emissions down. Very expensive capital schemes to go further will push up energy prices whilst requiring large subsidies. Some of these schemes increase world CO₂ whilst lowering UK output. There is plenty of scope for savings, rephasing of schemes, or more private capital.

This publication offers hope and a way forward

These are just a few highlights from this well researched case. The message is a strong and positive one. Government can do more for less. There is no need for the Chancellor to plot another tax-raising budget, no need to terrify people and business into doing less for fear of a bigger tax bill to come.

Cutting public spending by enough will bring longer term borrowing rates down. This sees off any chance of a bond crisis, cuts government spending on debt interest and allows the private

sector to borrow more to invest in growth. It is difficult to understand why these obvious ideas and this commonsense approach escape the government as it desperately thrashes around to find more tax revenue to spend more.

I strongly recommend this antidote to the doom loop of tax more, grow less, tax more. This is a good response to the idea that all public spending is all equally well directed and crucial to good public services. Its clear focus on the steps needed to restore stability and growth can help the government pilot a better future course well away from the rocks of a debt crisis.

The author and contributors have done us good service. They point the way to more growth, less borrowing and lower taxes. This is the golden staircase to prosperity, which will give the state more money for better core services. Controlling existing waste, eliminating inefficiency, directing benefits well are essential steps to get there.



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Executive summary

- This paper presents a series of coordinated policy responses in the event that the UK experiences a sovereign debt crisis. We have convened senior City, economic and political figures to develop a package of measures which we believe would, in most circumstances, send a credible signal to markets and restore confidence in UK government bonds (gilts).
- While we cannot predict *whether* a gilt crisis will occur, we consider this to be a plausible likelihood scenario, given the UK's macroeconomic position and recent nervousness demonstrated in the bond markets. This risk remains, despite the recent respite in government bond yields.
- At the point the bond markets lose confidence in the UK's creditworthiness, the government can no longer finance its budget deficit on affordable terms (or, in extremis, at all). That moment would trigger both an economic and a political crisis.
- This is therefore a high-risk scenario - a plausible likelihood combined with a crisis impact - thus necessitating a response plan.
- A number of events could trigger a crisis - for example, significant deviation from the Chancellor's 'fiscal rule' (not least following the forthcoming Budget), a credit rating downgrade, a failed gilts auction, or simply broader international market stress. The risk of a less prudent administration, following a change of Prime Minister or Chancellor, should not be discounted.
- In a crisis scenario, the number one objective would be to restore bond market credibility - and not make things worse. This would involve re-convincing prospective buyers of gilts that future tax receipts will cover coupon payments and redemptions. To achieve this, the government must convince the market that:
 - Public spending can be credibly cut back;
 - Growth can sufficiently support future tax receipts;
 - The value of nominal gilts will not be undermined by inflation, or indeed a fall in the value of sterling (noting that around a third of gilt holders are foreign).
- The measures outlined in this paper comprise four 'pillars' which should be implemented immediately and simultaneously:
 - I. Announce a package of immediate spending cuts;
 - II. Coordinate institutional and regulatory support (including the Bank of England);
 - III. Announce a credible commitment to longer term savings measures;
 - IV. Announce a similar commitment to longer term pro-growth measures.

- In addition to the measures within each pillar, the government would need to use judgement, understand bond market dynamics and communicate with the market effectively.
- We present Pillar I as a 'menu' of savings which can be implemented in the near term. We estimate that, in most circumstances, cuts totalling 2-3% of total managed expenditure would suffice, however the menu approach provides flexibility should more substantial measures be needed.
- Significant tax rises are a common feature of fiscal adjustments, especially if made under duress. However, we make the case that these would not be appropriate for the UK, which already faces its highest tax burden since the Post-War period.
- Pillar II primarily focuses on the expected policy responses of the Bank of England, noting that, in a sovereign debt crisis, QE can only be a temporary measure to buy time. The section also discusses changes to the approach of the Debt Management Office, as well as emergency regulations which can be introduced to stimulate domestic demand for gilts, as well as restrict short selling.
- Pillars III and IV outline how the Chancellor would have to demonstrate a commitment to address, respectively, spending and growth challenges. While less immediate in their implementation, these pillars will be as vital a part of restoring market confidence.
- Material reforms to energy policy must form a core part of any response package, as current 'net zero' policies not only incur large taxpayer subsidies, but high wholesale and policy costs - which are loaded onto consumers and industry - significantly undermine growth.
- The current Labour government must avoid the temptation to implement measures - notably increases to taxation and spending - which could worsen the situation and potentially necessitate more drastic measures later on. While the UK has previously sought an emergency loan from the IMF (in 1976), there can be no guarantee that this facility - which would carry punitive conditionality - will be available let alone desirable.
- We emphasise that the measures presented in this paper are framed around a rapid response to a fiscal emergency, and are not a replacement for a manifesto. Nevertheless, we make the argument that much of the paper's substance could and should ideally be implemented now, rather than under duress.

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Background

What is a sovereign debt crisis?

A sovereign debt crisis occurs when a country's public debt cannot be financed through the usual primary debt markets. Investors no longer believe a country's debt is creditworthy, or the interest required to purchase the debt is so high that this in itself necessitates additional borrowing, thereby increasing the country's debt and creating a debt spiral.

At this point, a government cannot finance its budget deficit and meet its cash flow requirements on affordable terms, leading to not only an economic crisis, but also a political one as the government now faces the choice of one or both of drastic changes to fiscal policy, and approaching their creditors to try to restructure their debt.

The UK has been here before: In 1976, the government was forced to seek a \$3.9 billion loan from the International Monetary Fund after a collapse in sterling and loss of market confidence.

Why is this now a concern?

The UK has experienced little productivity growth over the past 15 years¹. Combined with persistently high levels of public borrowing, a vast stock of accumulated debt now refinancing at much higher interest rates, and rising unfunded long-term liabilities, the country risks entering a fiscal 'doom loop'.

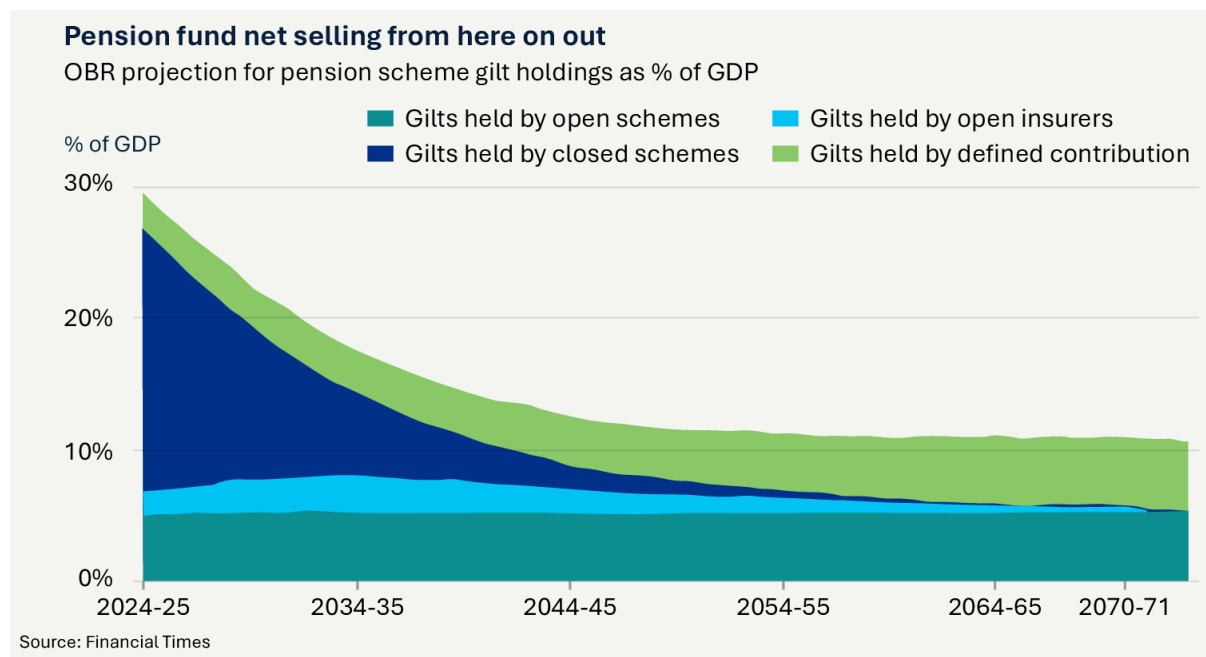
An extended period of near-zero interest rates after 2008, quantitative easing, and a global savings glut allowed governments to borrow cheaply and delay necessary structural reforms. That era has now ended, with inflation still above the Bank of England's target, and with increased global competition for capital, as other major economies issue record amounts of sovereign debt.

The UK is a reliable borrower having never defaulted on its sovereign debt. However, like other Western countries, it now owes a significant amount of money. Public sector net debt is approaching £3 trillion; it is burdened with post-pandemic levels of public spending and borrows hundreds of billions each year both to finance its ongoing deficit and to refinance the existing stock of gilts as these mature. Debt interest payments have risen sharply, now surpassing major spending departments such as defence and housing.

Furthermore, the UK currently runs both a current account and fiscal deficit; this combination of 'twin deficits' means the UK now especially relies heavily on external funding rather than domestic private-sector savings to fund spending. Historically, this lack of demand was offset by large domestic buyers of gilts from private-sector LDI schemes - structural buyers of gilts on leverage to deliver returns to large defined-benefit pension plans.

¹ <https://commonslibrary.parliament.uk/research-briefings/sn02791/>

Over recent years, the roll-off of these plans has resulted in large falls in demand for gilts from these domestic buyers. The following chart demonstrates that this trend is likely to continue.



Combined with the Bank of England's withdrawal as a net buyer as it pursues quantitative tightening (QT), this leaves the UK more reliant on attracting foreign buyers of gilts. Overseas investors now hold roughly a third of all gilts², in turn leaving the UK more exposed to global markets.

Indeed, the UK has displayed, since the middle of the last decade (and even more acutely over the past four years), a negative correlation between FX and bond yields during some stress episodes. This is worrisome for a developed market but is also rational in the context of the UK's fragile budget situation and trade balance.

What could trigger one?

Any number of events could trigger a significant sell-off in gilts which spirals into a debt crisis:

- **Failure to execute the Chancellor's budget plans** - a substantial deviation from the 'fiscal rule' - already with minimal 'headroom', and highly sensitive to small shifts in macroeconomic assumptions - could undermine credibility. This risk has grown following the government's inability, despite its large majority, to pass relatively modest welfare reforms.
- **Credit rating downgrade** - a significant downgrade of its credit rating could rapidly ignite a crisis. In particular, passive investors (bound by index rules) could be forced to sell UK government bonds.

² OBR Fiscal Risks and Sustainability Report, July 2025

- **Poor gilts auction** - difficulty selling new debt at reasonable yields - or failing to place the full issuance³.
- **Adverse global market conditions or contagion** - global shocks can easily catch governments off guard. A broad 'risk-off' shift, an unrelated market event, or tightening by major central banks could all push up UK borrowing costs. A directly related event such as a sovereign debt crisis in another developed country (e.g. France) could cause contagion.
- **Sharp rebound in the US dollar** - this could make fuel imports more expensive, worsening the UK's external deficit and adding to inflationary pressures. This risk is especially acute if the dollar rebounds during the peak demand winter months.
- **Heavy issuance by other major economies** - such as the US, eurozone countries, or Japan would intensify competition for capital. Competition with other government bond markets could trigger a crisis if the UK is considered less creditworthy than US or EU-issued debt.
- **Change of political leadership** - with the government currently struggling politically, the Prime Minister may choose to replace the Chancellor, or the Parliamentary Labour Party may be tempted to replace its leader. If either event represents a steer towards a less fiscally prudent fiscal stance, this could unsettle bond markets.
- **'Black swan' events** - an unforeseen shock - such as a systemic energy disruption or major geopolitical event (including another pandemic) - could quickly destabilise gilts.

³ Moreover, even when bids appear strong, the auction 'tail' often reveals higher yields required to attract sufficient buyers.

Overarching objective: Restore market confidence; do not make things worse

Upon materialisation of a crisis, the number one priority is to restore market confidence - and to not make things worse.

This involves re-convincing prospective buyers of gilts of one or more the following:

- Future tax receipts will be sufficient to cover public spending, coupon payments and redemptions;
- Public spending can credibly be cut back to enable this;
- Growth can sufficiently support future tax receipts, driven by structural reforms;
- The value of nominal gilts will not be undermined by inflation (or indeed a depreciated sterling - relevant to the one third of gilt-holders who are international).

While details are important, in the heat of a crisis, winning back credibility will also depend on the art of understanding bond market dynamics, and crafting a convincing narrative and vision - the Prime Minister can coordinate messaging between the Treasury, Bank of England and Number 10 to signal a direction of travel.

Policymakers must also understand the risks of delayed action, inaction or the wrong policy response could spark further selling of gilts, making a bad situation a lot worse. Markets are unlikely to give the government the benefit of the doubt without a clear indication to address the cause of the loss of market confidence.

In terms of impact, the difference between the right and wrong policy response is the difference between re-accessing the bond markets at affordable and sustainable interest rates, and consequences such as runaway inflation, ever higher interest rates and depreciation of the currency - and ultimately much more drastic countermeasures than the ones outlined in this paper.

The task is to restore confidence - not only in the government, but in the belief among bond holders that other holders will also remain confident.

Pillar I: Announce package of immediate spending cuts

A key part of a confidence-restoring plan must include an executable and credible fiscal consolidation. In the general case, this means one or more of 1) rapid cuts to public spending, 2) tax rises, and 3) measures to increase growth. For the current UK context - with the state now accounting for some 44% of national income⁴, near-zero growth, and the tax burden already at a post-war high⁵ - we argue that fiscal consolidation can only realistically come from a series of spending cuts, as well as measures to increase growth - this section covers the former, while the latter is covered within Pillar IV.

While it is impossible to predict, *ex ante*, the severity of a crisis and thus the scale of cuts needed, we estimate that cuts totalling 2-3% of total managed expenditure (TME) would likely suffice. We present a ‘menu’ of spending restraints which, in their totality, outweigh this range, but which are nevertheless included to provide political optionality as well as flexibility if the scale of a crisis necessitates a much more severe consolidation.

Stop active sales of gilts on the Bank of England’s balance sheet

Quantitative tightening (QT) was initiated in 2022, with the UK becoming one of the few major economies to pursue active gilt sales. The policy has not only created unnecessary selling pressure in the gilt market (as we discuss in the following section), but also carries a significant fiscal cost. We forecast the potential savings of ending the active sales component of QT (while continuing to recognise losses on gilt redemptions as they occur, which the government cannot control).

Reducing or ending the active sales of gilts held on the balance sheet of the Bank of England (BoE) under the Asset Purchase Facility (APF) will slow the realisation of valuation losses that have arisen during quantitative easing (QE). That in turn will mean that the Treasury will not have to compensate the Bank of England for such losses in the short term, which reduces the increase in public sector net debt (PSND)⁶.

⁴ OBR “Brief Guide to the Public Finances” April

⁵ <https://obr.uk/box/the-uks-tax-burden-in-historical-and-international-context/>

⁶ In reaching these figures, it should be noted that: 1) these valuation losses do not impact the current budget, the government’s fiscal target measure. We should therefore be careful not to imply that they do affect public sector net borrowing (PSNB); 2) some valuation losses arise from redemptions rather than active sales. The valuation losses incurred are dependent on the price at which the gilts were originally purchased. The timing of redemptions cannot be controlled. The split of these losses between active sales and redemptions has been apportioned on a pro rata basis.

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	10.8	12.3	12.9	13.2
Of GDP	0.35%	0.38%	0.39%	0.38%
Of TME ⁷	0.77%	0.86%	0.88%	0.87%
Of budget deficit ⁸	11.07%	15.30%	16.65%	17.81%

Introduce a tiered system for Bank of England reserve remuneration

The Bank of England can go further by introducing a tiered system for remunerating reserve balances, similar to that used by the European Central Bank⁹ and the Bank of Japan.

Paying interest on the Bank of England reserve balances that exceed the yield on the gilts held in the APF does incur a loss and negatively impacts the current budget and PSNB. Therefore, reducing the payment of interest on these balances would improve the budget deficit. Further, the cessation of active sales of gilts held under the APF would increase the interest received on the gilts held (estimated yield of 1.9%). Interest would continue to be paid on general reserves held at the Bank.

It should be noted that reducing this interest income to UK financial institutions would lower profits and, in turn, corporation tax receipts. Any projected savings should therefore be adjusted accordingly.

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	14.0	12.7	11.5	10.0
Of GDP	0.45%	0.40%	0.34%	0.29%
Of TME	1.01%	0.89%	0.78%	0.66%
Of budget deficit	14.45%	15.86%	14.81%	13.49%

⁷ Indicative of scale only, does not affect the budget deficit (PSNB), but does reduce public sector net debt (PSND)

⁸ Indicative of scale only, does not affect the budget deficit (PSNB), but does reduce public sector net debt (PSND)

⁹ The ECB also maintains a spread between its lending and deposit rates, allowing it to earn a modest margin on operations with the banking system

Reduce civil service headcount to 2019 levels and introduce productivity improvements

The headcount in the civil service has increased by 102,240 from 413,910 in 2019 to 516,150 in 2025¹⁰, with no perceivable improvement in service delivery. Over this period productivity in the public sector has fallen by 4.2%¹¹ and further lagged the increase (albeit modest) of the private sector. Reducing staffing levels back to 2019 levels would, taking a mean salary level of £40,700, unlock substantial savings when non payroll costs and other efficiencies are factored in.

The phasing of this saving would have to reflect the time required to undertake such a reorganisation, and the cost of redundancies. It is reasonable to assume that staff reductions of this scale would be redeployed into the private sector and other vacancies in the public sector.

Significant further savings could be achieved by extending productivity improvements across the wider public sector¹², notably the administrative functions of the Departments of Health and Education.

A reduction of £5 billion annually after 2 years is realistic given:

- This was previously achieved between 2011 and 2016;
- The scope to improve productivity (including through AI enhancements).

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	2.6	4.0	5.0	5.2
Of GDP	0.08%	0.12%	0.15%	0.15%
Of TME	0.19%	0.28%	0.34%	0.34%
Of budget deficit	2.67%	4.99%	6.46%	7.03%

Cap the cost and use of independent consultants

The government can go further by setting an expenditure cap on the use of external consultants at 2019 levels. This can be achieved by not renewing expiring contacts as they fall due and freezing new consultancy contracts except in exceptional circumstances. Across government spending on consultants was £3.3 billion last year, up from £2.1 billion in 2019¹³. As a further

¹⁰ Full-time equivalent - source: Institute for Government - Civil service staff numbers 18th September 2025

¹¹ Source: Office for National Statistics - measure of public service productivity March 2025

¹² See, for example, <https://johnredwoodsdairy.com/2025/10/25/the-budget-black-hole-equals-the-productivity-collapse/>

¹³ Tussell, 18 September 2025

control, a 'don't pay twice' rule could be considered, requiring departments to demonstrate that the work cannot be delivered by existing staff before engaging consultants.

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	0.7	0.9	1.1	1.2
Of GDP	0.02%	0.03%	0.03%	0.03%
Of TME	0.05%	0.06%	0.07%	0.08%
Of budget deficit	0.72%	1.12%	1.42%	1.62%

Revise welfare benefits system criteria, targeting 2019 levels

Working age benefits have increased substantially since 2019. Whilst the picture is confused by changes in the structure of the benefits system, and the blurring of unemployment and health benefits, in the main, this has arisen from the increase in the numbers of claimants rather than the level of the benefits themselves. Total claimants across all categories have increased to over 6 million currently from under 4 million in 2019¹⁴. For example, PIPs (Personal Independence Payments) claims have increased from a little over 2 million in 2019¹⁵ to almost 4 million today¹⁶. Claims based on a broader inclusion of health conditions for both UC (Universal Credit) and PIPs have encouraged this increase. The level of increase from 2019 clearly indicates the scope for reducing spending.

Overall spending on disability and incapacity benefits for working age adults has increased from £34.6bn in 2019 to £53.9bn in 2025, £19.3bn over the period a 56% increase. They are set to continue increasing by a further £8.9bn or 17% up to 2029¹⁷. Working age benefits are disproportionately driving the overall increase in these benefits compared to pensioners and children.

To put this in context, spending on benefits was 0.3% of GDP in 1985-86, had risen to 1.4% of GDP in 2023-24 and is forecast to rise to 1.8% of GDP by 2028-29¹⁸.

It is clear that spending on benefits has got out of control and bringing them back to the real terms cost in 2019 would deliver substantial cost savings to the taxpayer.

Accordingly, the focus would be on reducing both future and current claimants by:

¹⁴ DWP Stat-Xplore

¹⁵ Department for Work and Pensions February 2020

¹⁶ Department for Work and Pensions June 2025

¹⁷ <https://ifs.org.uk/publications/health-related-benefit-claims-post-pandemic-uk-trends-and-global-context>

¹⁸ <https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/welfare-spending-disability-benefits/>

- Tightening the eligibility criteria for disability benefits and ensuring that all assessments and reassessments are carried out on a one-to-one basis;
- Reinforcing the requirements for claimants to be looking for work to qualify for out of work benefits;
- Controlling out-of-work benefits if more than one offer of employment is declined;
- Limiting the level of out of work benefits over long periods of unemployment. For example limiting the new Unemployment Insurance (which replaces Job Seekers Allowance and Employment Support Allowance) claim period to 6 months would reduce spending by £1.4bn annually¹⁹;
- Limiting benefits to UK nationals (and EU citizens given permanent leave to stay under the succession agreement, unless a qualifying period and amount of NI contributions has been met).

These are indicators of the steps that could be taken to reduce claimant and claim levels effectively. Setting goals for claimant number reduction and the overall budget available for claims would underpin projected cost savings. These would also be based on 2019 levels of claimants.

It will take time to reduce claimant levels, reduce unemployment and help people back into the workforce. This is reflected in the phasing of the cost savings that will be achieved.

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	8.0	12.0	16.0	20.0
Of GDP	0.26%	0.37%	0.48%	0.58%
Of TME	0.58%	0.84%	1.09%	1.32%
Of budget deficit	8.23%	14.96%	20.67%	27.03%

Temporarily reduce foreign aid budget to 0.1% of gross national income (GNI)

The arbitrary target of 0.7% of GNI annually for foreign aid was first reduced to 0.5% by the Conservative government in 2021, and further to 0.3% (from 2027-28) by the Labour government in 2025. There is no reason for not following this trend in the event of a fiscal crisis by temporarily reducing spending to 0.1% of GNI. It would be hard to justify trying to borrow almost £10 billion a year²⁰ in a hostile bond market, at high interest rates, to be sent to other nations when the UK has pressing needs at home.

¹⁹ <https://ifs.org.uk/sites/default/files/2025-10/GB%20Options%20for%20Unemployment%20Insurance%20-%20PDF.pdf>

²⁰ <https://dataportal.orr.gov.uk/media/udsa42ql/rail-industry-finance-uk-statistical-release-202324.pdf>

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	6.2	6.4	6.7	6.9
Of GDP	0.20%	0.20%	0.20%	0.20%
Of TME	0.45%	0.45%	0.45%	0.46%
Of budget deficit	6.38%	8.03%	8.63%	9.36%

Reduce railway (TOC) subsidies to 2019 levels

In the latest financial results of the railway industry total revenue was £25.4 billion, of which £12.5 billion was government subsidies²¹. Whilst £8.3 billion was to Network Rail, £4.1 billion was to the train operating companies (TOCs). This contrasts with a subsidy of only £1.2 billion to the TOCs in 2019-20²². If passenger numbers have permanently reduced, and fare income with it, this new reality needs to be addressed. Subsidies can be progressively reduced to 2019 levels over the course of this parliament, allowing TOCs to adjust their services to the new level of funding available. This will save £2 billion annually by 2029-30. The estimates do not include further potential savings from the re-nationalisation of TOC operations as existing contracts expire, reflecting the removal of profit margins, albeit modest.

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	0.5	1.0	1.5	2.0
Of GDP	0.02%	0.03%	0.04%	0.06%
Of TME	0.04%	0.07%	0.10%	0.13%
Of budget deficit	0.51%	1.25%	1.94%	2.70%

Address asylum seeker claims backlog

The huge cost of housing asylum seekers is driven by the length of time that the asylum process takes both administratively and through the courts. Whilst hotels housing asylum seekers are the very public demonstration of this, moving that provision into the community via social housing or houses of multiple occupation will remain a substantial financial burden. Savings can be achieved by dramatically speeding up the processing of asylum claims, backed by an effective deportation process for those whose claims fail. As has already been proven, this cannot be achieved without immediate legal reform - most probably, leaving the European Convention on Human Rights (ECHR) and repealing the Human Rights Act, or as a minimum repealing any ECHR power over migration cases.

²¹ <https://dataportal.orr.gov.uk/media/udsa42ql/rail-industry-finance-uk-statistical-release-202324.pdf>

²² Office of Rail and Road, Rail Industry Finance 2019-20

Such legal reforms will further allow a substantial increase in the processing of illegal migrants resident in the UK but not in the asylum process, which also continues to place pressure on public resources. The exact numbers of illegal migrants in the UK is unclear due to poor data collection. However, based on various reports at least 700,000 are in the UK presently²³. A higher rate of removals would reduce the fiscal cost associated with providing public services to those without legal entitlement.

Collectively reducing the time spent assessing asylum claims and removing those not entitled to remain in the UK could reduce current expenditure by £4 billion a year.

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	2.5	3.5	4.0	4.0
Of GDP	0.08%	0.11%	0.12%	0.12%
Of TME	0.18%	0.24%	0.27%	0.26%
Of budget deficit	2.57%	4.36%	5.17%	5.41%

Extend ‘net zero’ target beyond 2050

Although we present a ‘menu’ approach to savings measures in this section, a fundamental policy response to a sovereign debt crisis must involve a significant easing of current ‘net zero’ policies - not just to ease immediate fiscal pressure, but also given the fundamentally negative impact this is having on growth (as outlined in Pillar IV).

The true cost of pursuing the net zero target by 2050 is unclear, combining as it does unproven projections of eventual cost savings and level of private sector investment. This was made abundantly clear in a House of Lords report published in March 2025. The many varied costs are however clearer. The OBR has estimated that the *net* cost of net zero will be approximately £344 billion over 30 years²⁴. This however assumes that 75% of the investment will be provided by the private sector; there is no precedent for this. Further, the OBR acknowledges that the UK has control over 1% of global emissions, so some of the benefits assumed are largely reliant on other nations to deliver globally.

Net zero is a front-loaded investment, the long-term benefits of which are based on a multitude of untested assumptions. Simply extending the target date alone of net zero to 2060 could reduce annual spending by £5 billion in 2029-30. In a financial crisis, such a tapering of spending is within the control of the UK government. This is a minimum response: a full repeal of net zero legislation would deliver far larger savings and materially improve growth, productivity, and the overall fiscal position.

²³ The Migration Observatory 2025

²⁴ Cost of Net Zero by 2050, House of Lords

Specific net zero measures that could be paused or cancelled include:

- Cease Carbon Capture Utilisation and Storage;
- Cancel Public Sector Decarbonisation;
- End electric vehicle subsidy schemes;
- Roll back heat pump grants, solar panel incentives and pace of wind farm development;
- Close GB Energy;
- End free smart meter roll-out

Estimated saving	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
£ bn	4.0	6.0	8.5	10.0
Of GDP	0.13%	0.20%	0.25%	0.29%
Of TME	0.29%	0.45%	0.58%	0.66%
Of budget deficit	4.12%	8.10%	10.98%	13.51%

Summary

Saving measure	Estimated saving			
	FY 2026-27	FY 2027-28	FY 2028-29	FY 2029-30
Stop active sales of gilts on the Bank of England's balance sheet	10.8	12.3	12.9	13.2
Introduce a tiered system for Bank of England reserve remuneration	14.0	12.7	11.5	10.0
Reduce civil service headcount to 2019 levels and introduce productivity improvements	2.6	4.0	5.0	5.2
Cap the cost and use of independent consultants	0.7	0.9	1.1	1.2
Revise welfare benefits system criteria, targeting 2019 levels	8.0	12.0	16.0	20.0
Temporarily reduce foreign aid budget to 0.1% of gross national income (GNI)	6.2	6.4	6.7	6.9
Reduce railway (TOC) subsidies to 2019 levels	0.5	1.0	1.5	2.0
Address asylum seeker claims backlog	2.5	3.5	4.0	4.0
Net zero savings (minimum)	4.0	6.0	8.5	10.0

Do not raise taxes unless absolutely necessary

Any immediate fiscal consolidation would normally consider tax rises, which are often part of an emergency response to a fiscal crisis. Such measures are normally necessary to assuage bond investors and are quicker to implement than spending cuts; historically, these have been an effective way to restore confidence - most notably through increasing income tax.

However, the UK's problem is not a shortage of revenue but an excess of spending and a lack of growth. The tax burden is already at a post-war high, leaving little scope for further increases without damaging growth. Recent policy changes - such as the abolition of non-dom status and higher Capital Gains Tax - are already accelerating capital flight, undermining both investment and receipts.

Raising taxes further would risk exacerbating the situation. Higher rates would further suppress consumption over and above that caused by spending cuts, as well as investment, reducing growth and ultimately weakening the fiscal outlook and eroding market confidence.

There is therefore no credible scope for significant tax rises as part of an emergency response. It is particularly important to avoid measures that would further depress retail spending - such as increases to VAT or other transaction-based taxes. The focus must remain on expenditure restraint (as well as the structural measures outlined in Pillars III and IV).

That said, the government should not formally rule out any option in an extreme situation. In a full-blown crisis, the Chancellor must retain the flexibility to raise income tax or VAT temporarily if unavoidable - but only as a last resort, and accompanied by a clear and credible plan to restore fiscal discipline and economic growth.



Pillar II: Regulatory and institutional support

Monetary policy - the role of the Bank of England

A sovereign debt crisis represents a breakdown in market confidence with respect to the sovereign's debt sustainability and the government's ability (or willingness) to address this, which much of this paper focuses on. Yet in as much as any building sovereign crisis will be exacerbated by building liquidity risks, so monetary policy also has an important role to play with respect to any crisis response.

In this way, market intervention aimed to stymie any rise in yields can be an important part of any co-ordinated policy response. However, it cannot be the sole response. Intervention policies will be destined to fail if underlying fundamentals are not appropriately addressed, as perhaps famously demonstrated in the Sterling ERM crisis in 1992.

Analysed from a monetary policy perspective, an unfolding sovereign debt crisis, which pushes yields higher represents an unplanned and unwanted tightening of financial conditions. From this standpoint, it is reasonable to determine that a central bank will seek to lean against this, starting with lowering interest rates.

However, it is very possible that moves to lower short term interest rates could see longer term gilt yields continue to move higher, should a sovereign debt crisis be accompanied by elevated concerns with respect to inflation, combined with weakness in the valuation of sterling in FX markets. In such a case, it is very possible that lowering cash rates could prove ineffective.

Nevertheless, monetary policy must form an essential tool in the policy kit. The case study of Greece's sovereign debt crisis demonstrates that, because membership of European Monetary Union left it without control over its monetary policy, it was forced to load its policy response onto an excessive fiscal consolidation. The subsequent contraction in domestic demand led to an *increase* in debt-to-GDP.

Quantitative Easing (QE) and Market Maker of Last Resort (MMLR)

Quantitative Easing (QE) is a tool for controlling the money supply. Under the Bank of England Act 1998, the Monetary Policy Committee uses tools such as interest rates and QE to meet its inflation target, currently at 2%. The Act prohibits the Chancellor from directing the bank to use QE for fiscal purposes. The 2024 Budget Responsibility Bill²⁵ reinforces this by requiring independent OBR assessments for any significant tax or spending changes exceeding 1% of GDP²⁶.

That said, we can reasonably assume that the Bank would redeploy QE, in some form, during a debt crisis.

²⁵ <https://publications.parliament.uk/pa/bills/cbill/59-01/0001/240001.pdf>

²⁶ Charter for Budget Responsibility Autumn 2024

In this instance, market intervention by the Bank of England to limit, or cap, a move up in long dated bond yields may be necessary. The Bank of England would restart QE to buy bonds in the secondary market, with the explicit intention of shifting the demand curve and lowering equilibrium yields²⁷.

Many would argue that the Bank of England has the ability to do ‘whatever it takes’ to avert a debt crisis. Indeed, it could adopt the role of Market Maker of Last Resort, which could result in the Bank absorbing all new debt issuance.

However, crossing this Rubicon into fiscal dominance would serve to feed inflation in a world where the government essentially ends up continuously printing money in order to finance an unsustainable fiscal position. Runaway inflation would thus be the price to pay and ultimately this would trigger its own crisis. To this end, the Bank *cannot* do ‘whatever it takes’.

Therefore, utilising QE in a sovereign debt crisis should only be viewed as a temporary policy response to buy the government time to organise its own fiscal policy response, as well as disincentivise short sellers - it cannot be a replacement for necessary spending restraints and structural reforms.

Market intervention also helps to ensure liquidity and orderly market function. During a sovereign debt crisis, upwards movements in yields risk becoming non-linear, as the very moves in themselves exacerbate debt sustainability fears. Investors may trigger stop-loss selling, creating a structural imbalance of sellers versus buyers. In this way another doom loop may be created, which policymakers should seek to prevent.

This was something witnessed in the gilt market crisis which came to define the Truss government of 2022. In this episode, LDI funds were caused to become sellers into a falling market, leading to an overshooting move in bond yields against the backdrop of a loss of liquidity.

On this occasion, the Bank of England, at the time, was far too slow in understanding and responding to this market dynamic, playing a role in allowing a crisis to accelerate (and failing in its financial stability mandate). The central bank must be well informed with respect to market dynamics and to stand ready to act on a timely basis, where this may be required. This includes a practical approach to decision making, above theoretical econometric modelling and academic argument.

²⁷ In extremis, it could also be deemed desirable to effectively manage yields through a policy of yield curve control (YCC) which has been utilised successfully by the Bank of Japan in recent years, in order to hold yields at lower levels than market conditions would otherwise have warranted.

Stop Quantitative Tightening (QT)

Indeed, in addition to the budgetary pressures outlined in Pillar I, increasing concerns in the gilt market during 2025 have been compounded by the Bank of England continuing to pursue a policy of QT. Just as a policy of QE serves to push yields down in order to ease financial conditions, so QT has the opposite effect. Active gilt sales into a weak gilt market during 2025 have been knowingly pushing upward pressure on yields during a period of market weakness.

In this way, QT has contributed to a rise in borrowing costs, directly impacting the budget deficit, in addition to crystallising losses which are aggregated into the UK National Debt. Indeed, Treasury outlays are projected to cumulatively reach a staggering £250bn²⁸.

Undoubtedly, QT represents the opposite of what is needed from a central bank at a time of a sovereign crisis. During the past year, the Bank has simultaneously pursued a policy seeking to tighten financial conditions at the same time as it has been lowering interest rates - analogous to a driver seeking to move ahead with one foot on the accelerator and the other on the brake.

Contingent Non-Bank Financial Institution Repo Facility (CNRF)

Following the Bank's recent System-Wide Exploratory Scenario (SWES) exercise²⁹, which identified vulnerabilities in the gilt repo market under conditions of severe market stress, the Bank has introduced the Contingent Non-Bank Financial Institution Repo Facility (CNRF). This allows eligible insurers, pension funds, and LDI funds to borrow cash against gilts during periods of market dislocation, thereby reducing the risk of forced selling and disorderly price movements. The facility provides an additional tool to support market functioning and financial stability, complementing the Bank's broader lender-of-last-resort framework.

Market trust in the central bank

What is important in any sovereign debt crisis is that there is trust in the central bank. Demonstrating that monetary policy is conducted in an independent fashion, free from political interference is important to ensure that markets do not become concerned with the risk to fiscal dominance and afford the central bank sufficient credibility.

Another crucial aspect of a central bank's credibility is the efficacy of its leadership, its clarity of communication and decisiveness, and its past track record. With recent history in mind, none of these should be assumed to be given.

²⁸ from Q3 2022 to end of program - <https://obr.uk/box/fiscal-accounting-for-quantitative-easing-and-tightening/>

²⁹ Bank of England, System-Wide Exploratory Scenario (SWES). The exercise engaged around 50 financial firms in modelling their responses to a severe, two-week global market shock scenario in which counterparty credit risk became elevated and crystallised with the default of a non-participating hedge fund.

The role of the Debt Management Office (DMO)

Away from the Bank of England, policy co-ordination during a sovereign debt crisis³⁰, should also incorporate the DMO with respect to Gilt issuance.

Although cancelling an auction could detrimentally affect market confidence, the DMO can still play an influential role in matching supply to demand across maturities. For example, if there is particular pressure at the long end of the curve, then the DMO should act to restrict issuance of long maturities relative to shorter dated bonds and Treasury Bills - a crisis environment would call for a more proactive and short term response. In extremis, the DMO³¹ could call for a pause in new longer term and inflation-linked gilt issuance, pending lower inflation and lower long term rates.

The DMO must in any case be more robust in considering the maturity profile of gilts it is selling, not least given the UK has, by some margin, the world's largest share of inflation-linked bonds as a part of its total issuance - at almost one quarter³². That latter point has created a structural vulnerability which is not present in other countries to the same extent. Indeed, the UK accounts for around 20% of global inflation linked bond issuance outstanding.

Moreover, the DMO continues to issue inflation linked gilts with a breakeven rate of inflation in excess of 3%; in doing so, it is effectively admitting that it has no confidence in the Bank of England's ability to deliver its 2% inflation target. In this way, the DMO is inadvertently undermining UK policy credibility. Although breakeven rates have moderated more recently, the period of heavy linker issuance between 2021 and 2024 contributed to perceptions that policy coordination between fiscal and monetary authorities had weakened³³.

Emergency regulation

In a period of crisis, emergency regulation can also be deployed to help prevent gilt yields rising. For example, during the Eurozone sovereign debt crisis, the EU prohibited speculators from buying Credit Default Swaps (CDS)³⁴, which had become a means by which short sellers could apply upward pressure to sovereign bond yields.

³⁰ And arguably also during normal market conditions

³¹ In consultation with the Chancellor - see <https://www.dmo.gov.uk/about/who-we-are/>

³² Based on full market values, index linked Gilts comprise 24% total supply - <https://www.gov.uk/government/publications/debt-management-report-2025-26/debt-management-report-2025-26-accessible>

³³ It should be noted, however, that these bonds are indexed to RPI, which typically runs around 0.7 percentage points higher than CPI, the Bank's target measure; nevertheless, breakeven rates have remained well above this margin in recent years

³⁴ <https://www.europarl.europa.eu/news/en/press-room/20111115IPR31525/parliament-seals-ban-on-sovereign-debt-speculation-and-short-selling-limitations>

The UK has long had a tradition of free and open markets and thus there is a barrier to intervention. However, in extremis, while we would not advocate the UK seeking to ban short selling of gilts from UK-based investors, higher margin requirements on gilt futures and swaps could be introduced to deter those overseas³⁵.

One area where regulation could be used more effectively would be with respect to stimulating domestic demand for gilts and Treasury Bills. For example, regulation could stipulate that ISAs (or a portion thereof) must be invested in UK securities in order to continue to benefit from tax preferred status, while new ISAs could be introduced which only invest in UK Treasury Bills. This would create incremental demand for shorter dated debt.



³⁵ As ICE Futures Europe and its clearing house are regulated in the UK by the FCA and Bank of England, the authorities could direct ICE to raise margin requirements on gilt futures and swaps, making speculative short positions significantly more expensive.

Pillar III: Announce a credible commitment to longer term savings measures

Simultaneous to immediate savings (as outlined in Pillar I) and policy responses from the Bank of England and DMO, as well as emergency legislation (Pillar II), **the Chancellor must commit to bring forward, within one month, a roadmap to address longer term spending pressures.** A medium term plan will form just an important aspect with respect to fully restoring market confidence.

Examples of these include:

Longer term measures to reverse huge real terms increases welfare budget

UK welfare spending is on a steeper rising trajectory than other developed countries. The failure to address this up to this point has been one of the principal sources of the structural deterioration in UK public finances and ongoing inaction in this context is a key contributor to concerns related to UK sovereign debt sustainability.

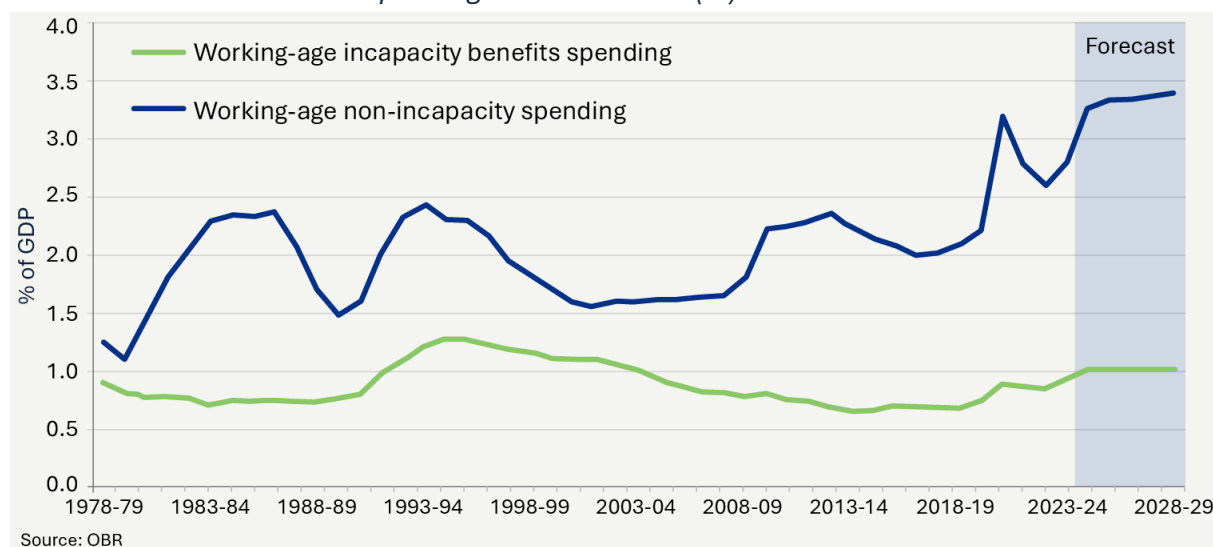
Further to the near-term measures outlined within Pillar I, the government must present measures to further reduce the total size of the welfare budget. In 2017, the UK expenditure on working-age non-incapacity spending amounted to 2% of GDP, as seen in the chart below. By 2025, this has climbed to 3.3% and in the coming several years, this is expected to continue to trend higher.

Furthermore, in 2025, more than half of the working age population receive benefits greater than the sum total they pay in taxes³⁶. A culture of benefit dependency appears to have taken root in the UK and there seems little doubt that this has been intensified in the wake of generous handouts in the wake of the Covid pandemic.

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<https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/theeffectsoftaxesandbenefitsonhouseholdincome/2024>

OBR data on Social Welfare Spending as share of GDP (%)



The state will only be able to afford its welfare system if the system is not abused and benefits are better targeted towards those who need them the most. An overhaul of PIP eligibility criteria should form reasonable a longer term initiative. In the short term, the government should seek to eliminate the abuse of schemes such as the Motability car purchase program³⁷. Indeed, more than 20% of new UK car registrations are made under the Motability scheme, while Motability has grown to the point where it is now, incredibly, one of the (if not the) largest issuer in the UK corporate bond market³⁸.

Longer term measures to increase public sector productivity

In addition to the measures outlined in Pillar I, the government must commit to a longer term program to raise public sector productivity, which has fallen sharply in recent years despite record levels of spending. The UK cannot sustain current levels of expenditure; reforms should focus on modernising service delivery, reducing administrative duplication, and accelerating the adoption of technologies, including AI.

The government can go further by linking pay and progression to measurable outcomes, and closing or merging underperforming functions.

A credible commitment to raise productivity across the public sector would form a vital part of confidence-restoring measures.

³⁷ Motability is not a new scheme - however, the past several years have witnessed a proliferation of applications for disabilities including ADHD

³⁸ <https://www.bloomberg.com/news/features/2025-03-04/how-auto-sales-giant-motability-cornered-britain-s-car-market>

Reforms to public sector pensions

The government must also demonstrate a credible commitment to reforming the UK's vast stock of unfunded public sector pension liabilities - a hidden debt roughly equivalent to the size of the formal National Debt, and which is inflation-linked.

A full picture of the UK's fiscal position must include these obligations, which represent a long-term threat to debt sustainability. The government would likely have to begin with the cessation of accruals under existing defined benefit schemes, the closure to new entrants, and a phased transition to defined contribution arrangements for all future service.

Reforms to the State Pension

A commitment to reform the State Pension must form part of any credible long-term plan to restore fiscal sustainability.

Every political party recognises that the 'triple lock' is unsustainable, yet none have been willing to confront it. The policy guarantees that pensions rise by the highest of earnings, inflation or 2.5%, locking in a ratchet effect that has outpaced both prices and productivity growth.

The government could consider committing to one or both of:

- Replacing the triple lock with an alternative index - for example, CPI inflation only, or retaining discretion with regards to annual increases;
- A tapered plan to increase the State Pension age in line with life expectancy.

With regards to the latter, this can be softened by considering eligibility and contribution rules to reflect modern working patterns³⁹, or allowing those who wish to retire earlier to make additional NI contributions in their last years of working.

³⁹ For example, differences between manual vs. 'white collar' work

Pillar IV: Announce commitments to longer term pro-growth measures

The Chancellor must also commit to bring forward, within one month, a credible roadmap to reintroduce growth into the UK economy. The UK suffers from a chronically low growth problem primarily of its own making. Without credibility that policies can be introduced to provide sufficient growth to fund coupon payments, it will not be possible to restore bond market confidence.

A core component of this must be to address costs on the UK economy caused by ‘net zero’ policies. While Pillar I provides the options for a modest saving, there are huge growth opportunities from going much further.

Equally important will be short term measures to stimulate the economy, in the context of any contractionary effects that the spending cuts outlined in Pillar I - as well as general economic conditions - may introduce.

Pro-growth measures

The government could immediately introduce a focused package to radically encourage growth and materially improve the fiscal outlook. Measures which could be announced within a month could include:

- Tackling the UK’s compliance economy - reduce time and cost spent on regulatory and reporting requirements;
- Reform planning rules;
- Lower labour market barriers - reduce existing obstacles to flexible employment, pause or cancel forthcoming government proposals which will introduce new restrictions;
- Boost private investment - remove capital investment disincentives such as the complexity and instability of the UK’s capital allowances regime, high corporation tax on reinvested profits, and frequent policy reversals that undermine investor confidence;
- Promote productivity-enhancing tools such as AI across both public and private sectors;
- Widen financial participation - channel more domestic savings into productive UK investment (over and above housing and cash).

Together, these measures would help raise the UK’s growth rate, attract investment, and deliver an improvement in the public finances.

Energy

Scrapping commitments to net zero and ending green subsidies could deliver material cost savings and simultaneously deliver an economic benefit, albeit at the expense of the UK’s CO₂

commitments. At a time when many of our large competitor economies in the global economy are not subject to such policies, it is clear that increasing costs in the UK has harmed competitiveness and thus generated a material transfer of national wealth away from the UK to a host of countries overseas.

Such a policy stance would deliver cost savings commensurate with the volume of subsidies, which are scrapped. It would also save industry costs in net zero compliance and regulation. This policy stance can be reasonably expected to materially lower energy prices, possibly by 50% or even more, when comparing UK energy prices to those overseas, where such net zero commitments are not adopted (as shown in the table below).

Lowering energy costs would act as an effective tax cut on consumers, lifting consumption. It would also benefit industry by lowering costs, boosting investment and employment. Consequently, this is an area where a policy adjustment would generate a rare mix of fiscal savings and provide a boost to economic activity and this is highly attractive in economic terms.

International electricity price comparison⁴⁰

	Price KWh (\$)
China	0.08
Canada	0.13
Korea	0.13
USA	0.18
Japan	0.22
Spain	0.23
UK	0.37

As discussed in Pillar I, significant fiscal and growth benefits can be achieved through a fundamental rethink of the UK's net zero strategy. In a crisis context, measures could include ceasing Carbon Capture Utilisation and Storage (CCUS) projects; cancelling the Public Sector Decarbonisation Scheme; ending electric vehicle subsidy programmes; rolling back heat pump grants, solar panel incentives and wind farm developments; closing GB Energy; and ending the free smart meter roll-out.

The government should also remove the Energy Profits Levy and other net zero-related costs imposed on business. Encouraging increased domestic production and exports of energy - including proceeding with the Woodhouse Colliery project for domestic steelmaking and investment in onshore gas production where safe⁴¹ and commercially viable - would support the balance of payments and reduce reliance on imports. All taxes, levies, and environmental

⁴⁰ Source: worldpopulationreview.com - 2025 estimates

⁴¹ E.g. away from settlements and with proper regard for safety and the local environment

surcharges on industrial energy should be scrapped, alongside the removal of carbon emissions taxes on UK industry.

Reducing the regulatory burden is equally important. Current environmental and sustainability reporting obligations impose significant compliance costs on business, often with negligible economic or environmental return. For example⁴²:

- The Streamlined Energy and Carbon Reporting (SECR) initiative can cost large firms up to £50,000 per year;
- The Sustainability Reporting Standards and new ESG disclosure framework can cost listed and large companies up to £100,000 per year;
- The Corporate Sustainability Reporting Directive (CSRD) could cost UK firms with EU operations up to £150,000 per year;
- The Procurement Act 2023 will require suppliers to account for 'environmental and social value' in public tenders, adding further cost and bureaucracy.

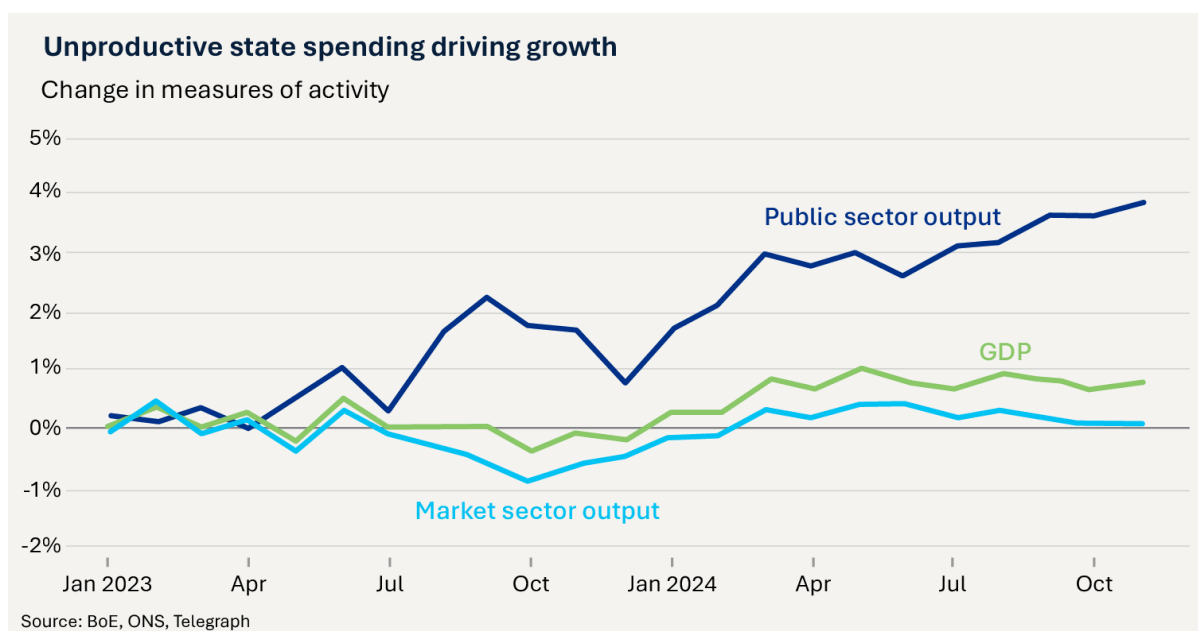
Together, these measures amount to a substantial drag on competitiveness and productivity. Rolling them back would send a strong signal that the UK is serious about reducing compliance costs, restoring industrial competitiveness, and re-establishing itself as an attractive business destination.

Mitigating risks to short-term demand

Substantively, a sovereign crisis will bring about a requirement to align taxation and government spending. However, there is a material risk that a substantive fiscal tightening, as may be required in order to bring about such an adjustment, will have a very damaging impact on the economy - not least given the proportion of government spending to total output. If executed inappropriately, or if the private sector cannot step up and increase investment and consumption, this risks damaging economic growth, not only in the short term, but in the long term as well⁴³.

⁴² Source: Catherine McBride

⁴³ An argument can, however, be made with respect to the spending cuts outlined within Pillar I: that these would not result in overall slower growth given the room they create for private sector expansion



As in the example of Greece, where growth contracted by around a quarter between 2008 and 2016⁴⁴, it can be seen how material fiscal adjustment can be extremely economically painful, but depending on the severity of a sovereign debt crisis, this may become necessary if the underlying reality is that the country has been living beyond its means.

In this context, it may be important not to rush this response, but to convey to financial markets that a planned adjustment incorporating a raft of measures will be shortly forthcoming. Determining policy adjustments which can deliver material fiscal savings, whilst minimising the impact on growth (via employment and consumption) are key considerations.

After all, it should be remembered that the key ratio in the context of sovereign debt is the measure of government debt relative to GDP. Consequently, markets will be much more forgiving of higher debt levels in economies, such as the USA in recent years, which have been able to deliver a robust track record of delivering economic growth.

The most crucial concern with cutting UK government spending is its current size and its proportion of total UK consumption. If the private sector cannot step up and increase investment and consumption, then a cut in government spending would push the UK economy into a recession or even a depression. Private sector growth is the key to long-term economic health.

⁴⁴<https://www.imf.org/en/News/Articles/2019/10/01/sp093019-The-IMF-and-the-Greek-Crisis-Myths-and-Realities>

Would this be enough?

In calibrating a policy response to a sovereign crisis, an obvious question relates to how far policymakers need to go in order to win around markets and restore confidence. There is no precise answer to this question. In many respects, what is required are measures and messaging, which will restore trust. Any policy response to such a crisis must take clear and decisive action to tackle an imbalance between government spending and taxation revenues.

In this respect, taking policy action which is front-loaded and with immediate effects will be given much more weight than measures which are more back-loaded and take a longer period to deliver results.

Yet, as discussed, any short term fiscal policy action which is taken will need to be supplemented with a credible set of medium and longer term measures in order to demonstrate that there has been a decisive change in trajectory, which will ensure that risks to debt sustainability will not end up resurfacing.

In this respect, it will be important not to implement fiscal changes, which save or generate revenue, merely at the expense of economic growth. In this context, it is also critical that any policy changes are politically achievable and sustainable.

Delivering a fiscal tightening to cut spending will always tend to be unpopular with voters. The onset of a crisis may deliver the pretext for substantial adjustment, though should crisis conditions abate, it is understandable that voter patience will be tested over the years to follow, if economic pain from such adjustments persists.

In this way delivering change, whilst limiting the impact on growth and productivity is politically imperative. Growth oriented policies, such as cutting regulation can thus help to deliver an uplift to growth, even as a tighter fiscal stance detracts from aggregate demand.

Assuming that inflation can be contained, aiming to create a pathway for monetary policy easing to offset fiscal tightening is also desirable. An optimal policy framework, in this way, will see monetary policy and fiscal policy co-ordinating together in a constructive fashion.

Having identified measures which will deliver the required adjustment to government finances, a key question to address is whether markets will be able to conclude that they have trust in policymakers to deliver on their commitments and that the resulting policy mix is coherent and addressing pre-existing concerns.

The existence of a sovereign debt crisis will have meant that trust and credibility has been lost. Trust is a fundamental commodity in financial markets. It is hard won and easily lost. In order to restore trust, where this has gone, it is therefore important to demonstrate through clarity of leadership and communication, that lessons have been learned and that appropriate adjustments have been and will continue to be made.

From this point of view, joining a fiscal policy response with co-ordinated monetary policy support and regulatory changes will help to reinforce fiscal policy steps and should help to deter speculators from projecting a move deeper into crisis.

Ultimately, the arbiter of whether sufficient policy action has been taken will be the financial markets. In this way, it is important for policy makers to be properly informed from inputs from those directly responsible for making investment decisions.

It is important for policymakers to listen, to be educated and informed and to seek to bring market participants onto their side. Arguably, this was something the leadership of the EU was ultimately able to do as the Eurozone sovereign debt crisis unfolded. In this way, by the time Mario Draghi famously quoted that the ECB would do ‘whatever it takes’, markets were quickly thereafter able to give policymakers in the Eurozone the benefit of the doubt.



What not to do (and what a Labour Government might be tempted to pursue)

While this paper sets out proposals for how a fiscal crisis should be addressed - through spending cuts combined with credible growth measures - this final section considers the risks if, once a crisis has materialised, policymakers either fail to do enough or take the wrong course. In such cases, a bad situation could quickly become much worse.

During 2025, concerns with respect to UK sovereign debt sustainability have started to emerge in the gilt market. It is estimated that the OBR will identify a black hole of around £30bn in its November update and consequently this has led to speculation as to what policy steps may be announced in the upcoming budget.

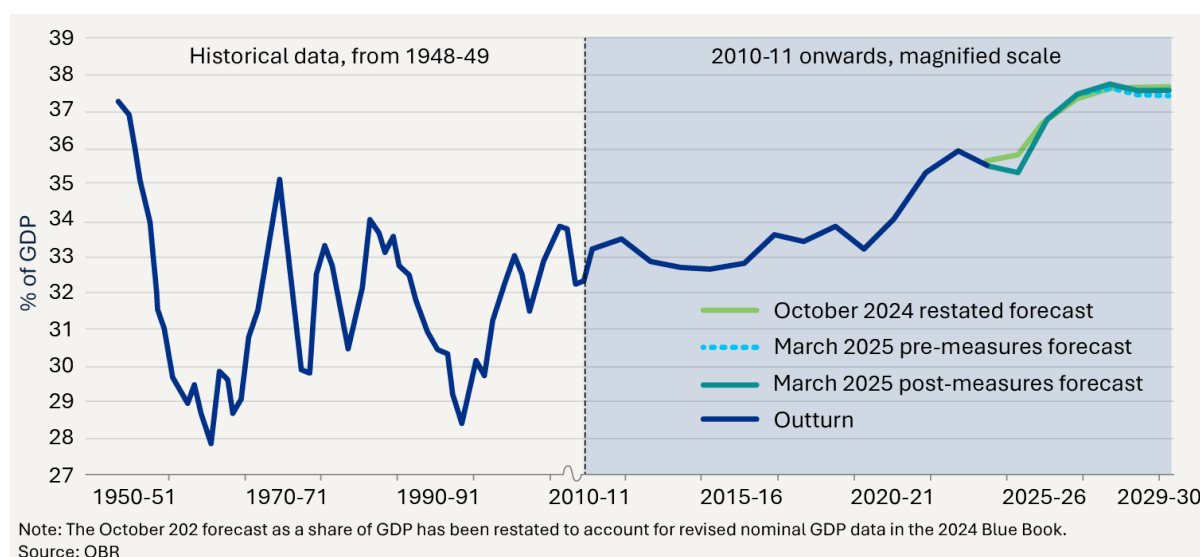
The Labour Party has been clear to reject prior policies of austerity. Therefore, there is little appetite within the government to cut government spending, as was seen in the middle of 2025, when Chancellor Reeves was forced to ditch plans seeking to make a modest reform to welfare entitlements. Instead, attempts to align taxes and spending have focussed on higher taxation instead.

In the past year, the Labour government has already raised National Insurance taxes on employers, have raised taxes on non-doms and have also applied taxes to private school fees. Yet, despite making a pledge not to raise taxes further in 2024, Reeves now finds herself in a position with the deficit in 2025-26 widely expected to exceed the 4.8% of GDP recorded in the prior fiscal year, against a backdrop of weak economic growth.

Subsequently, a range of additional tax-raising measures are currently being discussed in the light of the upcoming Budget. These include wealth taxes, property taxes, inheritance taxes and taxes on pensions and savings. There is also speculation of bank taxes and other measures relating to income tax and VAT.

However, it may appear that the government has been tone deaf to market concerns that adding to taxes in an economy, which is already paying an historically high tax burden, risks being counter-productive. Raising tax rates in such a situation is a drag on growth, discouraging consumption and investment and this ends up curtailing any resultant uplift in tax revenues.

UK taxes as a share of GDP (%)



In particular, a bank tax - while politically more saleable than other taxes - would likely hit growth because it takes cash and profit away, limiting their ability to lend to the private sector which needs to borrow to expand.

During 2025 the Bank of England has lowered interest rates and taxes have risen, yet during much of the year, gilt yields have been on an upward trajectory. This suggests that markets have an underlying distrust in the government, something also demonstrated with respect to long term swap spreads, with UK 30-year swap yields are more than 0.8% below UK 30 year gilt yields⁴⁵.

Raising wealth taxes is widely discounted as an economic policy as it deters wealth creators from living and paying taxes in the country. This may see a net loss in employment and investment as a result. An exodus of wealthy individuals also risks impacting consumption and therefore the net sum in revenue raised may even be negative, after the aggregate impact is considered.

Adding to employer taxes and VAT also discourages employment and investment. Furthermore, this has the effect of lifting inflation and inasmuch that a material share of the UK debt stock is in inflation linked format, so this adds to debt levels in the process and limits the scope to offset fiscal tightening with additional monetary easing.

Taxing banks may appear a soft target for revenue. However, this action will ultimately mean that banks pass on these costs to their customers as they act to reinstate their margins.

⁴⁵ Swap rates reflect the rate of interest over different time periods, based on market discounted future levels of Bank of England interest rates. Swap rates can be considered as a true underlying market risk free rate of interest. Bonds (including gilts) trade at a premium to swap rates, as a reflection of embedded credit risk. The greater the perception of credit risk, the wider the spread. This is something also seen in derivatives such as credit default swaps, which embed a market based assessment of default probability, in the event that the bond issuer fails to meet coupon or principal repayments on a timely basis

Again, this will potentially impact consumption as well as investment if credit becomes more scarce.

Ultimately, a healthy banking sector can play an important role in helping to support economic growth through credit creation. But if banks are made to be unprofitable, they will retrench, thus starving the economy of the credit and liquidity it needs to thrive.

Belatedly, the Chancellor has suggested that welfare spending might be addressed, with a reform to Motability being considered. However, it may appear likely that any cuts to spending are likely to be relatively trivial relative to moves on taxes.

There is a risk that if this is the case, these plans will again end up called into question if the underlying fiscal position fails to deliver much of a near term improvement against a backdrop of anaemic economic growth.

Meanwhile, there may be building risks to Starmer's premiership as we move through the life of this Parliament, especially if the UK economy continues its limp performance and living standards continue to stagnate.

In such a situation, it is widely speculated that Labour would look further towards the 'left wing' of its own party for a new leader. It has been notable that leading candidates are publicly even more committed to raising government spending and raising taxes.

Financial markets have been sending a clear message that the economic approach the Labour government has been pursuing is an incorrect one. History suggests that governments who fail to listen and to learn are destined to ultimately fall.

If the government were to delay or dilute the necessary fiscal measures, the situation could deteriorate rapidly. Attempting to sustain borrowing at current levels without credible spending restraint would almost certainly exacerbate the loss of market confidence, leading to rising gilt yields, sterling depreciation, and capital flight. Although the Eurozone crisis of 2012 is not directly comparable to the UK (not least as the UK can rely on an independent and sovereign monetary framework), it provides a clear warning of how such dynamics can unfold - with mass capital flight, brain drain, civil unrest, and widespread strikes.

While an external rescue package is a potential route should the government fail to reassure bond markets, this should be avoided. Not only would an IMF loan be contingent on fiscal reforms, particularly spending cuts (which a Labour government might find politically impossible to deliver), whether such support would be available today is less certain, given the scale of funds required to stabilise a G7 economy. Alternatively, the government could seek

bilateral assistance from the EU or the United States, though such arrangements would almost certainly come with geopolitical conditions.

Failure to restore confidence could eventually leave the UK confronting the unthinkable prospect of a sovereign debt restructuring - a scenario that would devastate household wealth, pensions, and market credibility. Even then, the underlying deficit would remain unresolved, leaving unanswered the question of how the government would continue to fund day-to-day spending.

Politically, the implications would be severe. A government unable or unwilling to take the necessary steps to stabilise the public finances would almost certainly face an early general election. In the event of internal divisions within the Labour Party, the country could even see the formation of a temporary unity government, or a cross-party arrangement to restore stability and confidence.

All this of course represents a severe scenario and can, in all likelihood, be avoided if the government proactively adopts the measures outlined in this paper. The UK is not Greece - the situation is likely to be fixable.



Could measures in this paper be enacted without a debt crisis materialising?

While this paper sets out an emergency response to a sovereign debt crisis, many of the measures it proposes could arguably be implemented now, not least to mitigate the likelihood of a crisis occurring. It is telling that even among policy experts there is growing recognition that much of what needs to be done will not be attempted until a crisis compels it to.