

OUR VIEW

The Coalition Government needs to confront a combination of intractable problems and grand delusions which previous administrations have either created or conveniently ignored. This will require near superhuman effort, supreme political judgement, a determination to relentlessly pursue radical policies which are unpopular in the short term and the ability to convince a cynical and disparate electorate that there is no alternative. Given the fragile nature of any Coalition Government, you would have to be quite a gambler to wager that this can be achieved.

Over the years we have highlighted some of the economic problems that have been stored up and which threaten to permanently reduce the prosperity future generations will enjoy. The day of reckoning for so many of these problems may not be here yet, but the UK, along with many other Western governments is reaching a point where matters can no longer be brushed under the carpet. Some of the key issues are as follows:

DEBT

The Mr Micawber principle of life, set out by Charles Dickens was as follows:

Income 20 shillings, expenditure 20 shillings and sixpence, result misery. But income 20 shillings, expenditure 19 shillings and sixpence, result happiness.

The fundamental need to align income and expenditure seems to be a principle which has been ignored for too long. Our entire economic system has been founded on debt, with debt seen as the lubricant for economic growth and increasing prosperity.

This is fine, as long as overall debt (Government, corporate and household) is kept at a sustainable level and where debt is taken on to pay for investment, not consumption. It is also necessary to be absolutely certain that the future will always be 'bigger' than the past, to justify this model.

The levels of debt in the UK and many other Western countries have now reached toxic levels. This indebtedness has not been caused by an extraordinary event, such as a world war, but by chronic overspending structurally embedded in the vast welfare states that have emerged.

Although we are constantly bombarded with talk of 'savage' cuts in Government spending and austerity, the Government's own figures show a very different story. A few key points are as follows:

- Britain is increasing its debt by approximately £2 billion per week
- UK Government spending has increased in real terms (after adjusting for inflation) from 2000 to 2010 by 53%, with spending rising from £451 billion per year to £688 billion per year

- Figures from the Office of Budget Responsibility tell us that real public spending rose by 1.5% in 2010, 0.3% in 2011 and is forecast to rise by 0.5% in 2012
- The Coalition's deficit reduction programme represents an attempt to merely get to a position where we are adding less to the new borrowing. There is no plan to reduce the accumulated Government debt. This is forecast to reach £1.4 trillion (£1,400,000,000,000) by 2015/16
- Britain's households now owe £1.5 trillion (£1,500,000,000,000) on mortgages, overdrafts, loans and credit cards

For many people, talk of deficits and debt may seem to be something that is very remote from their own day to day lives. However, there comes a point where a country's overall indebtedness begins to significantly reduce its growth, as interest payments devour an ever increasing tranche of government income.

A recent report by the Bank of International Settlement suggested that the tipping point is reached where debt exceeds 90% of GDP. In Britain, Government debt has reached 89%, corporate debt 126% and household debt 106%. It is hard to see how our indebtedness will not slow our growth going forward.

EUROGEDDON

Norman Tebbit recently recalled Enoch Powell's definition of a sacred cow as "**a beast that one lacks both the means to nourish and the will to put down**". There could be no more apt description of the Euro.

A year ago we talked about the inevitable collapse of the Euro and the resultant chaos that would ensue. Nothing that has happened in the last 12 months has done anything other than strengthen our view.

The Euro project was flawed from its very beginning. It represented a triumph of political will over economic reality. In cloud cuckoo land, occupied by European finance ministers and policy makers, the entry criteria meant that only countries with converging economies would join the club.

A very significant proportion of the British establishment threw their support behind Britain joining the Euro. The CBI, TUC, BBC, Civil Service, Financial Times and numerous politicians from all parties pressed for the UK to join. Opponents of Britain's membership were written off as cranks, Little Englanders, xenophobes etc. Incredibly, Gordon Brown, the architect of so many ills affecting us now, decreed that we were not to join. For this at least, we must thank him.

In reality, numerous countries effectively 'lied on their application forms' and were accepted without question. This enabled countries with chaotic public finances to borrow vast amounts at artificially low rates because of the implicit German guarantee of the system. The Greeks and others went on spending sprees and the credit crunch of 2008 exposed the utter folly of all concerned.

Rational decision makers would see that the project has been a disaster and would now be attempting to design a system where sovereign nations returned to the sanity of their own floating currencies. However, Eurozone finance ministers and their Brussels henchmen have convinced themselves that if they keep throwing money at Athens, the problem will go away. This is delusional on a breathtaking scale.

This course of action will lead to peripheral countries suffering poverty, unemployment, loss of democracy and emigration, while core countries suffer perpetual tax rises so that the supporters of this doomed currency can save face. How outrageous.

THE WELFARE MONSTER

The Labour Government massively expanded welfare spending in a misguided and flawed attempt to reduce poverty. They did this because it was far easier to “carpet bomb” people with benefits and tax credits rather than tackle the underlying causes of poverty and welfare dependency.

Nearly 30% of Government spending is now allocated to the welfare budget (for some reason officially called Social Protection). The Coalition has taken some tentative steps to tackle this huge slice of Government spending, including capping the extraordinarily high amount of welfare payments that can be received by one household. However, they have not had the courage to tackle the fundamental issue of how someone should become eligible for support from the welfare state.

William Beveridge, the architect of the welfare state warned in 1942 that welfare “**must never stifle incentive, opportunity or responsibility**”. Presumably he would be spinning in his grave if he could see how that is precisely what the modern welfare system does.

Surveys have shown that the vast majority of people in the UK believe that welfare, based solely on the grounds of need, is wrong. There is huge support for the idea that welfare should instead be earned, so that benefits are awarded to those who have paid in under the insurance based system.

Welfare reform must make work pay and at the same time be fair to those who receive benefits and fair to those who pay for them. Unfortunately, successive Governments have been unable to achieve this.

QUANTITATIVE EASING

Quantitative easing (QE) is an extraordinary policy which has been pursued in the UK with little or no public debate or knowledge.

Under QE, the Bank of England digitally creates money to buy its own debt. As we’ve said previously, common sense suggests this is smoke and mirrors trickery. It has been suggested recently that the QE experiment may eventually result in the creation of an extra £500 billion by the Bank of England.

Under QE, wealth is transferred from the thrifty to the profligate as interest rates are kept artificially low and inflation is fuelled. The three main parties have accepted QE with barely a question and given the low calibre of our political class, this adds to our concerns.

History may show that QE was the correct policy to pursue and that causing extra poverty, primarily amongst pensioners, is a price worth paying to control unemployment and avoid a severe recession. There can be no doubt however that the deployment of QE is very much a desperation strategy.

PENSIONS

The Coalition has taken some small steps to address the problems of unfunded public sector pension liabilities by increasing retirement ages and insisting on higher contributions going forward.

It is understandable that those people in the public sector affected by the changes are deeply aggrieved by the Government attempting to water down earlier administrations' extravagant pension promises. However, there is no enthusiasm for people to pay higher taxes to subsidise public sector pensions which those in the private sector can never hope to enjoy themselves.

Calculations show that public sector employees earning £32,000 are retiring on pensions which would require an accumulated pension pot of in excess of £500,000. A recent Pension Corporation report showed that a worker aged 35 in the private sector would need to contribute a mind blowing 55% of their salary to get the same retirement income as a public sector worker contributing 5.1%. Clearly these differences are unsustainable.

CONCLUSION

We have highlighted a few of the issues which show the massive challenges the country faces. We remain a wealthy nation in global terms, but we have been living "high on the hog" for too long now and a sustained period of retrenchment is inevitable.

Churchill contended that **"for a nation to try to tax itself to prosperity is like a man standing in a bucket and trying to lift himself up by the handle"**. There is no doubt we don't need any more taxes in the UK, so a balanced budget will only be achieved by economic growth and by controlling Government spending. Given the noisy objections that arise with every fiscal proposal, it seems inevitable that we are heading towards a period of domestic strife.

When we remember that repayment of **our** debt will require the endeavours of future generations, we can see that it is morally unacceptable for this generation to continue to consume beyond its means in the expectation that future generations will pick up the tab. Whether the electorate will be willing to accept this remains to be seen.