THE ECONOMIST'S SOCIETY

Review on Mark Littlewood's talk "Drowning in Debt: Cutting the state back down to size"

On the 29th October 2014, The Economist's Society had the pleasure of welcoming the renowned Mark Littlewood, Director General of the Institute of Economic Affairs, as a speaker to their society. Consequently he gave an insightful, and slightly pessimistic but realistic view of the UK's current economic position, articulating the difficult situation that has developed. Which is largely due to exponentially rising debts during the 2008 financial crisis.

Firstly, he propounded that the additional £600bn added to our national debt over the course of this government doesn't particularly equate to austerity. This debt problem is augmented by many other hidden debts that do not reach the government books; firstly pension liabilities for the future and secondly other promises made by the government. Moreover, public sector spending has increased steadily since 1970, despite different political party's policies. The issue with this rising debt is that it starts to become increasingly difficult to service (paying back repayments on debt) when debt reaches about 70% of GDP, however according to the UK government it is now around 80%, which clearly gives rise to concern. However if you actually include pensions, then the UK debt rises to a massive £6 trillion, which is equivalent to roughly 400% of GDP.

In the current government, the combination of the Healthcare, Education and Welfare Budgets is worth 59% of government expenditure, despite the current government's rhetoric on reducing these budgets they have instead flat lined. However Mr Littlewood argued that if the total government expenditure is going to be significantly reduced, then the only realistic way to cut it is by cutting one of these substantially. Otherwise there would have to be a colossal squeeze on other budgets that would render them almost incapacitated. Given that there is essentially a political ring fence on healthcare, then education or welfare are the only two genuine options, however the potential privatisation of education is perhaps too controversial despite quality results in other countries such as the Sweden, meaning that welfare is perhaps the most feasible option to reduce.

However Mr Littlewood suggested that there may be an alternative, which is to increase taxes, although through the evaluation of historical data, he showed the ability to actually increase tax revenues significantly is almost impossible given the UK's current tax culture. In the past 50 years, there has been almost every method and rate tried to increase tax revenue, despite all this, the maximum revenue ever achieved

was 37.3% of GDP collected in a given year. On average 34% - 35% of GDP was the tax revenue, irrespective of top income tax rate and VAT rates, which suggests the possibility of actually increasing this value largely is hugely improbable as we may have reached the peak of our Laffer Curve. If in the long run, we were not to be in debt, then this would mean that the total government expenditure could not be over around 35% of GDP (unless high growth means you could make the revenue back in the next tax year). However the current government expenditure is an unsustainable 43% - 44% of GDP which is clearly a significant issue.

At this moment Mr Littlewood expressed his scepticism for current expenditure, and his concerns on the continued postponement of difficult government decisions to shrink the public sector back down to size in order to make the UK financially stable in the long run. However, even balancing expenditure with receipts is not enough, as the national debt needs to be reduced to a more manageable size, meaning the cuts need to be even deeper in order to reduce the huge cost of £55bn which is required to service the government's debts. Another potential cure is privatisation of key expenditure areas such as healthcare and education, as often the return on government investment is very low. However these are unlikely in the current political landscape so this would mean the government needs to cut welfare to reduce its total expenditure perhaps through the use of privatising some of the system, as this is perhaps where cuts could be done most efficiently and feasibly.

Mr Littlewood then expanded his perspective to Europe as a whole, suggesting that its entire economic position is being put in risk from an increase in total government debts. He suggested that it may be likely in the future that we witness some level of default from various governments, which may indeed topple over banks who are expecting to be paid in full, haircuts have already happened in some EU countries such as Greece so the possibility of this happening is not underwhelming. Also, the strategy of trying to inflate away debts would have limited effectiveness, as many of the debts are index linked, forcing haircuts to be one of the main policy instruments used when the debts are finally faced in full.

According to a UK survey, 78% of people were in favour of cutting welfare payments, showing a large political appetite to reduce spending in that sector, and instead make it more efficient in supporting the poorest in the community. Moreover, it is the case in many EU countries that the population is aging significantly, with a higher proportion of people becoming over 65 years of age. Furthermore, this means that there is a higher pressure on the economically active to support them due to pension promises made by previous generations, however it also means that the total pension expenditure would need to increase, especially as life expectancy is increasing. At this point Mr Littlewood addressed some potential policies that could be put in place to help solve the issue of the pension time bomb. Firstly there would be certain protocols in the British Constitution to increase responsibility for overspending on government budget, to incentivise top officials to stay within their budgets limits. Another potential scheme could be a Save as You Go scheme for citizens to create their own pensions through out their life, so the necessity for government to maintain their standards of living to an appropriate level after retirement age is reduced. Also, Mr Littlewood saw it as inevitable that the retirement age would have to increase, as the proportion of the populations' lives spent working is falling, meaning that our productivity would have to increase, even negating other

factors such as changing demographics. However, currently UK labour productivity is very poor, compounding this problem. Mr Littlewood drew on a comparison from when the pension was first introduced, whereby the expected life expectancy in the UK was 67, and the pension began at the age of 68, and expected life duration if you made it to this age was very limited, showing that in the past the pension payments would have been minute, almost negligible compared to todays standards.

These schemes could hopefully reduce both the absolute current pension expenditure, but also the pressure on economically active to provide it in the future, reducing the pressure of the younger generations of today who will need to deal with this pension time bomb. Through this it may be possible to cut the public sector back down to size and improve the sustainability of the UK government, furthermore it may be a necessity to ensure the sustainability of our continent. Only with the reduction of national debt will the UK truly be a stable economy, and as Mr Littlewood shows, there really isn't much time to wait, and there are no easy solutions, but simple solutions.

In conclusion, Mr Littlewood's talk was highly informative, and although incredibly stimulating, at the same time was quite depressing for the younger generations who will have to pick up the bill from their ancestors and deal with the abundant debt left to them. It was highly enjoyable having him to talk, with excellent animated debate from a question and answer session at the end of the talk. It was a great privilege for the Economist's Society to invite such as distinguished guest such as Mr Littlewood, and we would like to thank him again for his time, enthusiasm and invaluable insights and suggestions he took the time to share with us.

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