

## the high price of envy

### why politicians should forget the trivia and focus on vital issues

**In the run-up to the most important general election for at least 30 years, Britain needs to be debating critical issues, such as excessive public spending, an unsustainable deficit, and the imperative need to boost economic performance. Instead, the public is being treated to counter-bidding on quite how tough parties can be on bashing bankers and plundering overseas earnings. Envy might be good politics – but it is lousy economics.**

The British, famously, love team games and, indeed, actually invented soccer, cricket and rugby. But they are much less comfortable with individual sports – for example, no Briton has won the Wimbledon men's singles title since Fred Perry in 1936. This emphatic preference for team games is highly unlikely to be changed by the expenditure of £9.3bn – a sum equivalent to about 50 state-of-the-art hospitals – on hosting the Olympics in 2012.

Given this strong predilection for team activities, it is, perhaps, not surprising that, with a general election looming, all of the major parties are now, to a greater or lesser degree, engaging in the new national pastime of bashing not only bankers but those people who earn money overseas.

Not surprising, perhaps – **but deeply depressing, in two key respects.** First, it represents a form of beggar-thy-neighbour activity from which the economy can only suffer. Second, and worse still, it diverts attention from critical economic issues – including, ironically, the future of the banking industry itself. With Britain facing its most important general election for at least 30 years, this concentration on comparative trivia is a deeply worrying trend.

### The bigger picture

Before looking at banker-bashing, though, we need to remind ourselves of what the critical economic issues are. First, **Britain's economy is desperately weak**, growing at just 0.3% in the final quarter of 2009 despite a massive fiscal stimulus and the creation of £200bn of new money through quantitative easing (QE).

Second, government expenditure – of £674bn, or 48% of gross domestic product (GDP), during 2009-10 – exceeds revenue by an eye-watering £167bn, or 11.8% of GDP. National debt, which even the government admits will continue to rise briskly, stands at £760bn, or 54% of GDP – **but only if we ignore a further £1.3tn or so of off-balance-sheet obligations**, such as public sector pensions and PFI<sup>1</sup>. Most challenging of all, the economic framework within which Britain has been operating for more than a decade – the minimally-regulating Anglo-American model – has proved a busted flush, and no-one seems to have any very clear idea about what its replacement is likely to be.

Yet the only things that British politicians seem capable of discussing at such a pivotal time are comparative trivia such as the excessive remuneration of some bank executives, the payment of MPs, and the taxation of British citizens' overseas earnings.

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<sup>1</sup> Private Finance Initiative

The aim of this paper is not to stand up for bankers – who are perfectly capable of sticking up for themselves – but, rather, to add our voice to those who are **calling for the debate to move away from arguments over envy-driven irrelevances and towards honest consideration of substantive and critical issues.**

The first of these issues, of course, is that £167bn deficit. Government has said that this will be reduced to £73bn – or 4% of GDP – by 2015, but can make this projection only by combining a job-destroying increase in National Insurance (NI) with the heroic assumption that the economy delivers real growth of 3.25% in each year from 2012.

**Thus far, no party has provided a convincing road-map for a route back to fiscal solvency.** Unless this is tackled – and the election campaign has thus far given us no reason to believe that it will be – then Britain is faced with some pretty unpalatable options. **If no party is prepared to act** - by slashing spending, or by increasing the tax 'take' by at least 20% - **what, precisely, is the UK supposed to do?** Expect foreign investors to go on funding excessive spending, by lending at low interest rates and in a vulnerable currency? Or print the deficit through QE?

**The simple fact – one which, for all its simplicity, no political party is prepared even to discuss – is that government simply spends far too much.** If public expenditure was reduced from £674bn to £507bn – which would eliminate the £167bn deficit altogether – spending would still be higher than in 2002-03, when the public services were hardly starved of resources. A less ambitious spending cut of £100bn would leave outlays at the same level as they were as recently as 2005-06, when government spent £524bn, equivalent to £580bn in current money.

Neither need front-line services suffer if major cuts are implemented. Government spending has risen on the back of administrative excess, itself driven by a burgeoning of quangos combined with the fragmentation of public service provision in pursuit of entirely chimerical 'competition'. The Conservatives have recently denied that their spending plans would eliminate 40,000 public sector positions, when the reality is that Britain's top-heavy bureaucracy could actually be pared by far more than that *without in any way impairing the provision of services to the public.*

## Questions, questions

The principal decision that Britain has to make is a simple one – is the UK going to continue along the road to quasi-socialist statism, with half of the entire national income spent (very inefficiently) by the state, a quarter of the entire workforce directly employed by government, and a not dissimilar number supported by state hand-outs? Or is Britain going to return to being a free-market mixed economy, in which the state has to live within a realistic share (say 35%) of GDP, allocating this sum on the basis of rational choices?

**This is less an ideological choice than a matter of pragmatism** – raising the level of taxation to the same (48%) proportion of GDP as public spending would inflict further colossal damage to the wealth-generating private sector, destroying jobs, deterring investment, and driving both talent and capital offshore.

One might hope that this crucial philosophical issue might have secured at least part of the national political debate. Instead, however, the public is being treated to a series of competitive spats about the remuneration of bankers, the payment of MPs, and the taxation of those who earn all or part of their incomes overseas.

Yet each of these subjects, stripped of their emotive and envy-driven components, is essentially a simple one. First, the taxation of overseas earnings. If a person earns all of his or her income in the UK, then the whole of that income should, of course, be subject to British taxation. But if part of that income is generated in, say, the United States, then any tax on that income should go to Washington, not to Whitehall.

Second, the incomes of Members of Parliament. This issue, too, is surely a simple one. The country needs to pay appropriate salaries (by which we mean about £100,000) to those entrusted with making its laws. Britain also needs to *encourage* its MPs to have interests outside politics, though total transparency should of course be mandatory.

British democracy would be far healthier if working doctors, engineers, farmers, businessmen and trades union officials were present in Parliament. Without the acceptance of outside interests, Parliament would become a supine group of career politicians whose ability to challenge the executive would be gravely undermined by their total dependence on the political system for their livelihoods. This would be even more dangerous in Britain – where a new administration, with almost unlimited powers, is chosen, every five years or so, by as few as 20% of those entitled to vote – than it would be in a country with stronger democratic safeguards (such as the US, with its separation of powers, or most European countries, where more representative electoral systems make balanced coalitions the norm).

## Towards practical banking

Which brings us back to bankers. Within recent memory, government habitually praised bankers to the skies. Peter Mandelson famously remarked in 1998 that he was “intensely relaxed” about people (which presumably includes bankers) becoming “filthy rich”. As James Buchan has put it, Gordon Brown “thought that the profits of the City would finance a new welfare state that would be a monument to him more lasting than bronze. He was mistaken”<sup>2</sup>. In other words, **escalating profitability in the financial services industry was fine and dandy so long as it filled the Treasury’s coffers**.

Now, of course, the tune has changed, a trend symbolised by Alistair Darling when, in the 2009 PBR<sup>3</sup>, he unveiled a savage bonus tax which even the chancellor himself thought, at the time, would only raise a pretty meagre £550m. The Liberal Democrats have followed Labour’s lead on the issue, while the Conservatives’ defence of free-market banking has been conspicuous by its absence.

There are two facts to be faced here. The first is that bankers are, intrinsically, neither moral nor immoral – rather, they work within a regulatory system for which politicians are ultimately responsible. **The British regulatory system, just like that of the US, has failed miserably**. The required solutions are tightly enforced mortgage lending rules – to prevent the reoccurrence of the ‘notional value’ bubble in property markets – and the re-imposition of separation between commercial and investment banking<sup>4</sup>.

Second, banking and related activities are a vital component of the British economy. **Driving bankers overseas because they earn more money than the rest of us would be about as logical as Chelsea fans demanding the sale of Didier Drogba because he gets paid a lot more than the average supporter**. In other words, it would be wholly self-defeating.

Envy might, just occasionally, be good politics. **But it is always lousy economics**.



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<sup>2</sup> ‘Is Britain Bust?’, *Prospect*, August 2009, pp28-33

<sup>3</sup> Pre-budget report

<sup>4</sup> On this issue, see *Tullett Prebon Strategy Insights Issue Three, Forever Blowing Bubbles*, March 2010

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