

A new and nasty normal

The batch of new UK MPs heading to parliament this summer face some difficult decisions on tax and public spending in what could prove to be a period of radical change. **Tony Travers** sets out the issues and charts the role of LSE academics in guiding debate on these 'nasty realities'.

Economics and political science are, by any standards, disciplines with a future. The extraordinary events of the last three years have kept the economy and government constantly in the headlines. Yet because we have all, in our own lives, lived through the financial crisis and ensuing recession for over two years, it is already easy to treat current conditions as the 'new normal'. In fact, it is almost certain that the events of the period from 2007 to 2010 will change the way Britain thinks and behaves in ways that are exceptionally hard to predict – lacking as they do any recent precedent.

The general election took place against a vaguely articulated understanding of the gravity of the financial/economic situation, but without much consideration of the longer term political consequences of all that has happened. The major political parties found it almost impossible to spell out with any clarity the kind of public spending cuts that now lie ahead. Yet the really interesting aspect of the 2007-10 crisis will be the way in which it affects society in the coming generation.

The new Parliament will have to confront the electorate with a number of nasty realities, including the need to push up taxation and reduce public spending for a period of five or more years. The squeeze on unprotected expenditure looks set to be the most severe since 1945. Moreover, if the UK's economic growth does not fully recover to a trend of 2.5 to 3 per cent per annum, all existing projections for the need to raise taxes and/or cut spending will have to be revised – in the unpopular direction.

Thus, the economy and the future of Britain more generally will be the key themes to be addressed

in the new Parliament. The question of how to put up taxes and/or reduce public spending will be accompanied by the issue of how the UK economy is to develop if its former dependence on growth in financial services falters. No one yet knows whether banking and finance can be regulated with just the right level of subtlety to allow it – and therefore the City of London – to flourish in the coming years. Anyway, there are plenty of policy makers who think the country should attempt to make itself less dependent on finance. But no one yet has the answer to the question: if not financial services, then what?

British governments have, over time, become less and less willing to intervene in industrial policy, so it is unlikely the government will attempt to 'pick winners'. Sectors that have shown strong growth in recent years (apart from finance) include business services, creative and media, private health and, encouragingly, higher education. Business services, including lawyers, consultants and accountancy, could probably grow even if the City were held back. But it is unclear whether additional expansion in other sectors could offset any ongoing constraint on banking and finance.

Tackling the country's vast borrowing and indebtedness will clearly dominate the new government's thinking. Former chancellor Alistair Darling's autumn 2009 commitment to cut the public borrowing figure in half by 2014-15 was, by common consent, going to require reductions in most parts of state spending. Going further and faster, particularly if growth is weak, will mean many services facing 20 to 25 per cent real

ALUMNI VIEWPOINT

Alastair Newton on post election challenges



Irrespective of the policies which the new government pursues, rebalancing the UK economy away from its heavy dependence on financial services cannot be achieved overnight. It follows that the financial services

industry will play a key role in sustaining an economic recovery and in medium term fiscal consolidation. Yet the wellbeing of this vital part of the UK's economy is now under threat from EU overregulation, driven in part by a populist backlash against 'the banks'.

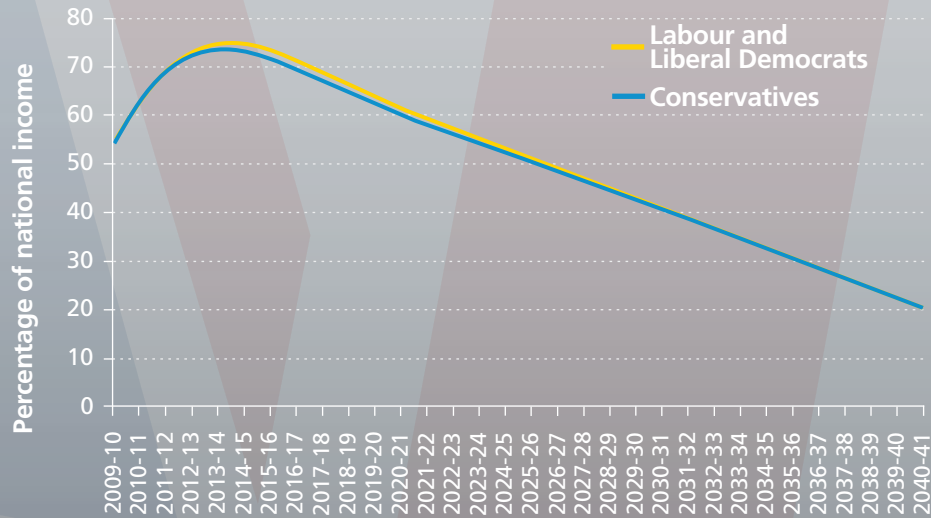
Getting any regulatory reform right is essential for the economy of the EU as a whole; but nowhere more so than the UK. And the UK's greater vulnerability to overregulation is nowhere more exposed than in the desire of some of its EU partners to impose a far greater regulatory burden on Alternative Investment Funds (AIFs), ie, hedge funds and private equity houses, despite the fact that the EU's own de Larosière report states clearly that they were in no way responsible for the current financial crisis.

The battle lines are already drawn in the form of the EU's draft Alternative Investment Fund Managers Directive, which threatens to drive AIFs out of the EU. This is a battle which is relatively low cost to the UK's EU partners, but one which the UK cannot afford to lose.

The expectation among political commentators is that what is likely to be the most eurosceptic British parliament since 1972 may be rather too ready to pick fights with Brussels. But defending the UK's interests over regulating AIFs is one battle which is definitely worth fighting.

Alastair Newton (PhD student 1975-78) is a managing director at investment bank Nomura and on the board of LSE's *Global Policy* journal.

Debt high for a generation

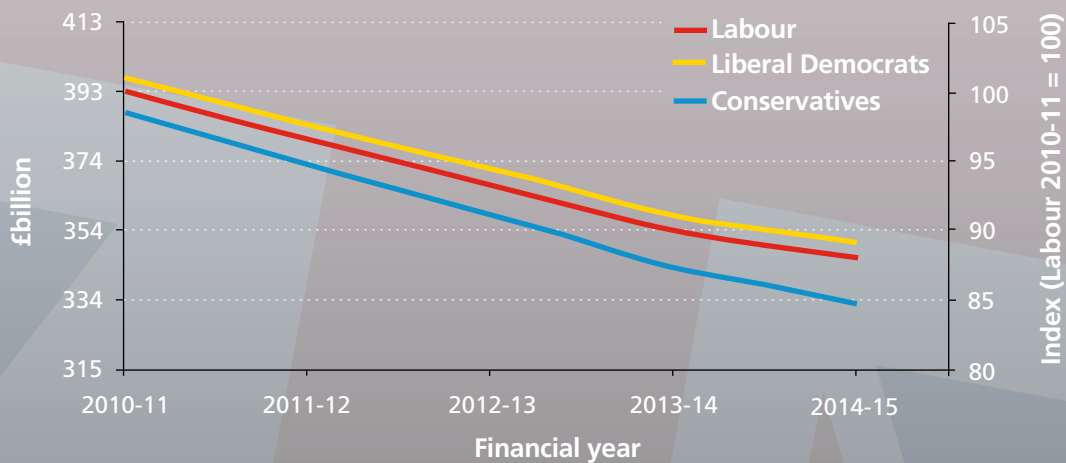


Source: Institute for Fiscal Studies

To reduce the growth in government debt...

... deep cuts will have to be made to 'unprotected' services

DEL* spending plans by party, £billion



*DEL (Departmental Expenditure Limits)
Source: Institute for Fiscal Studies

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A NEW AND NASTY NORMAL

reductions between now and the start of 2015. The more that some parts of public expenditure are protected, the deeper the cuts elsewhere.

Earlier in the year, LSE found itself at the epicentre of a national discussion about whether the government should carry on with existing, relatively high, levels of public spending or, alternatively, start cutting expenditure programmes during 2010. A letter, signed by several leading LSE names, was sent to the *Sunday Times* advocating immediate action to reduce the deficit. Within a week, two letters signed by a group which included another list of top LSE figures, were written to the *Financial Times* urging the continuation of the fiscal stimulus. It is hard to think of an issue in recent times where the School has found itself leading both sides of such an important public debate.

It is unlikely the necessary reductions in public spending will now be delivered without some industrial strife and, possibly, aggressive challenges to government policy. The economy looks set to be a dominant issue throughout the new Parliament, with significant uncertainty about the path of the UK and global recovery. Other issues that will be important include the delivery of healthcare and education, Britain's role in the world, climate change, the rise of the eastern powers, apparently rigid levels of inequality within the UK, and the longer term role of the State. There may also be constitutional reform.

LSE is well placed to contribute to each of these key themes of government. The Centre for Economic Performance and the Financial Markets Group, for example, have established their capacity to contribute to the debate about the development of the City of London and the UK economy more generally. Members of the Social Policy and Administration Department have shaped debates about how to provide incentives to public sector providers, and about the future of ex-industrial cities.

As Britain considers the future of its nuclear capability, international development and the evolution of transnational institutions such as the United Nations, a number of School departments and centres, notably International Relations and the Centre for Global Governance, look likely to be at the forefront of debate. The Grantham Institute has already become a leading repository of economic understanding about climate change.

What seems likely, looking ahead from early summer of 2010, is that Britain will face changes not only to its economy but also to politics and society at large. The global banking crisis, taken together with the deepest recession since 1945 and the Parliamentary expenses scandal, will together affect the way the British think about many issues. Attitudes to wealth, poverty, taxation, politics and government have all been opened up to discussion and debate. Think tanks have been chattering away and providing inputs to this uncertain new world. But no convincing alternative has been put forward to replace battered market capitalism, despite many lobbyists knowing that the events of 2007-10 created a once in a lifetime opportunity to push for significant changes to many aspects of society, the economy and government.

The 2010s will be as important a decade as the 1960s or the 1980s in shaping new ways of thinking about these themes. For a relatively conservative country with a long evolved democratic system,

Britain has proved capable of surprisingly radical change. The late 1960s saw the passage of social legislation that for all time changed the way people think and behave. Mrs Thatcher's 1980s government brought about a similar revolution in attitudes to business and money.

By 2020, it is likely there will have been a similarly dramatic change in societal thinking, though it is not yet at all clear which direction the post-crisis world will move in. I believe the School is better placed than any other UK institution to provide the analysis and intellectual background to inform such a move. Change is good for social scientists, though not always for the society they study. The new parliament provides a major opportunity for LSE and other universities to inform and respond. Economics and political science have never been more important. ■



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is director of LSE London.

Election Experts

The LSE Election Experts blog began as an experiment to test the waters in March 2010. Our idea was to cut through the normal restrictive filtering of the media so as to provide our readers with direct commentary and analysis from a wide range of LSE academics. We sought to improve knowledge of key social science insights and context that all too often gets lost or dumbed down in short-termist media commentaries. Covering the election campaign in depth, we ranged widely over public policy issues and topics (especially with policy briefs from the Centre for Economic Performance). And in electoral analysis and coverage of parties we drew on sophisticated forecasts specially conducted by Professor Simon Hix and Nick Vivyan, and we used an innovative 'median-smoothing' approach to distil the message of most recent polls in a systematic way, a technique which the BBC subsequently picked up on for its own poll of polls.

The blog has over 35 contributors, drawn from 12 LSE departments and centres, and ten different disciplines. It was subscribed to very widely, with several hundred Twitter followers, and mentions and re-posts in *The Guardian*, the BBC, Wikipedia, many different news media in Europe, Canada, USA and wider, and many websites and blogs, such as Facebook, Politics Home, *The Financial Times*, and Intute (the social science resources site).

The blog has helped to encourage research dissemination, created new research impacts, debate, and engagement with staff, students and members of the public. For example, we generated over 150 comments in a month, allowing members of the public in both the UK and abroad to interact directly with our election experts. Posts were not confined only to LSE; we had contributions from Bob Worcester, the founder of MORI, and LSE connected academics

'No convincing alternative has been put forward to replace battered market capitalism'

from Queen Mary, the University of Essex and the University of Liverpool.

Because the Election Experts blog has been so successful so fast, we have decided to transition it first into a blog covering the formation of the new British government in the immediate aftermath of the election, and by the end of May 2010 into a permanently operating British Politics and Public Policy Blog. The new blog will carry over the community of commentators and contributors from Election Experts, with the same aims of achieving serious social science analysis but in an accessible and highly relevant way. As now, we will aim always to be blogging with excellent and up to date data and evidence, and explaining some technical concepts and methods properly. The new blog will also be deploying some more sophisticated analysis or arguments than are normally handled by the UK press and media, and reporting more 'state of the art' social science ideas and perspectives.

British Politics and Public Policy takes a holistic and fully interdisciplinary view of politics and public policy. We focus on current trends in Britain but in the light of developments in the rest of the world, and with many comparisons and historical insights. We hope that the new permanent Blog will become an important point of reference and participation for LSE's worldwide network of staff, alumni, and associates, allowing them to keep in touch with the UK's always exciting and fast moving political and public policy scene, and contributing their insights and knowledge of how change happens and where fruitful comparisons can be drawn.

The editors of the new British Politics and Public Policy Blog are Professor Patrick Dunleavy (Department of Government) and Chris Gilson (LSE Public Policy Group). They are keen to hear from anyone with contributions and ideas, ideally in the form of 300 to 1,000 words text. Please feel free to include also one or two well explained tables or charts for key data. Email: c.h.gilson@lse.ac.uk.