

Britain's Coalition government: keep calm and carry on?

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Summary

- This month marks the second anniversary of the UK's Conservative-Liberal Democrat Coalition government. After a strong start, the Coalition now looks increasingly strained. Two years of austerity politics, public sector job cuts and unpopular changes in areas such as university tuition fees have tested the political ambitions and comfort zones of both partners.
- Decisions on public spending cuts, raising VAT and raising student fees may have fulfilled Liberal Democrat leader Nick Clegg's ambition to demonstrate that his party is capable of taking tough decisions, but they also provoked a minor crisis of identity and confidence among much of the Liberal Democrat activist base.
- For business the Coalition has had a mixed record. Ironically, it is the traditionally pro-business Conservatives who have brought the greatest element of uncertainty to business policy with their approach to energy, immigration and Europe.
- Nevertheless, despite the tensions and current political speculation, our prediction is that the Coalition is likely to last the full five year parliament until 2015. Not only is it cumbersome to dismantle, but it is in neither party's interest to do so.

This month marks the second anniversary of Britain's Conservative-Liberal Democrat coalition government. As far as political marriages go, this one was both largely unforeseen, and initially, relatively successful. It offered Conservative leader David Cameron a chance to govern despite having failed to win an outright majority, and to anchor his party in the political centre ground. For the Liberal Democrats it provided the opportunity to be a governing party rather than a party of perpetual opposition. Given the result of the 2010 election it was probably the only permutation that offered Britain an effective and stable government.

The economic backdrop of 2010 and the challenge of the public spending deficit gave the Coalition an initial coherence and sense of purpose. During this period the UK economic debate turned decisively. It became widely accepted that cuts on

the scale the Coalition planned were necessary to deal with the legacy left by the previous Labour government. The Labour party, in transition to a new leadership and the role of opposition after thirteen years in government, found its reputation on economic competence tumbling. The Coalition's ascendancy on economic issues was crucial to it capturing the political initiative and public support. Surprisingly rapidly it was able to draw up, agree and present plans for significant expenditure cuts.

This sense of momentum was underwritten by initially constructive working relationships both among the senior leaders of the Coalition and between the Coalition and the senior members of the British civil service. Within the Coalition strong personal chemistry between the leaders of the two parties and the collegial atmosphere of the first few months of the government also

tempted some - not least the partners themselves - to suggest that a new, more consensual and mature, political era had arrived in Britain.

That was then. On its second anniversary the Coalition looks an altogether more strained and pragmatic affair, with the press and the public much less prepared to give the Coalition the benefit of the doubt. Two years of austerity politics, public sector job cuts and unpopular changes in areas such as university tuition fees have tested the political ambitions and comfort zones of both partners. The Coalition's handling of events in recent months has looked ragged and, as a result, strains have appeared in relations between the civil service and the Coalition. Among backbenchers and activists in both parties the arrangement has never been as popular as with those who became ministers and is increasingly blamed by both for stalling - or falling - party support.

Both Coalition parties suffered significant losses in local government elections two weeks ago. They did however between them poll 47% of the vote, and the Labour opposition's advances were solid rather than stellar. Moreover, despite a renewed challenge from the Labour opposition and considerable internal dissatisfaction, the likelihood is that the Coalition will last the full five year parliament. This Global Counsel Insight explains why.

A necessity, and a calculated risk

Coalition government in the UK is a function not just of a single indecisive election result, but of a longer trend in falling support for the Labour and Conservative parties that have dominated British politics since the Second World War. Britain's first past the post electoral system has masked the extent of the decline of two-party dominance. But the 2010 election was the first in which the largest group of voters was the group of voters who voted for neither major party, and in which this fragmenting of political allegiance translated into a hung parliament. It opened the serious prospect of a Britain in which single-party majority governments could well become the exception

rather than the rule and government by coalition an inevitable part of British politics.

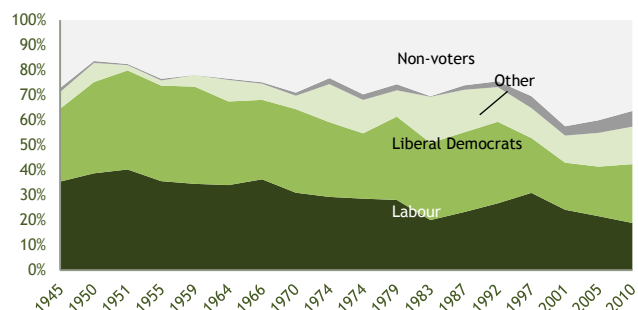


Chart 1: The decline of two party politics in the UK 1945-2010

Source: Public

For this reason, coalition was and remains a product of necessity for the Conservatives. The largest party after the 2010 election, but with a mediocre vote share and without an absolute majority, David Cameron moved quickly to secure power through a coalition agreement with the Liberal Democrats. After a five year campaign to anchor the Conservative party in the political centre, the coalition had the fortuitous effect for Mr Cameron of giving his rightwing little choice but to accept a tempering of their ambitions in the name of accommodation with their junior partner. The complaint that Mr Cameron did this a little too willingly, and has been too accommodating to keep his junior partner on side, has nagged him from his rightwing backbenches ever since.

For the Liberal Democrats, the coalition offered a different kind of high-risk, high-return political gamble. Liberal Democrat leader Nick Clegg defied the gut preference of his centre-left party base to give the Liberal Democrats their first experience of governing since the 1930s. For a party that in the past decade has honed an effective politics of leftist opposition on issues from tuition fees to Iraq this is by any measure a challenging course to take, especially in partnership with a centre-right party with an agenda of sharp fiscal contraction.

Decisions on public spending cuts, raising VAT and raising student fees - the latter a particularly emotive reversal of party pre-election policy - may

have fulfilled Clegg’s ambitions to demonstrate that the party was capable of taking tough decisions, but they also provoked a minor crisis of identity and confidence among much of the Liberal Democrat activist base. In opinion polls support for the party has more than halved (Chart 2).

For the leaders of both Coalition parties the hope must have been that 2012 would see a recovering economy combined with the Royal Jubilee celebrations and the Olympic Games in London to foster a newly buoyant mood among voters. Instead, the UK looks to have entered a double dip recession, the Eurozone crisis has worsened, and weak external demand has meant that the UK has extracted only limited benefit from a weakening pound. Public trust in the Coalition’s economic competence has fallen sharply since 2010 (Table 1).

	Oct-10	Mar-11	Sep-11	May-12
Conservatives	38	31	33	31
Labour	25	28	23	30
Liberal Democrats	10	6	8	7
None	8	11	12	10

Table 1: Which party has the best policies on managing the economy (%)

Source: Ipsos Mori

This growing public unease at the Coalition’s economic strategy has been compounded by unsure political handling of major reforms, most notably to the UK National Health Service. And, fairly or unfairly, there has been a growing media commentary on the Prime Minister’s weak grip and strategy. The Tory leadership has also been harmed by a succession of political missteps and scandals - above all the perception that Mr Cameron himself was close to some of Rupert Murdoch’s London lieutenants implicated in newspaper hacking of mobile phones, police bribery and excessive political influence.

At face value, the local government elections held earlier this month provided evidence of this. The

Coalition parties between them polled 47%, but lost many seats and control of a number of councils. As a party that has built its grassroots strength through local government and councilors this was a significant psychological blow for the Liberal Democrats in particular. There is however some solace in the details. The Liberal Democrats did well in the local council vote in many of the parliamentary seats they hold, including Nick Clegg’s Sheffield Hallam seat and Portsmouth South.

	2010	2011	2012
Conservative	201	205	193
Labour	55	81	113
Liberal Democrat	22	13	12
No overall control	127	106	87

Table 2: Shifting Council control in the UK 2010-2012

Source: LGA

Media commentary also flattered Labour’s achievement. Its thirty-eight per cent vote share is solid enough, but at the low end of the range of recent national polling and the large tally of seats and councils captured by Labour said rather more about how denuded its position had become in recent years in local government than it did about the strength of Labour’s vote on a putative future polling day. The Tories remain the dominant party of local government by some margin (Table 2).

Has Coalition government been bad for business policy?

An early Coalition honeymoon with business has also cooled somewhat. The Coalition’s rhetoric on big business reflects a perceived political need to tack with public resentment of the banking crisis and high executive pay. But this would have happened under any government. In practice, although the UK banks in particular have had a rough political ride for the last three years, the relatively small levy on their balance sheets imposed in 2010 has sated the political appetite for fiscal punishment. The implementation of the Vickers Commission recommendations on ring

fencing and raising capital requirements for retail banking operations in the UK will have few implications for foreign financial firms operating in the UK unless they want to get into the retail banking business.

In other areas, the Coalition has opted for actions that they think will have favourable global resonance. Cuts in UK corporation tax from 28% to a projected 24% in 2015 have improved the UK's comparative international ranking. The reduction in the top personal tax rate may have been mistimed from a domestic political standpoint, but it was more positively interpreted among large multinational investors and their well paid staff.

On energy, the Coalition has embarked on an ambitious programme to reform the electricity market to support investment in low carbon generation. However, there is scepticism in the industry about its deliverability not least because Conservative backbench opposition to renewables has grown. There is a good deal less talk of the government wanting to be the 'greenest ever'. Here, as elsewhere there is a lack of consensus within the Coalition about what a pro-business agenda should look like. A faultline runs between both parties, and to an extent within them, between those who favour a purely de-regulatory approach - at least outside of financial markets - and others who want to see a more activist approach built around a more conscious 'industrial policy'.

This tension also reinforces the point that it is often Conservative political instincts that have been the greatest source of uncertainty for business rather than those of the more business-wary Liberal Democrats. Tory hostility to immigration has seen the Coalition impose strict restrictions on working migrants to the UK and on the granting of work permits to foreign students in the UK, although business pressure and Liberal Democrat resistance helped exempt high earners moved within multinational corporates from these restrictions.

By no means the least damaging of these Tory instincts may prove to be the Conservative view of the European Union. Tory hostility to Europe helped ensure that David Cameron excluded the

UK from negotiations on the new European Treaty and by implication from the core group of European member states who are tentatively embarking on closer fiscal coordination based on the Eurozone. This has arguably weakened the UK's political hand in areas where it has key European single market interests such as financial services, at a time when financial markets governance has largely been delegated upwards to Brussels. The Liberal Democrats' more pro-European sensibilities are likely to be little constraint on a Tory party that is edging towards making anti-Europeanism one of its defining public causes.

The case for going the distance

Despite its internal tensions and external scepticism, a number of things strongly suggest that the Coalition will last until the next British general election in 2015. Absent a strong economic recovery Mr Cameron suspects that he could not secure a majority government at the polls. Despite the bullishness of some Tory backbenchers, he is almost certainly right. The Tories have regained and consolidated much of the support they lost to Labour in more prosperous southern English constituencies in the 1990s onwards. But a majority Tory government would require far greater capture of Labour seats outside traditional Tory heartlands than current polling or anecdote suggest is likely, given that Labour now consistently leads national polls by 10% or more (Chart 2).

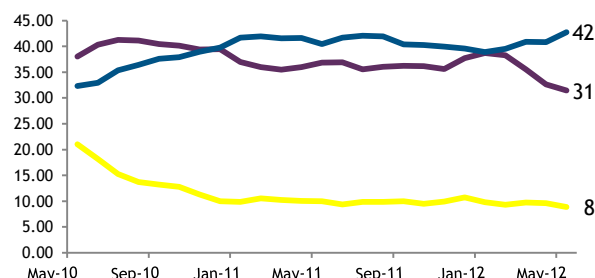


Chart 2: Support for the three main UK political parties May 2010- May2012, monthly averages.

Source: You Gov, Opinium. Ipsos Mori, ICM, Comres, Populus, TNS

Even if Mr Cameron felt he could win an early general election, the Coalition itself is actually quite cumbersome to dismember. Under the terms of the UK Parliament Act - revised in 2010 at Liberal Democrat insistence to prevent the Tories jilting them after six months - the Prime Minister no longer has the power of all previous incumbents in No10 to call an election before the parliament's end date. To have an election before the full five year term now requires either the House of Commons to pass a no confidence vote by a simple majority or to vote by two-thirds for a dissolution. The former would require the Coalition to have acrimoniously collapsed. The latter would require revived poll numbers and a sufficiently positive economic backdrop that the Conservatives would think that they could win a majority government (not to mention the support of the Labour opposition for the move). Both of these are actually quite unlikely in the short to medium term.

Any Liberal Democrat attempt to bring the Coalition to an early end by deciding to back a motion of no confidence would require a significant number of the 57 Liberal Democrat MPs to split from their own party and vote with the Labour opposition to bring down their own government. Regardless of the resentment among their activists, Mr Clegg and his backbench Liberal Democrat MPs are still likely to calculate that their best option remains governing until the 2015 election, campaigning on their new credibility as a responsible party of government and hoping they can take some of the credit for a recovering British economy. As the key likely beneficiary of further hung Parliaments in Britain the Liberal Democrats also have a vested interest not just in defending their own record in government, but in defending the whole nature of Coalition government itself.

But this also reinforces the point that the Liberal Democrats lack a clear extraction strategy. Leave early and they appear to disown their own record in government in a way that undermines much of the hoped-for dividend in public perceptions of their political maturity, especially if the British economy is on the mend. It is possible that a

single defining issue may give them an opportunity to bail out of the Coalition early with some credibility intact; Europe, perhaps, although the Liberal Democrat's pro-Europeanism is a negative for most British voters. Yet wait until the eve of an election and they will find it harder to campaign on their points of difference from the Conservatives and harder to project the 'equidistance' from both major parties that would enable them to be a credible partner for Labour in a future government.

What to do with Mr Clegg will also pose a problem for the Liberal Democrats. If Mr Cameron consents to doing it, the prospect of moving Mr Clegg to Brussels as Britain's next European Commissioner in Summer 2014 will be a tempting way of giving the Liberal Democrats a new Parliamentary leader for the 2015 election campaign and the prospect of cooperation with Labour that would be much more difficult with Mr Clegg as leader. In any scenario, the Coalition looks more and more like the Liberal Democrats' political Vietnam: getting out may prove much more of a challenge than getting in.

So our reasoning is that the Coalition will be more durable than political speculation currently suggests. Its unpopularity with those in it and the hostility of those outside it is likely to matter less than the political costs of dismantling it. It is, nevertheless, looking increasingly under strain and shows less and less ability to converge on a policy agenda on which both parties can happily agree. All governments ultimately exhaust their political goodwill with the electorate, but the Coalition is currently burning up its capital surprisingly quickly.

In part, this is simply because of the controversial decisions it has made in cutting public spending and raising student fees and the vested interests this has challenged. In part, it is the perception of poor policy and political management and judgment. The 2012 budget, which appeared to be built on a tactical gamble that tax cuts for the very wealthy could be traded against rises in property taxes for the extremely wealthy tripped up on a politically toxic real-terms cut in pensioner allowances that confirmed the worst

caricatures of the government's social and political priorities.

Is this salvageable? Probably a lot more so than it seems, especially if the British economy returns to growth. Between now and 2015 the problem for the Coalition is likely to be defining an agenda that will span the remaining three years of its tenure. Reforms to the British health service, schools sector and social welfare system, with varying degrees of coherence, are underway. Banking reform is broadly completed. There is no money for large scale investment projects or new spending. In their place are likely to be fractious debates about the scope of Britain's engagement in the EU and Scottish independence and three years of further public spending cuts.

The prospects for the economy are central to any assessment. If Britain's double dip recession is confirmed and turns out to be anything but short, the Coalition will find itself in a difficult place. The independent UK Office of Budget Responsibility projects no return to trend growth until well into the second half of the decade and stagnant real wages until the eve of the next election. The UK consumer is still heavily deleveraging and domestic demand is weak. Unanticipated borrowing required by slower than projected growth has already pushed the government's ambition to eliminate the UK's structural deficit out of this Parliament and well into the next. Although sterling depreciated by almost 25% between 2007 and 2009, weak external demand has delivered only a moderate boost in exports.

Much of this is out of the Coalition's hands, but if voters are to face public spending pain with little economic recovery gain, Labour's critique of the scale and speed of public spending could gain new traction. What does remain clearly within the Coalition's command is sharpening up its competence, and trying to ensure that by 2015 this particular political partnership looks like a genuine political innovation for difficult political times, and not a lingering act of political desperation.

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