



# COVID-19

## UK Political Analysis

By Tim Hames, Senior Adviser | 10<sup>th</sup> July 2020



**Rishi's Rulebook. A very strong Chancellor in very strange conditions.**

A year ago today Rishi Sunak was Parliamentary Under-Secretary of State for Local Government. That is about as close as you get to 'Minister for Paperclips' in the UK system of government. He is now not only the Chancellor, but about the most popular figure within his own party and the public at large in the entire administration. If Boris Johnson were to fall suddenly under the proverbial bus, Mr Sunak would start as the red-hot favourite to succeed him. In his statement in the House of Commons on Wednesday he also hinted at numbers for spending and borrowing that would have been utterly unimaginable six months ago. Oh, and his father-in-law is a billionaire. A class act, clearly.

### **EXECUTIVE SUMMARY**

- This Chancellor is in an exceptionally strong personal and political position at the moment. One would have to travel back more than a century to David Lloyd George to find a (distinctly imperfect) precedent for such a situation.
- The crisis has also reinforced the authority and autonomy of the Treasury which had been weakened ever since the Brexit referendum result was revealed. The notion of it somehow being absorbed or tamed by Number 10 looks fanciful.
- The Chancellor is prepared to spend and borrow whatever it takes to limit the damage of the coronavirus crisis, and is confident that he will be able to do so at

acceptable cost (in the circumstances) and at atypically low interest rates. With the Bank of England clearly operating in tandem with him, this is a rational view.

- The real challenges to the public finances are serious but probably for the medium term. State spending on health in this decade will be substantially higher than envisaged at the outset of this year, and that has consequences.
- The Chancellor has, though, largely deferred the process of starting to make that assessment until his Autumn Budget and a fresh review of the numbers by the Office for Budget Responsibility. This is again logical because by that point he should know whether a vaccine will be available this calendar year or whether the UK will have to enter the winter flu season without such a solution. This is crucial to understand in order to estimate the duration and the cost of the crisis.

## **A very powerful Chancellor.**

The circumstances of his appointment on February 13th, triggered by the unanticipated resignation of Sajid Javid after a mere 204 days in post, led many to assume that Mr Sunak would be something close to a puppet for the Prime Minister, 10 Downing Street and Dominic Cummings, the most important adviser to Boris Johnson. Mr Sunak had, after all, agreed to the merging of his team of special advisers with those of Number 10, the issue that had led his predecessor to return to the backbenches rather than accept something which was far too close to a very public dilution of his status as Chancellor.

This was always a disputable assertion (see FTI UK Political Analysis, February 14th 2020). It underestimated Mr Sunak's personal and political qualities and put too much weight on his youth (he only turned 40 in May) and his parliamentary inexperience (he was first elected to the House in 2015). The idea that he would be not only a CHINO (Chancellor in Name Only) but a Baby CHINO was preposterous. Politics does not work like that. It was also a very dubious assertion that Mr Cummings (or anyone else for that matter) could somehow take over an institution such as the Treasury on the basis of appointing six or seven political loyalists probably aged in their twenties as Special Advisers. This was akin to believing that Berlin could be saved from the Soviet Army in April 1945 by recruiting half-a-dozen enthusiastic members of the Hitler Youth to engage in the task.

This Chancellor is very bright, has an interesting background in business that is atypical of the contemporary Conservative Party in the House of Commons, has been bold, has proved to have the popular touch at times and is extremely ideologically flexible. He may make mistakes and come a cropper later but for now no one can push him around. He is a politically sophisticated operator. He is aware that with a little luck he might well be able to steer through a deep short-term recession without the bulk of the electorate blaming him personally for it and then reach a point in the 2022-2024 period when the economy returns to where it was at the start of this year (and moves beyond it) at a very convenient hour in terms of fusing the economic and electoral cycles. If he can pull that off, then his standing as the obvious heir apparent to Mr Johnson will be even stronger.

There have been powerful Chancellors before, but not one quite in the same situation. Nigel Lawson, at the peak of his performance at the Treasury (1987-1988), was a very impressive intellectual heavyweight but nobody (including himself) thought that Tory MPs would elect him as Margaret Thatcher's successor. Ken Clarke was a strong and largely effective Chancellor but his views on Europe also made it unlikely that he would prevail if John Major were to be ousted. Gordon Brown was an exceptionally dominant figure at the Treasury but the continuous conflict between himself and Tony Blair was ultimately corrosive and his intellectual reputation as Chancellor was torpedoed when the global financial crisis of 2008 and subsequent economic slowdown made a mockery of his oft-repeated claim to have put an end to "boom and bust". George Osborne wanted to be a forceful Chancellor (and in some ways proved to be one) but he was constrained firstly by the existence of the Liberal Democrats in the coalition, then by the fact that the people to whom he initially needed to appeal if he were ever to succeed David Cameron (the parliamentary Conservative Party) did not instinctively like him, and finally by Brexit and a referendum which he knew would be fatal for him if it were lost (which is why he never liked the commitment that Mr Cameron offered in January, 2013 to hold such a plebiscite if a majority Conservative Government were to be returned). Philip Hammond was in many ways an impressive Chancellor but his relationship with Theresa May became extremely icy, he was never likely to be chosen as leader by Conservative MPs and he was perceived as an arch-remainer in a pro-Brexit party.

When you make the comparison in the manner of the above paragraph, it becomes clear why Mr Sunak holds so many cards at the moment and seems to know how to play them. The next few months will undoubtedly be very testing for him but he is in a solid place.

## **A restored Treasury.**

The crisis has restored the autonomy and authority of the Treasury which had been in an essentially defensive posture for most of the previous five years. This was mostly due to Brexit, to which it was perceived (correctly) to be hostile, and was then mostly ignored while the Brexit negotiations were being conducted to its intense irritation. When Mrs May entered Number 10 as Prime Minister she mostly brought with her officials with whom she has been comfortable at the Home Office, not Treasury high flyers. There was increasing doubt at the top of the Treasury about the austerity agenda. An era of low interest rates for much longer than expected had started to prompt fresh thinking. The Treasury was never to going to be marginalised, but it sensed that it was less important.

The crisis has changed all that. It has made control over the cheque book paramount. That in turn means that the Treasury is once again the centre of life within Whitehall. It has also provided a convenient alibi to move on from the austerity assumptions that had been articulated as something close to Gospel Truth but a very few years earlier.

This is represented by generational change in the high command at the Treasury. This is still a department that can recruit exceptional talent (despite modest salaries compared with banking or law or many other parts of the private sector). These clever figures are motivated by being awarded huge amounts of responsibilities at a tender age (the average age of a Treasury civil servant is 31) and rotated in their roles very regularly to keep them interested (which is infuriating to have to deal with as an outsider required to lobby and to work with the institution, but such is life). Promotion can also be very rapid.

People tend to be influenced by their generational experience. The Permanent Secretary at the Treasury from 2005 to 2016 was (now Lord) Nick Macpherson. He had joined the civil service in 1985. The Treasury then held orthodox views on government spending (it should be tightly controlled) and had a dim view of the rest of Whitehall when it came to

exercising expenditure with any efficiency. Austerity from 2009 onwards was a reversion to past thinking. It would have been an entirely natural mode of government for him.

The Permanent Secretary since 2016 has been Sir Tom Scholar. He was recruited in 1992, the year that the centrepiece of UK economic thinking – membership of the Exchange Rate Mechanism – collapsed in spectacular fashion and the Treasury was forced to devise a completely new approach which could achieve growth without reviving inflation. While manifestly not as extraordinary as the coronavirus crisis has been, this was still extremely challenging. Old rules are dead. New ones have to be invented. For Sir Tom, this must be a reversion to his very earliest days in Whitehall. It may even be fun. The Treasury is calling the shots again, and because of the scale of the issues which now confront the public finances and hence the public sector writ large it will continue to do so for some time to come. It may even find itself reconciled to Brexit, fully leaving the EU (after the transition period ends) opens up new options for policy after the crisis is over.

## **Spending (and borrowing) whatever it takes.**

The numbers that the Chancellor set out explicitly and implicitly are so large that it is easy to lose sight of their astronomical scale. The budget deficit this year was supposed to be around £55 billion. The Office for National Statistics rounded that up to £260 billion a few weeks ago. The Institute for Fiscal Studies yesterday put the number at far closer to £350 billion. It might well up knocking on the door of £400 billion. It will all be borrowed.

Lockdown has been an event without comparison in our economic history. If we are lucky this will be the deepest recession since 1870. It is completely possible that it will be the sharpest since 1706. Beyond that, you are going back to the Great Plague and to the Black Death. The Government has already through various public spending measures and tax moves thrown almost £160 billion at the economy. Mr Sunak chucked a further £30 billion at it via his latest tax cuts and spending increases this week. The NHS budget has involved almost £32 billion more than had been planned four months ago. The cost of additional PPE (personal protective equipment) alone has been £15 billion; for context that is more than has previously been budgeted for central government spending on the whole of the transportation sector. The Government has been subsidising the wages of almost 9.4 million people. GDP fell by an estimated 25% between February and April.

ATM transactions this May fell by 52% compared with a year beforehand. In that same period, job vacancies fell by 62%. These are incredible, almost unbelievable, statistics.

There is no V-shaped recovery that can compensate for these figures later. The central question is whether they are in effect a gigantic one-off which will largely run through the system in the course of a single fiscal year or whether sections of the economy (hospitality and construction) will be so badly crippled that it takes them years to recover properly (if at all). That is why Mr Sunak framed the measures which he announced this week in the manner that he did. He may have to come back and do more in the Autumn.

He can, though, be confident that the markets will sustain his spending. Interest rates will remain extremely low for a very long period of time. Loose fiscal policy and loose monetary policy will go hand in glove for a lengthy tenure. Inflation is not expected to be the enemy. The rules of the game are changing rapidly internationally. There will be some kind of reckoning on tax levels eventually (to pay for permanently higher health spending) but the Chancellor will not want to rush into this and probably will not be compelled to do so anyway. That will be true for the vast majority of his colleagues in ministries of finance across the developed world. The crucial political asset that this Chancellor and the Prime Minister enjoy is time. The US election is this November. The next German one will be in 2021. The French ballot is 2022. There could be an election in Italy or Spain at any time allowing for their complicated parliamentary compositions. This Government does not need to offer itself up for re-election until late 2024. That helps it.

## **A very different approach to unemployment.**

In the 1980s the UK Government did not exactly conspire to create mass unemployment, but it could legitimately be accused of not seeking to soften the blow of it as much as it could. A harsh but fair analysis of the economy then was that much of the manufacturing base could not be rendered competitive internationally. Mass unemployment also had the advantageous side-effect that it completely undermined a trade union movement that had brought down two governments (those of Edward Heath and Jim Callaghan) in the 1970s and had launched a full-frontal assault on that of Margaret Thatcher through a Miners' Strike of almost a full year. It took a very long time for unemployment to fall.

There is a very different attitude at work in Whitehall this time. No one privately wants much of the manufacturing sector that still exists to be decimated (quite the opposite; the crisis has exposed the problems that you encounter if your domestic chemicals and pharmaceutical industries are too small). Unemployment (and the avoidance thereof) is the key metric by which success and failure in economic policy in this decade will be measured. Whether it can be contained below two million at its height (which in these conditions would be close to a triumph) is unknown and depends to a very large extent on a single event (of which more below) over which ministers have influence but not control. The attempt to limit unemployment will, nonetheless, be there and that has its own impact on the spending and tax decisions that the Chancellor will make later.

## **The factor that will determine the Autumn Budget.**

One of the critiques that the Labour Party made of the Chancellor's statement this week was that he had deferred many sizeable decisions to the Autumn Budget (which will come with an updated set of forecasts from the OBR). The charge is valid, but it is equally true that it is entirely reasonable for the Chancellor not to overcommit himself just now.

For the vast difference between this month and, say, late October is that by then he will be in a much better position to know whether the Oxford University dash to create an effective vaccine has succeeded and when universal vaccination will occur. In the most optimistic scenario, the vaccine will pass its final set of human trials (currently being conducted in the UK, Brazil and in South Africa) in a matter of weeks and by the Autumn, the military will be recruited as part of a drive to ensure almost 70 million people in the UK are vaccinated before the end of this year. In the worst case outcome, it will be concluded that no viable vaccine is in sight for the foreseeable future, and that while there will still be a mobilisation to vaccinate, it will be against influenza so that the NHS does not have to enter the winter fighting flu and a second spike of coronavirus. The difference between these two possibilities, and indeed a range of options between them (including that a vaccine might work but, disruptively, need to be an annual event) and the effect that they would have on society and the economy (including the public finances) is absolutely gigantic. It makes a lot of sense for the Chancellor to see what the

vaccine situation might be, and then in light of that, comes to some conclusions on what his short-term strategy and medium-term blueprint for the economy should then be.

In this respect, the most important words in the Chancellor's *Plan for Jobs* that he published on Wednesday do not directly relate to employment. They are these:

"The Government has committed £313 million to support international efforts to develop vaccines, therapeutics and diagnostics, including £250 million towards the Coalition for Epidemic Preparedness Innovation (making the UK the largest contributor in the G20), £40 million on therapeutics and £23 million on diagnostics."

There were two other details in this document that were more important than Stamp Duty arrangements. The first was the ambition to establish an Office for Talent based in 10 Downing Street that would "focus on attracting, retaining and developing top research and science talent internationally". The second, simply entitled "world class laboratories", involved "£300 million to boost equipment and infrastructure across universities and institutions across the UK". Let us hope that it is money well spent.

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