As the UK Plunges into Political Uncertainty, Does that Mean Economic Policy Paralysis Ahead?

Vicky Pryce

With the Prime Minister's dramatic resignation this week, much in relation to economic policy is now put into suspense. When Boris Johnson appointed Nadhim Zahawi as his Chancellor mid-week to replace the departing Rishi Sunak, the talk was, momentarily at any rate, of a change in tax policy.

However embarrassing it was to lose a Chancellor who during Covid at least had sustained the economy with massive and much-needed stimulus measures, there was a chance to reverse some of the subsequent tax increases which Sunak had masterminded, both actual and planned, that many thoughts were inappropriate at a time of sharply rising cost of living for the population and pressure on real personal disposable incomes which have fallen in each of the four quarters to the end of March 2022.

Zahawi, previously education secretary and also a former businessman, is widely believed to favour cutting VAT and abandoning the planned rise in Corporation tax from 19% to 25% due to take place next year. That at least would put him in line with what seemed to be the thinking at No 10, fiercely we understand resisted by the Treasury on the grounds of fiscal prudence. This hawkish message was being reinforced by the Office for Budget Responsibility which has just issued a report warning about the pressures on public finances under a number of plausible downside scenarios ahead, both for the short and long term[i].

Well, the resignation of the Prime Minister may have changed all that. Boris Johnson intends to stay on until a successor is voted in September. This still leaves Mr Zahawi as Chancellor alongside an almost brand new Cabinet. But this saps his wings as it would be difficult to pass new policies through the houses in such a strained atmosphere. It could of course be tried although the Bank of England would then most likely be forced to raise interest rates faster to achieve the aim of controlling inflation and stopping it being embedded in the future when the current energy and food crises eases, as Sir John Cunliffe, Deputy Bank of England Governor and on the Monetary Policy Committee told the BBC in no uncertain terms this week[ii].

So the safe assumption to make right now would be that not much can change in economic policy in the short term. Given the drops in consumer and business confidence the economy will likely drift further down, mirroring, though perhaps in a more extreme form, developments in Europe which ING economists[iii] have just described as having cancelled the chance of recovery happening any time soon!

But there could be one change nevertheless. If there is relative policy paralysis, the enthusiasm – and ability- of getting the UK's Northern Ireland Protocol Bill[iv] through both houses in any hurry at all may well be diminished and a threatened trade war with Europe would move further away into the future. That would be good news. One wonders in fact whether the small recovery we saw in the Footsie 100 and the stability of sterling following the news reflected that thinking.

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[i] https://obr.uk/

[ii] https://www.euronews.com/next/2022/07/06/britain-boe-cunliffe

[iii] https://think.ing.com/articles/europes-recovery-is-cancelled/?utm_campaign=July-07_europes-recovery-is-cancelled&utm_medium=email&utm_source=emailing_article

[iv] https://commonslibrary.parliament.uk/research-briefings/cbp-9548/