

UK: Uncertainty to prevail beyond the Tory leadership ballot

- As the Conservative membership ballot gets underway, Foreign Secretary Liz Truss appears to have a significant lead over Chancellor Rishi Sunak in early polling of party members.
- The contest takes place against a backdrop of rising energy, food and fuel costs, with the soaring cost of living representing the government's most challenging political problem.
- Despite this and the economic dividing lines between the two candidates, the outcome might not immediately clarify the UK's direction of travel on fiscal, monetary, and regulatory policy.

The contest has already laid bare a fundamental rift in British Conservatism and its approach to the economy. This divide will likely widen as the two candidates make their pitches to party members over the summer. The result is expected on 5 September.

Tax and fiscal policy

Sunak advocates for a more traditionally Conservative, long-term approach, with only a gradual easing of the tax burden to spark growth, stem inflation, and pay off the UK's pandemic debt. Truss, meanwhile, has argued for what she describes as a "bolder" approach. She is promising significant tax cuts on her first day in office, with corporation tax, national insurance contributions, and income tax all set to be slashed. However, she is yet to outline how she would pay for these tax cuts. Sunak has vowed to stick with recent tax rises to balance the books following record government borrowing during the pandemic, stating that curbing inflation is his priority. Truss has countered that such plans would force the UK economy into recession, promising to go as far as reviewing the Bank of England's mandate to set interest rates, thereby at least playing with notions of putting monetary policy directly under the government's purview.

As Chancellor, Sunak implemented a GBP 15bn package of support to help Britons through the worst cost-of-living crisis in decades. However, Truss believes this is insufficient, vowing to use economic growth fuelled by her tax cuts as the primary way to tackle the crisis. With two entirely opposing approaches to managing the Exchequer's finances, the ramifications of the contest seem significant for the direction of the UK economy. At the same time, realities such as rising debt servicing costs might limit what can be done over the medium term.

On defense, Sunak also proposes a more conservative approach, arguing for a rise in the defense budget to 2.5% of GDP "over time." Truss has been more forthright, this week committing to spending 3% of GDP by 2030. Truss has also promised to scrap green levies on energy bills but, like Sunak, is committed to the UK's target of Net Zero emissions by 2050. The overall question remains unresolved. The aggressive tax cuts proposed by Truss (but also Sunak's promise to balance the books over time) are designed to please the more traditional Conservative grassroots, but how can this be married with the greater spending on infrastructure and social services that is required from the perspective of the "Red Wall" seats the Tories have won from Labour?

Europe

On Brexit, Truss backed Remain in 2016 before presenting herself as a zealous convert to the Brexit cause in the years since. This has earned her the backing of the Brexit-backing wing of her party and is likely to earn plaudits among grassroots members. Sunak, though a Brexiteer throughout, appears to be drawing his support from the One Nation and Remain-backing wings of the party who tend towards the center-right. While both candidates are attempting to claim the mantle of small-state Thatcherism, it is Truss who appears most likely to try and follow such policies where Sunak will retain a significant tax burden.

Both candidates have stated that they support new legislation to unilaterally rewrite Britain's post-Brexit commitments to the EU over Northern Ireland. But on Europe, too, the bigger question remains unresolved: Both candidates have indicated they would aim for divergence by scrapping the remainders of EU regulation from the UK rulebooks, but to what overall end? What would a new growth and trade-enhancing regulatory regime look like for the UK on anything from industrial product standards to food, animal, and plant safety rules?

Looking ahead

Truss is the early favorite, but Conservative leadership contests have turned out to be highly unpredictable in the past. But even regardless of the eventual outcome, the direction of UK public policymaking remains uncertain. The two possible outcomes promise very different approaches to economic management. Both, however, must contend with a fragile electoral coalition at the ballot box in 2024/25, facing a major challenge to maintain the traditional support of affluent seats in the south of England alongside the so-called "Red Wall" voters. They lean to the right on cultural issues but will expect significant capital expenditure and an improvement in their cost of living before any election.

Balancing these priorities – and sparking economic growth – will be the defining challenge for either PM in the next two years. With the keys to Downing Street up for grabs, how the UK contends with major crises at home and abroad will provide a significant headache to the winner who, after 12 years of Conservative government, has just two years to show first the party then the country that they are up to the challenge.

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