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# Britain's Coalition Government

*A Preliminary Verdict*

*By Dr. Robin Harris*





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# **Britain's Coalition Government**

*A Preliminary Verdict*

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## Abstract

Britain and the United States face similar budgetary problems. Deficits in both countries are unsustainably high. So is public spending. Action is being taken in Britain, but in the U.S., there is continuing pressure either to take no serious action at all or to take the wrong action, most notably by repairing the deficit with tax increases or—to make matters worse—by increasing spending even further.

The U.K. coalition government has proved unexpectedly bold in the decisions taken on the deficit but less bold on spending and, in some respects, bold in the wrong sense on taxes. The U.K. has also faced—and in some respects has yielded to—the temptation to adopt wrong priorities in its departmental budget reductions.

The U.S., when it faces up to financial realities, will confront the same kind of temptation. It can be resisted only if American budget cutters retain a clear conservative sense of what government truly exists to do and what functions are secondary, superfluous, or

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better performed by private business and individual citizens.

The United States has, of course, a different political system: A U.K.-style coalition government, as opposed to an Administration enjoying cross-party support in Congress, is simply a constitutional impossibility. The U.S. is also at a different stage in

the electoral cycle, with different political as well as economic uncertainties ahead. But the initial successes and failures of the Conservative-led U.K. coalition government offer food for thought—and possible indigestion—for American policymakers intent on restoring U.S. finances, creating a virtuous circle of economic growth, and maintaining America's status as the world's number one power.

# **Britain's Coalition Government: A Preliminary Verdict**

*By Dr. Robin Harris*





# SECTION I

## Inherited Problems

The problems inherited by the United Kingdom's new coalition government were of two sorts, though they had a common cause. There were the immediate financial problems, which stemmed from the handling of the banking crisis and resulting recession of 2007–2009. There were also deep-seated and interlocking economic and social problems, which had built up over a much longer period—some of them, in their origin, since the 1940s and then, in their current form, under the Labour government elected in 1997.<sup>1</sup>

All of these difficulties, though arising in response to unfolding circumstances, derived from a particular view of the state. Whether described as socialism (more appropriate to Old rather than New Labour) or as social democracy (with egalitarianism tempered by pragmatism and a reluctant pursuit of “what works”), the notable features of this view were, in truth, similar and threefold.

*First*, there was a high degree of confidence in the beneficent effects of government intervention, altogether ignoring the so-called law of unintended consequences.

*Second*, there was a zero-sum approach to economics, in which one person's gain is understood as another's loss, as opposed to a dynamic view in which incentive-driven growth is understood to benefit all.

*Finally*, there was the conviction that equality of outcome was so important that it should be pursued even at the expense of liberty and equality of opportunity.

The evidence of this ideological continuity is provided by the economic data. For the first two years of the Labour term, Prime Minister Tony Blair kept his promise to adhere to the previous Conservative government's spending plans. Against a favorable international economic background, public expenditure as a share of gross domestic product (GDP) accordingly fell to a low of 36.3 percent.

But once these inherited plans expired, and facing an election, the Labour government returned to type. Between 1999–2000 and 2005–2006, spending grew by 4.8 percent a year in real terms and rose to 43.1 percent of GDP. Spending then stabilized, though the previous budget surplus had become a regular budget deficit. Moreover, the international economic background had changed. European governments were now curbing their spending and taxes, and so reducing the advantages built up for Britain during the premierships of Margaret Thatcher and John Major. Britain was, therefore, badly placed to cope when the financial storm broke.

Decisions by Prime Minister Gordon Brown to bail out and effectively nationalize insolvent banks and to inject huge fiscal (supported by later monetary) stimulus—extolled by Mr. Brown on the international stage as proof of his pioneering foresight—dramatically worsened the public finances even further. Until the very eve of the 2010 general election, Mr. Brown was still denying the need to rein in spending and borrowing even though his own Chancellor of the Exchequer, Alistair Darling, felt compelled to allay fears about British creditworthiness by publishing plans to halve the budget deficit. The details of these plans were never filled in. Indeed, had Labour been re-elected, it is highly unlikely that they would have materialized, at least not without a run on the pound and a race to the International Monetary Fund (IMF).

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1. For a fuller treatment of these arguments, see Robin Harris, “The Decline of Britain: A Cautionary Tale for America,” Heritage Foundation Special Report No. 76, January 26, 2010, at <http://www.heritage.org/Research/Reports/2010/01/The-Divide-of-Britain-A-Cautionary-Tale-for-America.pdf>.

The incoming coalition government naturally had an interest in playing up rather than playing down the seriousness of the financial situation that Britain faced. There was much talk of opening the books and discovering unforeseen horrors, reinforced by warnings of “decades” of austerity.<sup>2</sup> There was overwrought discussion of Britain facing a crisis on the scale of Greece. In fact, the U.K. deficit in 2009–2010 turned out to be somewhat smaller than forecast. Growth in the first two quarters of 2010 then proved a good deal healthier than feared, running at an annualized rate of 3.2 percent.

That said, the new government's verdict on its predecessor was correct. It was right to highlight the unsustainability of its fiscal approach and is right to reverse it. Last year's budget deficit of 11 percent of GDP was still the highest in the country's peacetime history and constituted the largest structural deficit in Europe. The government is now borrowing one pound for every four spent and paying £43 billion a year in debt interest.<sup>3</sup>

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2. See, for example, Sarah Lyall, “Facing Deficit, Cameron Warns Britons of ‘Decades’ of Austerity,” *The New York Times*, June 8, 2010.

3. HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, at [http://cdn.hm-treasury.gov.uk/sr2010\\_completereport.pdf](http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf); George Osborne, Chancellor of the Exchequer, Spending Review Statement to the House of Commons, October 20, 2010, at [http://www.hm-treasury.gov.uk/spend\\_sr2010\\_speech.htm](http://www.hm-treasury.gov.uk/spend_sr2010_speech.htm).

## SECTION II

### The U.K. General Election Outcome

The May 2010 U.K. general election resulted in a hung Parliament. Given Britain's first-past-the-post voting system, this was highly unusual—only the second such outcome in modern times. But given the electoral arithmetic, neither was it wholly unexpected. Both the Conservative and Labour Parties had been seeking to win over Liberal Democrat voters. As the campaign got under way, and particularly when Liberal Democrat Leader Nick Clegg shone in the televised debates, these approaches also focused increasingly on Liberal Democrat Members of Parliament (MPs).

The Conservatives had two special reasons for being keen on close relations with the Liberals. The first was particular to David Cameron. He and his advisers make little secret that they prefer to deal with those on the Center-Left rather than with the Tory Party's unreconstructed Right. They are also convinced, and declare their conviction, that U.K. general elections can be won only on the center ground of politics, and this, it is presumed, is where the Liberal Democrats stand.

Less esoteric are the facts of political geography. There is—and in modern times has always been—a built-in electoral advantage enjoyed by the Labour Party. Long-term migration from the cities, with which redistribution is always running to keep up, means that Labour MPs need fewer votes than Conservative MPs to be elected. On this occasion, the Conservative Party had to achieve a larger swing against Labour than that obtained by Margaret Thatcher in 1979 to win a majority.

For much of the time, though, that seemed very likely.<sup>4</sup> The Labour Party looked stale and divided after 13 years in power. Gordon Brown was very unpopular. At one point, the Conservatives were 20 percent ahead in the polls. The party raised twice as much money as Labour. It had the overwhelming support of the press, reflected not just in leaders but, more importantly, in news. Mr. Cameron, because of his adoption of socially liberal positions, sustained much less hostility than Conservatives usually face from the BBC. The party had a more focused marginal seat operation. It should, therefore, have done better.

As it was, the Conservatives gained nearly 100 more seats, but it was not enough. The Tories were 20 seats short of a majority in the House of Commons. The Conservative share of the vote was also historically disappointing—lower, at 36.1 percent, than in any modern general election. Conservative supporters, by this measure at least, were notably unenthusiastic. That is a bad sign.

One can argue whether the overall strategy pursued by the Cameron “modernizers,” whenever they were suf-

#### Outcome of the 2010 General Election

Party	Seats Won	Pct.
Conservative	306	47.1%
Labour	258	39.7%
Liberal Democrat	57	8.8%
Democratic Unionist	8	1.2%
Scottish National	6	0.9%
Sinn Fein	5	0.8%
Plaid Cymru	3	0.5%
Social Democratic & Labour	3	0.5%
Alliance	1	0.2%
Green	1	0.2%
Independent	1	0.2%
Speaker	1	0.2%
<b>Total</b>	<b>650</b>	<b>100.0%</b>

Sources: UK Parliament Website, “Current state of the parties,” November 8, 2010, at <http://www.parliament.uk/mps-lords-and-offices/mps/state-of-the-parties/> (January 3, 2011).

Table I • SR 87  heritage.org

4. Much of what follows draws on “Falling Short,” the 2010 General Election Review conducted by the influential ConservativeHome Web site, at <http://conservativehome.blogs.com/files/electionreviewlee.pdf>.

ficiently in control of events, was electorally beneficial or, in alienating the Conservative base, even electorally disadvantageous. Two conclusions, however, both of which are relevant to the circumstances in which the U.K. coalition government finds itself—and, indeed, by implication to the American political scene—are hardly debatable.

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***David Cameron and his advisers make little secret that they prefer to deal with those on the Center-Left rather than with the Tory Party's unreconstructed Right.***

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of growth” (between tax cuts and spending increases) to sum up its approach. Then, after much public soul-searching, the leadership adopted a surprisingly harsh rhetoric, attacking the budget deficit and overspending and promising an “age of austerity.” Later still, after evidence that this approach was unpopular, the party played down the deficit reduction plans and backed away from its promise of detailed spending reductions, focusing instead on the traditional opposition party pledge of reducing “waste.” This was its stance on election day.

On two occasions, the Conservatives did turn to tax cuts as a way of easing the leadership's problems.

- The first was a pledge that only (sterling) millionaires would pay inheritance tax. This was made by the then Shadow Chancellor, George Osborne, at the 2007 Party Conference in order to shore up crumbling support for Mr. Cameron's leadership, which it did. (This pledge has since been abandoned.<sup>5</sup>)
- The second promised tax cut was the pre-election pledge not to implement Gordon Brown's planned increase in National Insurance Contributions—effectively a payroll tax levied on business. The proposal helped to secure well-publicized business support during the campaign, and so lent wider credibility to the Conservative economic strategy. (This pledge has been implemented, though paid for by other tax rises.)

The second more or less indisputable conclusion about the Tory election campaign is that it was, technically, a failure. When asked, 62 percent of Conservative Party members deemed it “poor,” while just 20 percent thought it “good” or “excellent.” This critical view was confirmed in a survey of Conservative Party parliamentary candidates.<sup>6</sup>

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***Until late 2008, the Conservative Party was pledged to match Labour's spending plans and relied upon a confusing and increasingly unrealistic formula of “sharing the proceeds of growth” (between tax cuts and spending increases) to sum up its approach.***

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The campaign failed to highlight important populist issues like immigration; was not credible on the economy; and was more “presidential,” focused on Mr. Cameron, than British electoral conditions warrant.

In particular, it was a serious mistake to agree to Britain's first-ever televised debates. These, as previous Conservative Leaders and their advisers had grasped, served to give equal coverage to the traditional third party, the Liberal Democrats, and thus provided a huge opportunity that the photogenic Mr.

Clegg duly grasped. Although in the event Liberal support fell back—the party actually lost seats, down from 62 to 57—the final stage of the Conservative campaign was taken up with frantic attacks on Mr. Clegg rather than exposure of the Labour government's record. Such diversion of activity almost certainly cost votes and seats.

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5. See below, Section III.

6. See “Tory Candidates Agree with All Conclusions of ConservativeHome's General Election Review,” at <http://conservativehome.blogs.com/generalelectionreview/2010/06/tory-candidates-agree-with-all-conclusions-of-conservativehomes-general-election-review.html>.

## SECTION III

### The Coalition and Its Program

When the results of the general election were known, it was clear that Gordon Brown would almost certainly cease to be Prime Minister and that Labour would probably—but not certainly—cease to form the government. This in turn meant that, although the bulk of Liberal Party members and most Liberal MPs were politically closer to Labour than to the Conservatives, any coalition government was more likely to be between the Conservatives and Liberals than between Labour and Liberals.

In fact, it now appears that from an early stage, the Liberal Democrat Leader had decided on a coalition deal with the Conservatives if he could obtain it on acceptable terms. Mr. Brown was kept in power just long enough to ensure that he did.<sup>7</sup>

Conservative willingness to enter a coalition with the Liberal Democrats was, however, by no means so predictable. It would be the first Conservative–Liberal coalition since 1922—not, after all, a happy year in Conservative historic memory.<sup>8</sup> It would be the first-ever coalition to emerge from a general election rather than engineered as a stopgap partway through a Parliament.

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***Rather than form a minority government, David Cameron chose to embrace as his preferred option a fully fledged coalition with the Liberals, dropping key Conservative commitments.***

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Although short of an overall majority, Mr. Cameron could have chosen, as did Labour Leader Harold Wilson in February 1974, to form a minority government, publish a truncated program, and challenge the opposition parties to bring him down. This the Labour Party, at least, would have been most unlikely to do for at least a year or two. Mr. Cameron might then have announced a program of spending and deficit cuts, perhaps endorsed by the IMF. He could have pulled up his sleeves and bided his time to seek a further mandate—which, again judging by the reaction of the electorate in 1974, it would probably have given in the form of an absolute majority.

Instead, as he has since confirmed, David Cameron chose to embrace as his preferred option a fully fledged coalition with the Liberals, having Mr. Clegg as Deputy Prime Minister, giving other key posts to the Liberals, and dropping key Conservative commitments. In his October 2010 Party Conference speech, Mr. Cameron spoke enthusiastically of the coalition as “a shared way of trying to do business, reasonable debate, not tribal dividing lines, give and take, respect when you disagree, trust.”<sup>9</sup>

These are not obvious features of traditional party politics, and the strong feeling was left that Mr. Cameron was anxious to bypass his critics to settle into consensual, coalition mode for the longer term. His closest aides have since suggested that coalition with the Liberal Democrats is the preferred option not just in present circumstances, but in all circumstances, and that it may last beyond the next general election.<sup>10</sup> Sir John Major, the former Conservative Prime Minister and Mr. Cameron’s mentor, has also floated this idea.<sup>11</sup>

The formal agreement on policy reached by the two parties, which constitutes the program of the coalition government, represents, as one would expect, a compromise. As such, it is subject to criticism from members of both

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7. Simon Walters, “Clegg ‘Propped up’ Brown to Seal Tory Deal,” *Mail on Sunday*, November 14, 2010.

8. In 1922, the Conservative Parliamentary Party refused to go into the forthcoming general election on a joint platform with the Lloyd George Liberals and, in the process, defied and overthrew the Conservative Leader, Austen Chamberlain.

9. David Cameron, Conservative Party Conference Speech, *Daily Telegraph*, October 6, 2010.

10. Simon Walters, “Cameron Aide: Coalition Will Survive Tory Majority,” *Mail on Sunday*, October 24, 2010.

11. James Kirkup, “John Major: Let’s Keep the Coalition After the Next Election,” *Daily Telegraph*, November 27, 2010.

parties who have seen some of their promises dropped or reversed, against which the coalition party leaders have sought to convince their supporters that they obtained the best deal possible.

The details are endlessly disputable. One point, however, is not: By necessity, no voter in 2010 ever had the chance to vote either for or against the array of policies now espoused by the country's elected government. Such problems of legitimacy have a way of coming back to haunt politicians. They are particularly likely to do so when, as in the present case, unprecedented constitutional changes are introduced—in the form of fixed-term Parliaments—to alter the established political rules.

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The Liberal Democrats have had to sign up to an accelerated program of budget deficit reduction and large spending cuts. They were also asked to accept university tuition fees, which they had previously promised to phase out, that will now be levied at a much higher level.<sup>12</sup> These are being introduced by a Liberal Minister, Vince Cable, which has added to the disarray. The Liberals have signed up to a new generation

of nuclear power stations.<sup>13</sup> In principle, they have accepted the continuation of Britain's independent nuclear deterrent, though the postponement of the final decision on Trident submarine upgrade means that this support will not be tested.

Viewed from the vantage point of the national interest, these compromises have paved the way for necessary reforms and so are to be welcomed, not least by Britain's allies. How long the arrangement will last is a different matter. A recent opinion poll suggests that Liberal Democrat support stands at 9 percent, compared with 23 percent at the general election.<sup>14</sup> In the short term, such a catastrophic fall in support should cement the coalition because the Liberals cannot afford to leave it and face the electorate. If the implosion continues, however, that may change.

The Conservatives have also had to make sacrifices. Those in economic policy are part of the price paid to win Liberal Democrats' acceptance of the spending cuts, but they are undesirable all the same. They could undermine public support for the wider policy, and some of them will inhibit growth, without which the policy will not work anyway. They may, therefore, prove too high a price to pay.

The Conservatives' planned cut in inheritance tax (IHT) has been dropped in favor of a large and (in revenue terms) costly increase in personal income tax allowances at the lower end of the scale. The promised cut in IHT was of importance to Conservative activists. It underpinned the Conservative rejection of what Mrs. Thatcher used to call the "one generation society." It also reflected the amount which people on quite modest earnings, particularly in the Southeast of England, have invested in their homes at the time of their death. Given the very low return on savings and the depletion of capital accumulated in pension funds, the Conservatives have given up on creating a property-owning democracy, without which capitalism can never have a stable base.

Other changes show a dismissive attitude toward business. A program of measures justified by the need to combat climate change, enforced by a zealous Liberal Democrat Minister, Chris Huhne, will add to the burden on struggling firms. The capital gains tax rate for upper rate income tax payers was also, at the Liberal Democrats' insistence, raised from 18 percent to 28 percent.

A still harsher regime, consisting initially of a one-off bank levy but aiming at a permanent tax on the banks, has been introduced, accompanied by populist anti-banker rhetoric, particularly from Mr. Cable. But the Chancellor too has bluntly warned that he intends to "extract the maximum sustainable tax revenues from financial services."<sup>15</sup> Mr. Osborne will, however, be aware of how easily this misleadingly tubby goose can, if it chooses, fly away to other tax jurisdictions.<sup>16</sup>

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12. The Coalition Agreement envisaged that the Liberals could abstain if the policy emerging from Lord Browne of Madingley's review of tuition fees was unacceptable, but given that the minister introducing the policy was a Liberal Democrat, this provision hardly covered the resulting situation. In the event, more than half of the Liberal MPs refused to back Mr. Clegg in the Commons vote.

13. Again, there is provision for Liberal abstentions, but again, the minister responsible for the policy is a Liberal Democrat.

14. "Sunday Times/You Gov Poll and Our Experts' Predictions for the Election Result," *Sunday Times*, November 28, 2010.

15. HM Treasury, *Spending Review 2010*.

## A Preliminary Verdict

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Two other Conservative policy commitments were abandoned to please the Liberals, and each has serious implications for both Britain and her allies.

*First*, the manifesto commitment to a “United Kingdom Sovereignty Bill,” intended to curb the inroads of European Union law, has been watered down. This more accommodating approach to the EU is echoed in other ways: by acceptance of the European plans for a new diplomatic corps; by refusal to use the opportunity provided by treaty changes demanded by France and Germany in the wake of the euro-zone crisis to win concessions on the U.K. budget rebate or employment and social legislation; and by support for a costly bailout of Ireland to protect the euro zone, of which Britain is thankfully not a member. Liberal Democrat enthusiasm for European federalism has been a contributing element in all these decisions.

*Second*, the commitment to a new “Bill of Rights,” intended to define in domestic law—and thus limit—“human rights” as currently applied under the European Convention on Human Rights through Tony Blair’s 1998 Human Rights Act (HRA), has effectively been abandoned. Just over three years ago, David Cameron said of the HRA: “It has to go. Abolish the Human Rights Act and replace it with a Bill of Rights.”<sup>17</sup> But times have changed. Abandoning curbs on human rights rulings in terrorism-related cases should cause worries, and not just in Britain, but in the United States. It also, as in the case of European policy, fits into a wider picture.

Principally because of Liberal Democrat pressure, though also responding to the libertarian wing of the Conservative parliamentary party, the government is still struggling to reach agreement on how to cope with Britain’s Islamist terrorist threat. That threat is large, growing, and immediate. At least 20 convicted terrorists were freed from jail in 2010. Another 26 will be eligible for release over the next two years. By some estimates, more than 100 convicted Islamist terrorists are in U.K. prisons. Other estimates suggest that as many as 800 Muslims have been radicalized within the system.<sup>18</sup>

A system of control over these people’s movements is required. This is currently provided by “control orders,” which effectively place suspects—previously convicted or never convicted—under house arrest by the authority of the Home Secretary on the basis of intelligence evidence and after scrutiny by a High Court judge. Control orders are obviously flawed, but given the need to protect intelligence sources and the impossibility under existing law of deporting those who pose a threat to any country where they might be deemed at risk, they—or some equivalent yet to be devised—also serve an essential purpose.<sup>19</sup>

Unfortunately, the Liberal Democrats and libertarian Conservatives disagree with that assessment. Hence the seriousness of the failure to take a grip on human rights law. Add to all this the fact that scores of British intelligence officers are currently tied up in the unnecessary and damaging inquiry into alleged complicity by MI6 in the alleged torture of Guantánamo detainees and in the inquest into the circumstances of London bomb attacks of July 7, 2005, and the country’s anti-terrorist strategy is under huge strain.

Discovery of explosives on an American-bound cargo plane at East Midlands airport on October 29, 2010, should remind Americans as well as the British public what is at stake. British intelligence officers must be free to do their jobs, intelligence must be used effectively, and nothing should get in the way of trans-Atlantic collaboration. The current U.K. coalition does not seem to recognize these priorities.

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16. Financial and related professional services account for about 14 percent of British GDP, more than manufacturing, and employ a million people, while last year the City of London contributed in tax revenue £61 billion, more than half the budget of the NHS or three-quarters that of education. See “Demonising the City Is Childish and Destructive,” *Daily Telegraph*, December 1, 2010.

17. Quoted in “Britain Must Make Its Own Human Rights Laws,” *Daily Telegraph*, November 26, 2010.

18. James Kirkup, “Danger: 46 Jailed Terrorists Go Free,” *Daily Telegraph*, November 8, 2010.

19. Alex Carlile, “A New Type of Control Order Is Essential,” *Daily Telegraph*, November 29, 2010.





## SECTION IV

### Curbing the Deficit

Despite these problems, and to give credit where it is due, the action taken by the coalition government to deal with the crisis in public finance has been vigorous.

The main aspects of the deficit and spending reduction plans, announced in Mr. Osborne's emergency June 22, 2010, budget and later detailed in his statement on the Spending Review on October 20, were as follows:

- The U.K.'s structural budget deficit is to be brought into balance in 2014–2015. Debt is by then to be falling as a share of GDP. (A new independent Office of Budget Responsibility has been created to make forecasts and check figures.)
- Some 80 percent of this deficit reduction is to come from spending cuts and 20 percent from tax increases.
- £81 billion of savings in planned expenditure is envisaged. £30 billion was announced in June, the rest in October. The latter includes savings in the welfare budget and public-sector pensions, which have yet to be detailed and which will certainly be difficult to achieve.
- Other than the ring-fenced spending on health and overseas aid, departmental budgets will be cut over the period by an average of 19 percent.

Despite these cuts, total public expenditure in 2014–2015 will be higher in real terms than in 2008–2009 (when it was already too high). At 41 percent of GDP, spending will stand, assessed by that measure, at about the

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***Compared with the previous government, and compared with expectations, the coalition government's deficit and spending reduction plans are a major step in the right direction.***

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same level as 2006–2007. There are still largely unasked questions about whether even current plans take sufficient account of the economic cycle—that is, the timing any new recession—or the effects of the worsening demographic imbalance.<sup>20</sup> There is also the more immediate worry about how to achieve growth.

That said, compared with the previous government, and compared with expectations, the plans are a major step in the right direction. This has been recognized by international agencies. For example, the conclusion to the September 2010 IMF report on Britain reads:

Economic recovery is underway, unemployment has been stabilised, and financial sector health has improved. The Government's strong and credible multi-year fiscal deficit reduction plan is essential to ensure debt sustainability. The plan greatly reduces the risk of a costly loss of confidence in public finances and supports a balanced recovery.<sup>21</sup>

The reaction from Fitch Ratings to the Chancellor's Spending Statement, to the effect that it was consistent with and made more credible plans which would "secure the U.K.'s 'AAA' status," reinforced the impression. Still more important, because more tangible, was the reaction of markets. After the plans were announced, market interest rates for Britain fell to near record lows at the same time as rates for many of Britain's European neighbors rose. The

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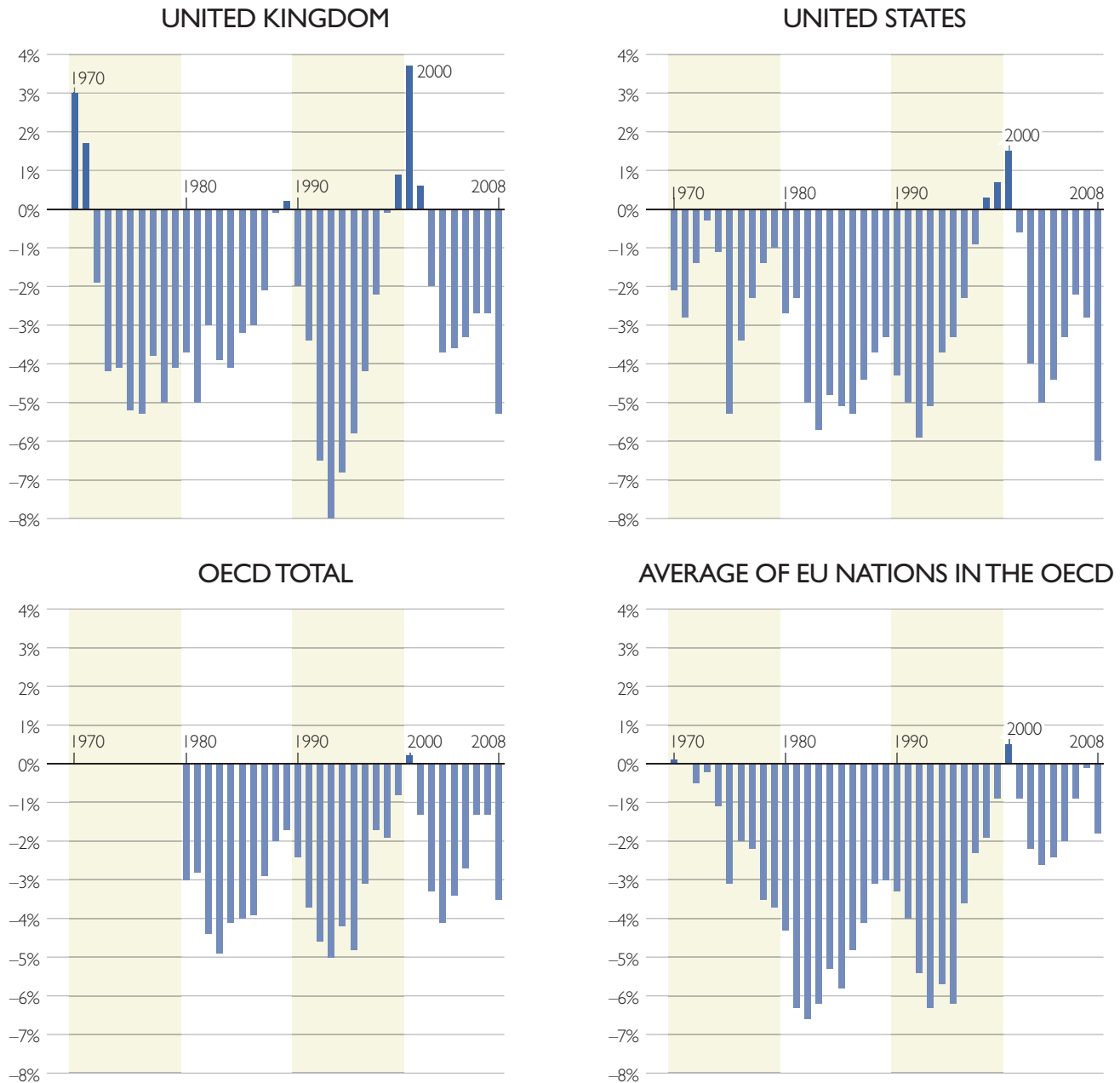
20. See Hamish Macrae, "The Long View Says the Cuts Are Not Deep Enough," *The Independent*, November 30, 2010.

21. International Monetary Fund, *United Kingdom—2010 Article IV Consultation: Concluding Statement of the Mission*, September 27, 2010, at <http://www.imf.org/external/np/ms/2010/092710.htm>.

importance of keeping down the cost of servicing debt is brought home by the fact that, even with the measures taken, debt interest will be running at £63 billion in 2014–2015.<sup>22</sup>

## Budget Deficits in the United Kingdom and the Industrialized World

Net Government Budget Surplus or Deficit as a Percentage of GDP, by Fiscal Year



Source: OECD, OECD Factbook 2010, General government net borrowing or net lending, at <http://dx.doi.org/10.1787/826240080468> (January 3, 2010).

Chart 1 • SR 87 heritage.org

22. HM Treasury, *Spending Review 2010*.

# SECTION V

## Priorities

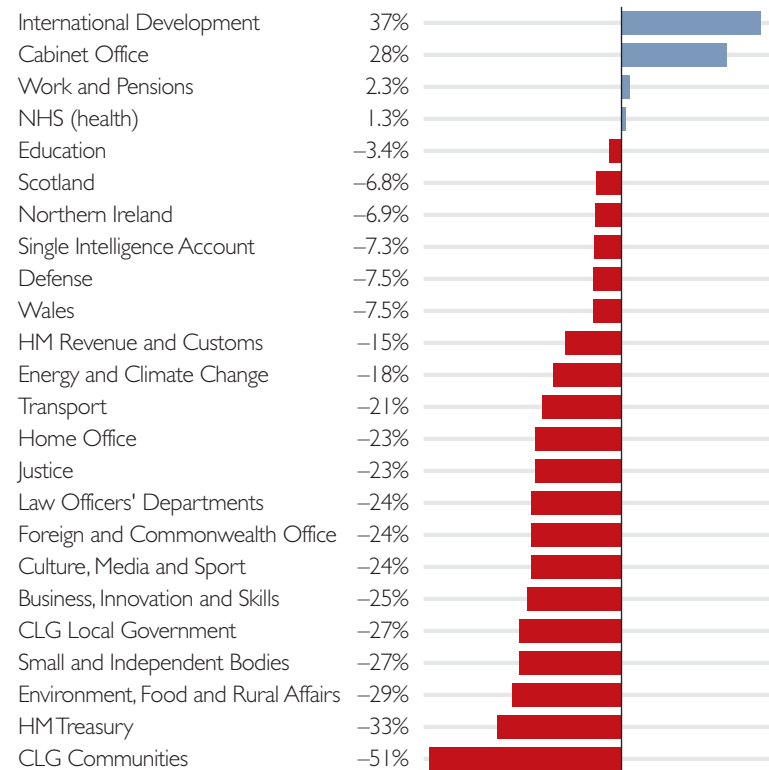
The overall emphasis of the coalition government's approach, therefore, makes sense—and not only to economists and investors. Despite Gordon Brown's collectivist triumphalism, most people in Britain, even at the height of the financial panic, understood that hugely expensive government interventions could at best be only a temporary solution and that the money would have to be repaid. Opinion polls so far suggest that, though there are anxieties about pace and fairness, most people support both the planned deficit reduction and the preference for cuts in spending over tax rises to achieve it.<sup>23</sup>

There are, however, other concerns that should and probably will soon start to emerge. As already noted, the coalition agreement with the Liberal Democrats provided cover for the Conservatives in one useful respect. Having failed to win the economic argument before the election, Mr. Cameron was able to summon Mr. Clegg's support after it in pushing through a program of sharp cuts. But the coalition provided cover of another less desirable sort: cover against Mr. Cameron's own party, which expected him to take a more ideologically conservative line that he really wished. The coalition arrangement has enabled him and his advisers to demonstrate more easily their ingrained preference for "soft" rather than "hard" issues.

Hence the decision, not forced on the Conservatives but announced well before the election, to give priority to expenditure on the National Health Service and Overseas Aid over expenditure on defense or law and order—defense, of course, being of particular significance to the United States and Britain's other NATO allies.

### Change in Departmental Program and Administration Budgets

From 2010/2011 to 2014/2015



**Notes:** Data for Olympics has been omitted. Cabinet Office spending is distorted by one-off electoral reform expenses, subject to which it is cut by 35 percent. Work and Pensions budget includes £2 billion over four years to implement new welfare reforms.

**Source:** HM Treasury, Spending Review 2010, October 2010, Table 1: Departmental Programme and Administration Budgets (Resource DEL excluding depreciation), p. 10, at [http://cdn.hm-treasury.gov.uk/sr2010\\_completereport.pdf](http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf) (January 3, 2010).

Chart 2 • SR 87 heritage.org

23. See, for example, Julian Glover, "Voters Want Spending Cuts Not Tax Rises," *The Guardian*, June 22, 2010.

Mr. Osborne declared in the course of his October Spending Statement that “[t]o govern is to choose. And we have chosen the NHS.”<sup>24</sup> He might equally have said that he had not chosen national security. This reprioritization marks a radical turnaround from any previous Conservative understanding of the purpose of government in a free society.

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***The coalition arrangement has enabled David Cameron and his advisers to demonstrate more easily their ingrained preference for “soft” rather than “hard” issues.***

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improvement—for example, by reform along the successful models developed in mainland Europe. Instead, they have embarked on a far-reaching internal organization, which the powerful vested interests are well placed to obstruct and whose unpleasant consequences will then be blamed on the government. And, of course, the politicians, despite the austerity elsewhere, are further increasing the NHS budget—a budget whose expansion was the single most important element of the unsustainable increase in public spending during the Blair–Brown years.<sup>25</sup>

Less fiscally damaging, because the figures are so much smaller, but arguably still less excusable because more obviously totemic is the planned growth in the Overseas Aid budget by a cumulative 37 percent, from £6.3 billion to £9.4 billion. The evidence-based arguments against government-to-government aid are so well known that it is hardly worth repeating them.<sup>26</sup>

- Such aid is so marginal as to make little impact when set against other huge capital flows;
- It is, by the very nature of things and however close the scrutiny, likely to be stolen or misdirected, particularly in those lawless environments in which demand for it is greatest;
- It may well even postpone economic adjustment, and so arrest economic development rather than promote it; and
- Quite patently, the internationally set figure of 0.7 percent of GDP, which the British government has decided to meet, has no more relevance to the real needs of poor nations than any other figure plucked out of the proverbial hat.

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***The Conservatives have embarked on a far-reaching internal organization of the National Health Service, which the powerful vested interests are well placed to obstruct and whose unpleasant consequences will then be blamed on the government.***

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As promised in the Conservative manifesto, real expenditure on the NHS will grow by a cumulative 1.3 percent, from just under £100 billion to just under £110 billion. The Health Service is notoriously inefficient. It has grown fat and lazy beyond the expectations of even the most pampered sacred cow. The Conservatives have foresworn any shake-up of its financing, which might offer hope of sustained

The policy is, in short, directed by desire to create a public impact, and so far, in Britain at least, the impact has not proved favorable.

In marked contrast to this approach has been the extreme austerity of the coalition’s approach to policing and prisons, both traditional priorities for Conservatives. One of the first decisions of Mrs. Thatcher’s government in 1979 was to increase the police budget and boost police pay and recruitment,<sup>27</sup> and one of the most tangible successes of John Major’s

government—and notably of Mr. Major’s Home Secretary, Michael Howard—was to establish that increasing use of incarceration serves to reduce levels of crime. As Mr. Howard said bluntly, “prison works.”<sup>28</sup>

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24. Osborne, Spending Review Statement to the House of Commons.

25. For more detail, see Harris, “The Decline of Britain: A Cautionary Tale for America.”

26. See, for example, Margaret Thatcher, *Statecraft: Strategies for a Changing World* (London: Harper Collins, 2002), pp. 435–444 (quoting, among other experts, the late Lord Bauer), and, more recently, Brett D. Schaefer and Anthony Kim, “David Cameron and Barack Obama Must Advance Economic Freedom—Not More Foreign Aid,” Heritage Foundation *WebMemo* No. 2966, July 19, 2010, at <http://www.heritage.org/Research/Reports/2010/07/David-Cameron-and-Barack-Obama-Must-Advance-Economic-Freedom-Not-More-Foreign-Aid>.

27. Margaret Thatcher, *The Downing Street Years* (London: Harper Collins, 1993), p. 32.

## A Preliminary Verdict

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The coalition disagrees and has adopted quite the opposite approach. Spending on the police, which, like the Health Service, is to be subject to major reorganization, is being cut by 14 percent. The use of non-custodial sentences and reduction in the prison population, with the eminently predictable result of a rise in crime committed by professional criminals free to reoffend, are the new priorities of the Ministry of Justice (whose budget is cut by 23 percent).

The most egregious decisions in the Spending Review—potentially dangerous for Britain, unsettling for NATO, and arguably of special worry to the U.S.—are those concerning defense.<sup>29</sup> The whole approach demonstrated frivolity and was criticized as such. What had been billed as a major Strategic Defence Review was overtaken by and effectively subsumed in a wider Spending Review, with which it was published in tandem.<sup>30</sup> Decisions were taken too fast, with insufficient thought and discussion and with too close a focus on immediate and politically high-profile questions like the soon-to-wind-down operation in Afghanistan (where, however, good decisions were made to increase equipment).

Had not the British Defence Secretary, Dr. Liam Fox (a committed Atlanticist), fought hard to prevent larger cuts, the result would have been even worse. As it is, the Ministry of Defence's 7.5 percent spending cut was less than the departmental average. Unfortunately, it was made in what the Conservatives in opposition had frequently and rightly described as an already inadequate commitment.

The share of British GDP spent on defense will fall further to 2 percent. Substantial cuts in manpower in the three services will be made. Large cuts will be made in the army's artillery and tanks. A decision on updating the Trident nuclear submarines will be delayed.

Most ridicule has been heaped on the treatment of the Navy. The naval budget had been squeezed till the pips squeaked in order to afford two new aircraft carriers. Both will be built, but one will be sold after completion, and the other will not be equipped with Joint Strike Fighters until 2020. In the interlude, Britain's existing carrier, *Ark Royal*, will be scrapped. So will Britain's existing Harrier aircraft. As a result, Britain will have no carrier-borne strike force until 2020.

Hardly less hasty has been the decision—in which, as with the Defence Review, Mr. Cameron rather than Dr. Fox played the prominent role—to enter into a potentially far-reaching strategic alliance with France. This involves a brigade-sized combined expeditionary force; joint operation of carriers; development of nuclear submarines; a 50-year nuclear treaty covering the testing of nuclear warheads (including, presumably, the U.S.-designed Trident warhead); and a 10-year plan to create a “single European prime contractor” for complex weapons.<sup>31</sup>

The details of this arrangement are probably less important than the overall impression that, beyond whatever gains may result and despite whatever problems closeness to the French may cause for U.K. relations with the

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***The planned growth in Overseas Aid is directed by desire to create a public impact, and so far, in Britain at least, the impact has not proved favorable.***

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***The most egregious decisions in the Spending Review—potentially dangerous for Britain, unsettling for NATO, and arguably of special worry to the U.S.—are those concerning defense.***

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28. For the evidence in context, see Robin Harris, *Criminal Negligence: How Current Policies Towards Crime, Policing and Punishment Fail the Nation* (London: Politeia, July 2003), at <http://www.politeia.co.uk/publications/criminal-negligence-how-current-policies-towards-crime-policing-and-punishment-fail-nat>.

29. For more detail, see Ted R. Bromund, “Spending Cuts in British Defense Review: Less Than Expected, but Still Damaging,” Heritage Foundation WebMemo No. 3039, October 22, 2010, at <http://www.heritage.org/Research/Reports/2010/10/Spending-Cuts-in-British-Defense-Review-Less-Than-Expected-but-Still-Damaging>.

30. HM Government, *Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review*, Cm 7048, October 2010, at [http://www.direct.gov.uk/prod\\_consum\\_dg/groups/dg\\_digitalassets/@dg/@en/documents/digitalasset/dg\\_191634.pdf](http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/documents/digitalasset/dg_191634.pdf).

31. James Kirkup, “Deal Clears Way for Shared Nuclear Future,” *Daily Telegraph*, November 3, 2010.

U.S., Britain is publicly surrendering its ability to act as an independent power. Such an impression of weakness can only harm U.K. and, by extension, U.S. interests.

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***Britain is publicly surrendering its ability to act as an independent power. Such an impression of weakness can only harm U.K. and, by extension, U.S. interests.***

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Britain is not a lost cause. The country's underlying commitment to making the Special Relationship work, though somnolent, is not dead. Its instincts have not changed, and despite the cuts, it has effective sea, air, and land forces, supported by the fourth largest military budget in the world, and remains a nuclear power and permanent U.N. Security Council member. But any new U.S. Adminis-

tration more interested than President Barack Obama's in strengthening Anglo-American military cooperation will have challenges to face.

## SECTION VI

### “Fairness” vs. Growth

Even in what is often described as a post-ideological age of British politics, the coalition government’s performance, with its contrasting high and low points, constitutes proof that, in Richard Weaver’s famous expression, “Ideas have consequences.”<sup>32</sup> This includes bad ideas.

One of the ideas embraced by Mr. Cameron’s modernizing Conservatives is “fairness.” This slippery concept, which may mean something as unexceptionable as equal treatment under the law but usually seems to amount to equal outcomes enforced by government, was given its own separate treatment in the Conservative Party platform in the form of a “Contract for Equalities.”<sup>33</sup> But its implications for economic policy are strikingly—even disconcertingly—evident in what under previous Conservative governments would have been the driest of documents, the Spending Review.

The 2010 Review claimed that “fairness,” not just balancing the books, was its underlying purpose and even included an unprecedented—and much criticized—“Distributional Impact Analysis” designed to demonstrate that richer people lost more than poorer people from the decisions taken.<sup>34</sup> By and large, the coalition seems to have lost this argument.<sup>35</sup>

That is not, in itself, of importance. The Thatcher government, in its day, was widely thought to have been too harsh to the poor, but because its policies created prosperity, such criticism—which Mrs. Thatcher was careful not to try to answer in the terms used by the critics—could be ignored, and the Conservative government of the 1980s and ’90s won four successive general elections. The mistake made by the Conservatives in the present coalition is to fight (and probably lose) the wrong battle and in doing so jeopardize victory in the right one.

The potential economic cost is already evident. It lies in the failure to devise a coherent strategy for growth. When challenged, the coalition government replies that cutting the deficit (while the Bank of England’s Quantitative Easing increases the supply of money) will encourage the private sector. In time it may, but whether it will do so sufficiently is another matter. The Prime Minister has also suggested that capital projects, some financed by government and others by business, will lead to growth, but this too depends on uncertain assumptions. The only tried and tested method of generating growth is the creation of a framework of low taxes and light regulation, which encourages individuals and business to seek out markets and satisfy customers. But this is a vision too redolent of the 1980s to attract the coalition’s enthusiasm.

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From the time of his succession as Conservative Leader, Mr. Cameron has resolutely refused to entertain the notion that marginal tax cuts, by providing incentives, lead to growth. He demonstrates a positive allergy to the widely accepted principles underlying the Laffer Curve. Mr. Osborne, after early flirtation with a flat tax, has firmly settled into the same position. The party leadership’s, and now the government’s, acceptance of an essentially left-

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32. See Richard M. Weaver, *Ideas Have Consequences* (Chicago: University of Chicago Press, 1984).

33. See “Our Contract for Equalities,” May 3, 2010, at [http://www.conservatives.com/News/News\\_stories/2010/05/Our\\_contract\\_for\\_equality.aspx](http://www.conservatives.com/News/News_stories/2010/05/Our_contract_for_equality.aspx).

34. For the respected Institute of Fiscal Studies’ observations on the budget as “regressive,” see Robert Chote, “Post Budget Presentations: Opening Remarks,” at <http://www.ifs.org.uk/budgets/budgetjune2010/chote.pdf>; for its observations on the Spending Review, see Mike Brewer, “Cuts to Welfare Spending, Take 2,” at <http://www.ifs.org.uk/budgets/sr2010/welfare.pdf>. These were indignantly rebutted by Nick Clegg; see Andrew Sparrow, “Nick Clegg Says Report Attacking Emergency Budget is ‘Partial’,” *Guardian*, August 25, 2010.

35. Andrew Grice, “Voters Reject Claims of Fairness as Majority Say Cuts Hit Poorest Hardest,” *The Independent*, October 23, 2010.

wing analysis of the purpose of government—that is, to impose “fairness”—has cemented this position, from which it is all but impossible to resile. And, of course, providing room for tax cuts would require even bigger and bolder cuts in public spending, an option which the coalition, particularly the Liberal Democrats, find unappealing.

Mr. Osborne has introduced some welcome cuts in business taxes (despite the unwelcome rise in capital gains tax). In his budget, he announced plans to cut the current 28 percent rate of corporation tax by 1 percent a year until it falls to an internationally competitive 24 percent. The small companies tax rate will also be cut.<sup>36</sup> In his Autumn Statement, the Chancellor also announced a “cross-government Growth Review.”<sup>37</sup>

The scale of the threatened (and indeed incipient) exodus of capital, investment, and talent as a result of unwelcome conditions for business in Britain has rung alarm bells in the Treasury, which fears for revenue. It also suggests that something more than tinkering is needed. The October 2010 Confederation of British Industry (CBI) survey of the “UK as a Place to Invest” reported that the “UK is perceived as less attractive now than ten years ago.” The CBI found that taxation, both business and personal, alongside regulation, was the main factor in this shift.<sup>38</sup>

However, Mr. Osborne’s sensitivity to the business tax régime (with the noted exception of the banks) finds no echo in his attitude toward personal tax payers. Indeed, he seems to take delight in imposing heavier burdens on wealthier earners, already bearing the lion’s share of the tax burden.<sup>39</sup> There are two notable examples.

- The first is the decision to retain the 50 percent top rate of income tax. This makes neither fiscal nor economic sense. It is intended to make an egalitarian point that no sensible conservative should wish to accept.
- The second is the decision to remove child benefit (originally introduced in place of a child tax allowance) from families where the main breadwinner earns £44,000 or more (but not, perversely, where two earners are earning £43,000 each). This measure, announced on the eve of the Party Conference, was intended to soften up opinion for welfare cuts to the poor. It penalizes stay-at-home mothers, despite the government’s pledge to be family-friendly; it is almost completely unenforceable; and it will lead middle-class people to withdraw from the labor force.

The Conservative Party election slogan, repeated much since, to the effect that “We’re all in this together” omits to notice that rich, mobile people, like well-financed, mobile business, can choose to get out altogether. Similarly, when Mr. Osborne declares that “those with the broadest shoulders [must] bear the greatest burden,”<sup>40</sup> he overlooks the possibility that they may merely shrug and stop working and earning in order to avoid penal rates of marginal tax and benefit withdrawal.<sup>41</sup>

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Two other domestic policy areas deserve mention here, both because of their inherent importance and because they have overseas—including American—parallels. The first is Education Secretary Michael Gove’s “free schools” initiative.

This will allow private individuals or voluntary bodies to start up and run schools with government funding, but levying no charges, all outside local authority control. The plan reflects thinking begun with Mrs. Thatcher’s education reforms in the 1980s, but it is based on the current Swedish model. Unlike Mrs. Thatcher’s, it rules out selection by ability. Unlike that of the Swedes, it rules out profit. That

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36. George Osborne, Chancellor of the Exchequer, Budget Statement to the House of Commons, June 22, 2010, at [http://www.hm-treasury.gov.uk/junebudget\\_speech.htm](http://www.hm-treasury.gov.uk/junebudget_speech.htm).

37. HM Treasury, “Growth Review,” November 29, 2010, at [http://www.hm-treasury.gov.uk/ukecon\\_growth\\_index.htm](http://www.hm-treasury.gov.uk/ukecon_growth_index.htm).

38. Confederation of British Industry, *CBI Annual Conference Survey 2010: UK as a Place to Invest*, at [http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc710d7a75c1365294a2802577bd0036ff2c/\\$FILE/CBI-Deloitte%20UK%20as%20a%20place%20to%20invest%20survey%20-%20Ipsos%20MORI%20report.PDF](http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc710d7a75c1365294a2802577bd0036ff2c/$FILE/CBI-Deloitte%20UK%20as%20a%20place%20to%20invest%20survey%20-%20Ipsos%20MORI%20report.PDF).

39. For the distribution of the tax burden and for comparisons with other countries’ tax rates, see Harris, “The Decline of Britain: A Cautionary Tale for America,” esp. pp. 10–12.

40. Osborne, Spending Review Statement to the House of Commons.

41. HM Treasury, *Spending Review 2010*.



combination may also, sadly, rule out success. Yet, if there is a large take-up and if regulations are eased, “free schools” could still force a new break in Britain’s quasi-state monopoly and so challenge the mediocrity it fosters.

The second area—and the large unknown, offering either radical social improvement or a financial and political minefield—is welfare reform, being undertaken by Work and Pensions Secretary Iain Duncan Smith. Mr. Duncan Smith intends to replace the current complex system of means-tested working-age benefits and credits with a single Universal Credit; to ensure that work always pays, which for many it does not; and to spend £2 billion on the scheme over four years while also reducing welfare spending in real terms. The aims of these reforms—to reduce dependency, to get people into work, and to save money—are laudable. The problem, which every other U.K. government has found, is that they may prove incompatible.

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## SECTION VII

### Lessons for the United States

The positive lesson that the U.S. can learn from Britain under the coalition is that U.K. public opinion is so far proving reasonably supportive of policies that not long ago would have been considered politically unthinkable. In Britain, the ratchet of public-sector patronage has swung much further than it has in the U.S. This, by extension, would suggest that America's political leaders have little to lose if they spell out in stark terms why America's budget deficit must be eliminated and why federal spending must be sharply reduced.

However, there is also another lesson. David Cameron's political strategy of "de-toxifying" the Conservative "brand," which many commentators on both sides of the Atlantic have urged on the Republican Party in the U.S., yielded no obvious electoral benefits.<sup>42</sup> But it quite predictably presented the U.K. government, which Mr. Cameron now leads, with serious problems.

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***David Cameron's preference for a coalition with the Liberals has led him to compromises on Europe, human rights, and immigration that annoy his grass roots and prevent his seeking support on these matters while the economic medicine takes effect.***

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1. Mr. Cameron sought, and so received, no electoral mandate for big spending cuts. Consequently, the only justification he has for taking swift and vigorous action is to avoid a crisis. Paradoxically, this means that if economic conditions improve, it will be much more difficult to see through the right economic strategy.
2. His promises to increase spending on the NHS and Overseas Aid (as well as largely to protect education) made it more difficult to achieve the overall spending cuts that were required.
3. His broader acceptance of the priority given to public services over security has resulted in damaging defense cuts and what will prove, if and when crime rises, highly unpopular cuts in police and prisons.
4. His embrace of higher taxes risks not only a permanently larger government, but also a weaker economy, perhaps incapable of generating the tax revenues he is anticipating to make his plan work while abandoning one of his party's heretofore clear distinguishing features.
5. His refusal to embrace the traditional conservative case for tax cuts has meant that he has no vision of how to create growth and jobs without government intervention.
6. His preference for a coalition with the Liberals rather than for a minority Conservative government (perhaps using the threat of resort, in the case of obstruction, to the IMF) has led him to compromises on Europe, human rights, and immigration that annoy his grass roots and prevent his seeking support on these matters—as Mrs. Thatcher probably would have done—while the economic medicine takes effect. The sacrifice of ideological clarity in favor of the center ground does not always reap political dividends.

By contrast with the U.K., the debate in America, which is anyway at a different point in the electoral cycle, has remained much more clearly focused and, indeed, polarized. The Republican Party won control of the House of Representatives in November 2010 largely on a small-government, tax-cutting, deregulating platform. It explicitly pledged to roll back spending.

If there is a change of Administration and the Republican Party retakes the White House in 2012, its candidate

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42. See the analysis by John O'Sullivan, "Cameron Capers: The Anatomy of the British Election," *National Review Online*, June 15, 2010, at <http://www.nationalreview.com/articles/229951/cameron-capers-john-osullivan>.

will presumably do so without the complicated legacy that now bothers the U.K. coalition government's efforts. On the other hand, of course, if Mr. Obama retains the presidency, the model of compromise offered by the U.K. coalition may become more applicable.

Finally, whoever is President of the United States will from now on have to cope with the consequences of Britain's reduction in its military capacity and with the diminution in national self-confidence which always accompanies such withdrawals. This should already be a topic of discussion in Washington.



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