The economic consequences of a hung Parliament: lessons from February 1974

About the Author:

Chris Rogers is an ESRC funded post-doctoral research fellow in the Department of Politics and International Studies at the University of Warwick.

Contact Details:

C.J.Rogers@warwick.ac.uk

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Abstract

The British general election on 10 May 2010 delivered Britain’s first hung Parliament since February 1974, and in the run-up, the Conservative Party made much of the economic difficulties Britain faced in the second half of the 1970s in order to try and convince voters that anything other than a Tory vote would risk exposing the nation to the discipline of financial markets. The question of how well equipped an exceptional kind of British government is to deal with exceptional economic circumstances is therefore of paramount importance. This paper argues that the Conservative Party made too much of the impact of the 1974 hung Parliament in precipitating subsequent economic crisis and suggests
that as such, there is no reason to assume that the Conservative-Liberal coalition government is ill-equipped to manage British economic affairs in difficult circumstances.

Key Words
Coalition Government; Minority Government; Economic Policy; British General Election 2010

Introduction

Following the first televised debate of 16 April between the leaders of the principal parties contesting the British general election, a YouGov poll placed the Conservative Party on 33 percent, the Liberal Democrats on 30 percent, and the Labour Party on 28 percent. The predicted 8 percent increase in the Liberal Democrats’ share of the vote from the poll taken immediately prior to the leaders’ debate\(^1\) raised the very real possibility of a hung Parliament in Britain for the first time since February 1974. The outcome of the general election itself confirmed the accuracy of these polls, with the Conservative Party falling 19 seats short of an overall House of Commons majority, leading to the formation of a Conservative-Liberal Democrat coalition government headed by David Cameron.

However, the Conservative Party did not sit idly by as polls predicted a lead that would have once produced a comfortable victory had slipped to such an extent that the best it could hope for would be a minority government or the principal
role in a coalition, which would be faced with the need to reduce the fiscal deficit in order to re-establish the market credibility of British economic policy. Instead, it explicitly made the case that a hung Parliament would be bad for the economy and bad for Britain by being unable to secure credibility in financial markets, and leading to weak and indecisive government. In doing so, it argued that the hung Parliament of February 1974 provided proof that everybody loses when there is no decisive outcome in a British general election.

The aim of this paper is to examine the propositions made about the minority Wilson government of February-October 1974 by the Conservative Party, in order to assess whether its pre-election fears were well-founded and consider whether there are any lessons that the new coalition government can learn from the experience. It specifically asks what the 1974 experience can say about the possibility for a minority or coalition government to reconcile the dual imperatives of economic stability (based on market credibility) and domestic political legitimacy. In light of the deterioration of British public finances and uncertainty about market credibility, these questions are of considerable contemporary significance. The paper argues that Conservative assertions fundamentally misrepresent the minority Wilson government by overstating its role in damaging the economy over the longer-term. The paper will also show how during this Parliament the Labour government was able to begin to retreat to a more moderate position than that espoused in its electoral manifesto, ably guided by the civil service. In doing so, it was able to efficiently balance both the political and economic constraints it faced without undermining international
market credibility until well into 1976. The lessons of the February 1974 general election therefore, are not those that the Conservative Party identified.

Nonetheless, with Britain facing an exceptional fiscal crisis, the likes of which has not been seen in this country since the 1970s, and finding itself in exceptional political circumstances which have not been seen in Britain since 1974, there are lessons to be learned from the experience of Wilson's minority government. These lessons revolve around clearly distinguishing the difference between uncertainty and indecision on the one hand and measured compromise on the other. For while uncertainty and indecision may sew the seeds of distrust among financial markets and increase the severity of the consequences of failure to swiftly act on the public finances, there is no reason to assume that measured compromise will do so. Rather, it is possible that measured compromise holds the greatest potential to balance the imperatives of economic stability and domestic political legitimacy. This is because a compromise scenario holds the greatest potential for the British government to address its deficit problems with significant authority to secure market credibility, without appearing indiscriminate and thereby antagonising voters. The coalition may therefore offer the greatest potential to produce stable and effective government during the current economic crisis.

The Conservative Position

As polls began to show the Liberal Democrats encroaching on the Conservatives’ lead after the televised leaders’ debates, thereby reducing its prospects of
forming a majority government after 13 years in opposition, it began to mobilise its public relations apparatus in order to warn of the potential dangers of a hung Parliament for Britain in general and the economy more specifically. The centrepiece of this was a press conference—or rather an election broadcast for ‘the Hung Parliament Party’—held by the Shadow Chancellor, George Osborne, and Shadow Culture Secretary Jeremy Hunt, and the associated pamphlet, *A Hung Parliament will be bad for Britain.*

Much of the document was dedicated to citing the view of ‘experts and business leaders’ about the consequences for the economic recovery of any uncertainty about who would be governing Britain, and the weakness and vulnerability of coalition governments elsewhere in the world. The document noted that 77 per cent of professionals polled by Opinion Research Business ‘thought that a hung Parliament could lead to a downgrading of the UK’s sovereign credit rating’, and that the Centre for Economic and Business Research had estimated that the cost of a hung Parliament for individual consumers could reach up to £5,000 per year. It also presented the views of a number of representatives of globally prominent investment banks, including Morgan Stanley, Nomura, Barclays Capital and Deutsche Bank, all of which presented the hung Parliament as a worst case scenario with a considerable downside for the prospects of sterling. The issue of Britain’s sovereign credit rating and the prospects for sterling clearly showed the Conservatives’ prioritisation of the importance of securing credibility within international financial markets, however the Party also made a point of highlighting problems faced by coalitions elsewhere in the world. In doing so it drew attention to the collapse of the Belgian government in April 2010 after just
five months in office, the difficulties for decisive decision making posed by the
German electoral system, and persistent political instability in Israel and Italy
where coalition governments are the norm.

Of the opinions presented in *A Hung Parliament will be bad for Britain*, one stood
out in terms of its reference to the experience of the hung Parliament of February
1974; Peter Hargreaves of Hargreaves Lansdown argued that the absence of a
clear winner in the general election ‘could trigger a similar situation to 1974
when the government was eventually forced to go to the International Monetary
Fund for a loan.’ It was this experience that the Conservative Party drew on most
clearly with its own voice. It argued that ‘The last hung Parliament in 1974 was a
disaster for the British economy’, citing a 15 per cent fall in the FTSE All Share
Index between the February 1974 general election and the end of the year, rises
in inflation and tax rates throughout 1975, and increases in interest rates to
protect sterling which had become increasingly vulnerable. In combination with
the view that ‘closed door politics’ and ‘indecision and weak government’ would
be inevitable in the event of a hung Parliament, the exercise was clearly intended
to make a very serious and decisive argument. However, the argument does not
reflect the facts about the minority Wilson government, nor accurately
characterise the relationship between the hung Parliament and international
financial market credibility in 1974.

**The February 1974 General Election**
The Conservative Party called the February 1974 general election in the midst of a 3 day week and growing industrial unrest on the issue of who governs Britain? The election was held on Thursday 28 February, and of the 635 constituencies in the United Kingdom, Labour returned 301 Members of Parliament, while the Conservatives returned 297 Members of Parliament, and the Liberals returned 14 Members of Parliament. As a result of Edward Heath’s inability to draw support for a coalition, Harold Wilson duly formed a minority government that had been elected on the basis of a promise to bring about ‘a fundamental and irreversible shift in the balance of power and wealth in favour of the working people and their families.’ In light of the Conservative Party’s recent claims, the apt question therefore is, to what extent was the fact that this was to be a minority government in a hung Parliament responsible for Britain’s subsequent economic difficulties?

Firstly, it is necessary to consider the state of the economy that Denis Healey inherited as Chancellor, and he has since described as ‘on the brink of collapse.’ The anatomy of the faltering economy included a deficit on the Balance of Payments current account of £979 million in 1973 that had worsened to £3,278 million in 1974, and an annual rate of inflation of 23 per cent as measured by Retail Price Index figures from 1973 and 1974. In light of these indicators, it is fair to assume that the government’s credibility with the financial markets would be closely linked to their improvement. Indeed, the economic situation was problematic enough at the beginning of 1974 for the Conservative Chancellor, Anthony Barber, to inform Heath that it would be necessary for the government to ‘have access to really big sums’ of money in order to maintain market
confidence, and to broach the subject of an IMF loan with its Managing Director, Johannes Witteveen. While the prospect of borrowing from the Fund had passed by the end of January 1974, these events offer strong evidence to suggest that the fundamental problems of British economic policy pre-dated the hung Parliament of February 1974.

This raises the question of whether it was a failure to act decisively between February and October 1974 that precipitated the IMF crisis of 1976, or rather, whether there is anything the minority Labour government could have done to avoid the crisis? To answer this question, it is not sufficient to look at the economy in isolation; the political context and the implications for governing authority that decisive action on the economy would have must also be considered, on the grounds that all democratic governments must strive to find a balance that brings with it both political legitimacy and economic stability. Finding this balance was the principal problem for Wilson’s minority government, which while in opposition in 1973 had seen over 7 million working days lost to industrial disputes, a figure which rose to over 14 million working days in 1974.

The fact that the Labour Party’s social contract was founded on a relationship with the TUC that was only just recovering after the divisive conflict over In Place of Strife, and the discontent over the Heath government’s involvement in industrial relations and wage determination, are of paramount importance. This is because the political situation made it highly unlikely that any of the ‘decisive’ measures (i.e. current year expenditure cuts, tax increases and monetary
targeting) assumed to be feasible by critics of the Wilson government in 1974 would have done anything more than exacerbate political unrest and create further market instability. Indeed, the immediate introduction of strict money supply targets and an incomes policy to control the rate of inflation would have been likely to further antagonise the labour movement. Much the same can be said of cuts to front line services as part of an attempt to divert resources to the export sector and correct the balance of payments, which would have represented a wholesale repudiation of Labour’s manifesto commitments and likely destroy the fabric of the social contract.

When political context is taken into account, it is clear that there is no straightforward choice when it comes to decisive action on the economy because of the implications for political legitimacy. This was clearly recognised by British officials after the February 1974 general election, and it was striking a balance between economic and political necessity that formed the basis of this short Parliament. This is adequately demonstrated by the March Budget, which Tony Benn described as ‘a Budget that will undoubtedly disappoint the Party and the movement, and one which as I was listening to it, I was convinced was written by the Treasury and not by ministers’, and on the other, Healey has argued was ‘received with rapture by the Labour movement as representing the first step in that “irreversible transfer of wealth and power to the working people and their families”’ that the Labour Party had promised.6

In the Budget preparations, the Chancellor had demonstrated his awareness of the economic constraint, informing his colleagues that ‘in order to avoid a
disastrous loss of confidence, I must show in my Budget how the extra expenditure, and the effects on demand of all these additional commitments, are going to be met by increased taxation.’ This position closely reflected the Central Policy Review Staff’s view that there was ‘very little money in the till and inadequate scope for filling it up.’ This fiscal modesty was also reflected in the final package announced on 26 March, which included a 3 per cent increase in the basic and higher rates of incomes tax, increases in personal and child tax allowances, a £500 million commitment to additional food subsidies, the fixing of corporation tax at 52 per cent, £50 million of defence cuts, and the extension of VAT at a rate of 10 per cent to confectionary and petroleum.  

In light of the economic situation and the Labour Party’s manifesto commitments it might be argued that such a Budget package represented the worst of all worlds. But there was no immediate sterling or political crisis, and it is by no means certain that a Labour government elected with an overall majority of fifty would act decisively to cut expenditure and limit the rate of growth of incomes in order to appease the market in light of its mandate. Indeed, it is likely the case that it would have acted to ride out the crisis by reflating demand, confident in the knowledge that such action would serve to bolster support among its core demographic. If anything, this would surely have served to accelerate the onset of acute economic crisis; as Jim Tomlinson notes, the mere election of a Labour government in 1964 was enough of itself to aggravate Britain’s current account position and resulted in ‘an almost continuous balance of payments crisis in the mid-1960s.’ With this considered, it is possible to construct a rather different interpretation of the fall in the FTSE All Share Index after February 1974 than
that of the Conservative Party, which reflects not the markets' concern about indecision, but rather a concern that even a minority Labour government would be able to implement a return to free collective bargaining as it had promised, and thus potentially do further damage to the profitability of firms with operations in the UK. Indeed, throughout 1974 the operation of the Price Code's Productivity Deduction, which allowed for only 50 percent of wage increases to be passed on to the consumer, while helping to reduce the RPI by approximately 2 percent, had done so 'primarily by depressing industry's profits by approximately 8 percent, although maybe more.' As equity based investment decisions on which the value of indices like the FTSE are based factor in such information, there is a strong case to be made which argues that the fall would have been worse if Wilson's Labour government had had a large overall majority and been politically more able to aggressively pursue its manifesto commitments.

The evidence does suggest that the minority Wilson government of February – October 1974 was one of moderation. However, if it were not one of moderation it is difficult to see how it would have been able to act decisively to correct the poor health of the British economy—or why it would want to given its manifesto commitments—without provoking a major challenge to its political legitimacy. Of course, it is likely that the Labour government's aspirations would have been moderated by the reality of government, but it would have required a leap of faith from the markets to accept this in the months after a decisive election victory. As such, it is more plausible to suggest that the hung Parliament of February 1974 was of benefit to the British economy; it showed that the Labour
government would not be reactionary, was able to understand the magnitude of
the problems that were faced, and could maintain popular support. Having done
so, it was subsequently able to begin to introduce measures (ably guided by
officials) to reduce the rate of growth of incomes and public expenditure, while
acting to improve the balance of payments, in a measured and strategic way.
Indeed, while the sterling crisis of 1976 was very real, official documents show
that many of the measures introduced by Wilson and Callaghan throughout 1975
and 1976 that are commonly understood as crisis measures formed part of a pre-
existing (if sometimes opportunistic) economic strategy revolving around deficit
reduction justified by depreciation of the pound sterling that dates from
December 1974. In this case therefore, it is possible to make a convincing case
arguing that hung Parliaments can be good (or less bad) for external market
credibility and domestic political legitimacy than a decisive election victory. This
may also prove to be the case for the new Conservative-Liberal Democrat
coalition.

The May 2010 General Election

The economy that the Conservative-Liberal Democrat coalition has inherited
shares much in common with the economy inherited by Denis Healey. Issues of
fiscal rectitude and the extent of the British deficit are once again at the head of
the agenda, with government borrowing for the fiscal year 2009/2010 estimated
by the Office of National Statistics to have been £156 billion. Furthermore, while
inflation is not of the double digit proportions of the 1970s, it has represented a
problem for British macroeconomic policy making that has forced the Governor
of the Bank of England, Mervyn King, to write his seventh letter to the Chancellor over the last two years explaining a missed inflation target. Inflation in the United Kingdom has now reached its highest rate, 3.7 per cent, since oil prices peaked at $147 per barrel in 2008. The challenges of reducing the deficit and restoring British counter-inflationary credibility are therefore consistent between the two eras, while the spectre of a loss of market confidence in the sustainability of macroeconomic policy and the consequences this could have for sterling has been ever present since the return to floating exchange rates in the early 1970s.

Both of the parties in the new governing coalition outlined their plans to address the issue of British fiscal credibility in their election manifestos, and from these proposals it was clear that there was no pre-election cross-party support for a particular strategy to reduce the deficit. The Conservative proposal closely reflects the kind of ‘decisive’ action that it had argued was necessary in A Hung Parliament will be bad for Britain, and promised a Budget within 50 days of taking office to ‘set out a credible plan for eliminating the bulk of the structural current budget deficit over a Parliament.’ This programme was to be made up of measures including £6 billion worth of efficiency savings in the Departments, a one year freeze in public sector pay for all but the one million lowest paid workers, an end to tax credits paid to families with incomes above £50,000, a cap on public sector pensions above £50,000, a Ministerial pay cut of 5 per cent and a 10 per cent reduction in the number of MPs. Over its first term in office, the Conservatives also promised to cut funding and regulation costs by £2 billion a year and bureaucratic quango costs by a further £1 billion per annum. This was
to be coupled with the creation of an independent Office for Budget Responsibility to audit the way in which the government managed the public finances. The Liberal Democrat proposals on the fiscal deficit were more reserved in terms of the timescale for adjustment. The Party, having identified £15 billion of savings in government expenditure per year, nevertheless advocated the position that 'If spending is cut too soon, it would undermine the much-needed recovery and cost jobs.' As such the timing of cuts was to be based ‘on an objective assessment of economic conditions’ which had produced a ‘working assumption [...] that the economy will be in a stable enough condition to bear cuts from the beginning of 2011-12.’ The programme of deficit reductions would be overseen by a Council on Financial Stability constituted of members of all parties, as well as the Governor of the Bank and the Chair of the FSA.11

If due consideration is paid to the political and market constraints faced by governments, both strategies appear to be high risk. While the Conservative proposal to act swiftly to cut the deficit had the clear potential to antagonise voters who rely on front line services or are employed in the public sector, the Liberal proposals risked incurring the wrath of markets by appearing tentative on their timescale in a way that could have been perceived as a lack of conviction. The new coalition’s proposals for deficit reduction tread something of a middle ground between the two, promising an accelerated reduction of the deficit over the course of the Parliament, beginning with cuts of £6 billion from non-front-line services, which included cuts of £670 million from education; £683 million from transport; £1.18 from local government; £836 million from
Business, innovation and skills; £704 Million from the devolved administrations; £451 million from the Chancellor's departments; £325 million from the Ministry of Justice, and £367 million from the Home Office. However, the deficit reduction program was qualified by the statement that all cuts would be subject to advice from the Treasury and the Bank of England. A cynical appraisal might suggest that this element of the agreement between the parties contains something to offend everyone; enough cuts to antagonise people who may be asked to vote for one of the parties in the not too distant future, and enough vagueness about how far the government will ultimately be willing to go to convince market opinion that there is no conviction to do what is necessary. Early responses to the coalition programme have indicated elements of both. However, despite initial caution, there is no reason to assume that either the electorate or financial markets do not possess the required degree of realism to assume that this deal represents a genuine attempt to blunt the initial pain of adjustment felt by the electorate and a genuine commitment to make the adjustment. The government’s Budget of 22 June, which coupled expenditure cuts and an offset increase in the rate of VAT with an increase in the personal income tax allowance and freezes in alcohol and tobacco duty suggest that the new coalition is attempting to find a measured compromise of this kind. If the measures so far introduced are interpreted this way, the prospects for the recovery gleaned from political stability will be of great benefit, and while only time can tell, the experience of Harold Wilson in February 1974 suggests that this outcome is not beyond the realms of possibility.
Indeed, the biggest threat to British economic stability under this hung Parliament—a threat that Wilson did not face after February 1974—may lie in the nature of the political compromise. For if the Conservative Party and the Liberal Democrats fail to convince their Parliamentary Parties that compromises on fundamental ideals and have not taken place as part of a cynical power grab, there is clear potential for the coalition government to undermine itself from within. For the new coalition, three non-economic issues with the potential to have this impact have already presented themselves. The first is the ever-thorny issue of electoral reform, for while the coalition has committed to support a simple majority referendum on the introduction of the Alternative Vote system, this commitment has not prejudiced the way either party will campaign in that referendum. This opens up the possibility that the proposal will be rejected by the people on the back of a Conservative ‘no’ campaign and opening Nick Clegg up to accusations that he has fundamentally compromised the Liberal agenda for a seat in government. The second is the constitutional change requiring a 55 per cent vote of no confidence in the government. While this may be popular with leading figures of both coalition partners, it may be perceived as a simple ploy for an unsuccessful and poorly supported government to cling to power, and thereby antagonise both opposition and back bench Members unhappy with the progress of government. Finally, the Conservative Party's reform of the 1922 Committee may be perceived as an attempt to stifle back bench opposition to government policy and limit dissent toward the Party’s position on controversial issues. Each of these political issues has the potential to create internal division and discontent in the House, and threaten to undermine the credibility of the governing coalition. If this comes to pass, it may do so with attendant
consequences for the economy arising from the resultant instability of
government. However, even if such a scenario arises, this is not a lesson that
could be learned from February 1974, and in no way justifies the Conservatives a
priori assumptions about the negative consequences of British hung Parliaments
drawing on that experience. The question therefore, is not whether it is possible
to govern effectively in times of economic difficulty under a hung Parliament;
Harold Wilson showed that it is possible. Rather, the apt question is whether
this generation of politicians can govern effectively in times of economic
difficulty? In order to succeed, they will have to show that they can secure both
economic stability and domestic political legitimacy simultaneously. This, in
large part, will be dependant on whether they are able to exploit the potential for
measured compromise to balance economic and political imperatives that the
hung Parliament has offered—as Wilson did after February 1974. There, you
might say, is the rub.

Conclusions: Lessons from February 1974?

The above analysis suggests that there may well be important lessons to be
learned from the hung Parliament of February 1974, but they are not the ones
that the Conservative Party presented during the May 2010 general election
campaign. In fact, the argument presented here suggests the superficial Tory
presentation should be seen at best as a public relations experiment and at worst
as cynical scaremongering in a context where economic crisis already has many
people fearing the worst about their employment prospects, the value of their
property, and the likelihood of cuts to front line services on which many rely.
The major lesson that should be drawn from the experience of February 1974 is that a hung Parliament does not necessarily equate to uncertainty and indecision that will inevitably precipitate economic crisis, but could equally allow for measured compromise and response that reflects more appropriately both the political and economic constraints faced by state managers. Economic policy, after all, is not made in a vacuum; it affects people in a very real way, and because the legitimacy of government is dependant on the support of the people, this cannot afford to be ignored. As things stand, the shockwaves of the current financial crisis and the aftershocks of the sovereign debt crisis have been deep and resonant within the United Kingdom, calling into question the sustainability of the British macro-economic fiscal stance and its sovereign credit rating, and by implication casting a shadow on the framework of fiscal policy and financial regulation that survives the Labour Governments of Blair and Brown. However, even though the political situation in the UK is far less volatile than in February 1974, a decisive strike at the expenditure commitments of the state has the potential to provoke deep popular discontent that could resonate just as deeply. The consequences for the markets may then be substantial, because a government with no mandate creates further uncertainty.

By viewing political and economic constraints as two sides of the same coin, it would seem that there is no reason to assume that a hung Parliament will produce a worse outcome than an overall majority; it may be more suited to securing support from the electorate and sufficient to hold the confidence of markets in a way that reflects the government’s need to secure financial
credibility and domestic political legitimacy. Furthermore, while it is dangerous to make predictions on such matters, short-term market fluctuations in the initial aftermath of the election should not necessarily be understood as signals of impending crisis. After all, while long-term stability is in the interest of financial investors, it is short-term fluctuations in market values from which traders make their profits. Indeed, it is likely (and not revolutionary to suggest) that the soundest basis for economic recovery and stable government is to produce a credible (most likely rules based) medium-term strategy for reducing the deficit that is able to dull the pain of initial adjustments felt by voters. In many respects, this would seem to have been the least likely outcome had any party won an overall majority, and there is no reason to assume that the Conservative-Liberal coalition government will not be able to achieve this. However, in the event that it fails to do so, it is likely that the reason for this failure will arise because of the major difference it has from the Wilson government—namely as a coalition as opposed to a minority government. For if the kind of political infighting which the relationship within and between two parties with different values has the potential to create undermines the government, markets may well react unfavourably. This was not a problem for Wilson to nearly the same extent. Nonetheless, regardless of this speculation, one thing is for certain: with the issue of electoral reform now squarely on the agenda, the suitability of coalition government to meet the demands of governing Britain’s economy within the framework of the prevailing British party system faces an acid test.


5 Butler and Butler (2000) 401.


7 TNA CAB 129/175, C (74) 2, 12 March 1974; TNA CAB 130/726, Misc 9 (74) 2, 12 March 1974; Hansard, 26 March 1974, cols 277-328.


