Jon Moulton's Diary

What does the election and a likely change of government mean for private equity?

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I am writing this in the first week of the election campaign.

The dissolution was a surprise for a lot of people – including some of the Cabinet. Given the position that the Conservatives have in the polls of 20% wanting to vote for them as opposed to 41% for Labour the decision looks bold, tending to suicidal, and some members of the private equity fraternity believe that Prime Minister Rishi Sunak wants to lose before the campaign wrecks his August holidays.

It is also being heard that after losing and resigning as leader the PM will move to his home in Santa Monica and get a job in PE or in a hedge fund – and the weather is lovely in Santa Monica in August.

Anyway, the working hypothesis must be for a Labour Government. And as its 14 years since they were in power we have only their statements and heritage to estimate the future.

My thoughts follow.

Still further employment law with full "rights" clicking in on hiring and lots of change on implementing paid union reps and easier processes for strikes and work to rule. Whatever the social desirability of these changes they assuredly will diminish overall productivity and tend to hurt profits.

Target taxes

Actions to diminish inequality could come in numerous ways. The tax burden on high incomes will likely rise and given the spending plans and tendencies of the Labour party the need for taxes will be considerable and hitting higher incomes will be their least painful route to raise tax revenues. There are many taxes that could be hit but among the targeted will be the 28% carried interest tax. It seems highly probable that this will effectively rise to the highest marginal income tax rate at (guess) 55% or so.

Inheritance taxes and stamp duties are going to rise. There is a real possibility that capital gains taxes will go up.

VAT on school fees will hurt most private equity parents. Some schools will close. So certain is this that many schools are offering VAT free advanced payments to avoid this – I suspect "anti-avoidance" (aka retrospective taxation) will be brought into effect.

Our UK PE industry has many foreign nationals in senior roles. Still further tightening of non-dom rules and residence tests seem likely. Given the multi-jurisdictional nature of many of the international PE firms you can expect actions intended to catch more income into the UK tax net. Tax advisers will do well! I expect more of the job will be being done outside the jurisdiction.

Clearly there is a good case that the expensive houses occupied by the more senior souls in PE will underperform the general housing market.

The election will most probably bring in a Labour government — so how will its policies affect private equity?

Borrowing and debt

The Labour party has set the same borrowing levels as the Conservatives. Given that these can only be achieved by cutting large areas of public spending to continue to feed the "protected" areas (the NHS, defence etc) it's a judgement as to how much stomach Labour has for the nasty job of spending cuts.

In a more macro way, there will be effects from any still higher indebted government finances. High taxes will tend to reduce output and if government spending rises substantially then borrowing from overseas may rise with effects on the exchange rate and consequent imported inflation and higher interest rates. No one knows the likelihood and magnitude of these changes but both likelihood and the magnitude will have higher values than at present.

This is probably a good moment to remember the Truss budget – Labour does not have a monopoly on disastrous economic and fiscal policies.

Will PE be much affected by all this? When I started in the PE business, we had an 83% top income tax rate and a 30% CGT rate (most of us were too naïve to have spotted how you could greatly reduce CGT at this stage!) The dropping of income top rates to 75% and then 60% had a great effect on entrepreneurial spirits – in the recession ending in 1981 the economy shrank 5.9% - by the end of the 1980s it was growing at 5% per annum and the top rate of income tax had fallen to 40%.

Live long enough, probably a decade, and you might see something similar!

'Expensive houses occupied by the more senior souls in PE will underperform the housing market'

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