Britain: The Enthusiastic Transformation

Though it was not top priority when she was elected, few of Margaret Thatcher’s reforms were as fundamental as her governments’ overhaul of the British financial system. When she entered 10 Downing Street in May 1979, British finance was cliquish, internationally closed off, and loosely controlled by the state. Within a decade, Tory policies successfully reforged it as a dynamic, internationally competitive, and thoroughly liberalized system. This transformation has proven remarkably durable: even after Labour returned to power in 1997, the Thatcherite approach toward financial markets established during the 1980s remained the British status quo. Britain, perhaps more than any other advanced economy, has adhered to the conventional wisdom that competitive, liquid, and deep financial markets—largely unhindered by state intervention—greatly benefit society.

Thatcher herself held the simple conviction that free-market competition served the interests of the country at large. That vision as it applied to financial markets was given form by others—above all, by Geoffrey Howe and Nigel Lawson, her first two chancellors of the exchequer. Beginning with the abolition of controls on foreign capital, they oversaw the dismantling of rules that had carved out protective niches for foreign firms, eliminated government guidelines on credit allocation and credit growth, and generally opened the financial system to greater domestic and foreign competition. Britain’s financial sector responded with an aggressive increase in lending, together with a flurry of mergers and acquisitions (M&A) activity. Households took advantage of the new credit-rich environment to borrow heavily, producing a consumption boom and skyrocketing home prices that propelled the British economy of the 1980s.

Despite the collapse of that boom into a pronounced economic downturn—one that Lawson himself admitted had been caused in part by financial liberalization¹—Britain continued to embrace financial freedom and

encourage financial innovation. The end of the boom presaged Thatcher’s ouster prior to the 1992 elections, and Labour—for the first time since the 1970s—found itself within striking distance of victory. Their failure to capitalize on that opportunity forced Labour to forge a new identity under Tony Blair and Gordon Brown. Under their stewardship, “New” Labour carefully steered clear of the party’s legacy of hostility toward businesses and the financiers of the City, ensuring that Thatcher-era financial policies were there to stay.

Brown became the most important figure in shaping Britain’s post-Thatcher relationship with financial markets. Nearly a decade before entering government, Brown had written a book critical of the Thatcher boom and the greed it fostered. Yet when it was Brown’s turn to govern—first as chancellor and then as prime minister—he thoroughly embraced the Tory approach to financial markets. New Labour trusted markets to self-regulate and, in particular, encouraged financial firms to innovate—which they did. From the late 1990s to the 2000s, British financiers innovated with abandon, stimulating another cycle of credit-fueled consumption and housing gains—only to watch catastrophe strike again in 2007–2008. Looking back, Brown made another about-face, arguing that the late 2000s financial collapse was caused by “recklessness and irresponsibility all too often caused by greed.”

The Lawson–Howe–Thatcher reforms—built upon by Brown—have placed Britain on the leading edge of the global debt transformation. Few countries have experienced a more pronounced shift of capital: more than 80 percent of all outstanding British liabilities are now owed by the financial sector and households, up from 66 percent in the late 1980s. As a result, financial markets moved from the periphery to the core of the British economy. According to the OECD, the British financial sector now employs more than a million workers and accounts for nearly 40 percent of the country’s corporate profits. An assessment in 2010 found that financial firms pay more corporate taxes than any other sector of the economy. The results of this transformation have been mixed: Britain’s economy boomed during the 1980s and 2000s—but has crashed harder in economic downturns. It has developed one of the largest and most persistent external deficits in the world. And the country has experienced an especially rapid growth of top incomes as well as expanding inequality.

The story of British financial reform begs several interesting questions: If financial liberalization was widely seen as responsible for a severe recession, why did it continue? If corporate greed was economically destructive before Brown entered government and after he left, why did he embrace the freedom of financial firms to innovate when it was his turn to govern? In short, why has Britain remained at the forefront of the great debt transformation despite ample evidence that it entailed some severe costs?

The aim of this chapter is to answer these questions. It begins with a historical narrative of reform in Britain—starting with the pre-Thatcher state