

The Role of the State in the Financialization of the UK Economy

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Introduction

This paper asks two things: what role did the UK State play in the rise of financialization in the UK, and, what were the institutional mechanisms by which financialization came to be supported?

Most critical accounts of financialization tend to ignore the role of the state or to assume states have reacted to irresistible economic trends. They usually rely on macro-level quantitative data to demonstrate the transformation but rarely look at the social and institutional mechanisms through which change is achieved. This paper seeks to fill this gap by investigating some of the key state institutions and actors involved in UK financialization. More specifically, it looks at the Treasury and the Department of Trade and Industry (DTI), from the 1976 IMF bailout to the end of New Labour (1976-2010), a period coinciding with the UK's lurch towards a more financialized economy. Evidence was collected from a series of interviews and insider accounts, archive documents and from an analysis of four decades of UK budget statements.

All of this suggests that the UK State became an active participant in the process of financialization. At the heart of this pro-finance institutional shift was a changing balance of power between the Treasury and DTI. In the late 1970s both departments went through a series of dramatic changes that left the Treasury far stronger relative to the DTI. The Treasury then attempted to remake the DTI in its own image, subjugating the Department's alternative economic outlook to that of the Treasury's. In the process the UK financial sector was continually boosted while its core industrial base was undermined and further placed in the hands of its London-based financial sector. This was not simply a lurch towards free markets, but a particular economic policy paradigm that advantaged finance and aided the financialization of UK industry. It propelled the UK towards financialization faster than almost any other leading economy of the time.

The Financialization of the UK Economy and Industry

Financialization describes a particular set of trends, associated with mature capitalist economies, that have developed markedly since the late 1970s. Although often assumed to be an element of globalisation and neo-liberalism, it has its own distinct features (Epstein, 2005, Froud et al., 2006, Palley, 2007, Stockhammer, 2010, Krippner, 2011). In Palley's words (2007: 2) 'Financialization is a process whereby financial markets, financial institutions, and financial elites gain greater influence over economic policy and economic outcomes. Financialization transforms the functioning of economic systems at both the macro and micro levels.' Most obviously, financialization is about the growth of financial markets relative to both the state and real (productive) economy of goods and services. Thus, the capital managed by banks, and their ability to create credit, has grown several-fold compared to state expenditure or GDP. The stock, bond, commodity, commercial real estate and currency markets have also grown significantly relative to the real economy.

However, the spread of financialization goes rather wider and deeper, as many economic activities in society are reshaped to serve financial market needs. This pure market finance paradigm alters behaviour and activity at all levels, beginning with the financial sector itself. Banking is less about savings and loans and more about short-term profit-seeking and 'rentier' behaviour (Piketty, 2014). In turn, large NFCs (non-financial corporations) are increasingly run to create 'shareholder value' by any means (see Crotty, 2005, Froud et al., 2006). Corporate merger, demerger and acquisition activity, under-investment, asset sell-offs and global tax evasion, are all encouraged by financialization. Similarly, ordinary households are drawn into financialization through a range of activities, from the securitization and collateralization of mortgage debts to the nationalization of bankrupt banks (see Seabrooke, 2006, Engelen et al., 2011). Such trends have been in evidence in many economies since the 1980s. However, they were particularly advanced in certain, more financialized economies such as Ireland, Iceland, the US and UK.

Although the UK has had a strong financial sector for centuries, it expanded very significantly from the late 1970s. From 1979 to 1989, investment in financial services grew 320.3% next to investment in manufacturing, which rose only 12.8% (Coates, 1995: 6). Until the 1970s, UK bank assets had been equal to roughly half the value of UK GDP for a century. Following changes, by the mid-2000s, they had risen to five times the value of GDP (Haldane, 2010). In 1979/80, the equity value of the stock market (£30.8 billion) was roughly 40% of government income (£76.6 billion). By 2012 it was worth £1.76 trillion or three times government income (£592 billion, HMSO 2013/14). From 1997 to 2013, the UK's debt rose from £34 billion in 1997 to £1.3 trillion or 88% of GDP in 2013. By the time of the financial crisis (2007-08), the UK's financial sector relative to its economy was bigger than any other G7 nation. In contrast, UK industry has suffered a faster decline than all its economic rivals in that same period. In 1970, UK manufacturing accounted for 30% of GDP, 16.3% of total world exports (Coates, 1995: 7), and had trade surpluses of 4-6% annually. 35% of UK employment was in this sector. By 2010, 13% of GDP and 10% of total employment was in manufacturing and the UK was running a trade deficit in manufacturing of 2-4% (Chang, 2010: 90).

The questions posed in this study regard the UK State's role here. By many measures, the UK economy has become more financialized and has gone through a more pronounced process of deindustrialization than any of its major economic rivals. This suggests that such developments were more than just a consequence of natural global economic trends. If successive UK governments have contributed, how have they and through what institutional mechanisms?

In this case, studies of state actions, and the UK state in particular, are relatively thin on the ground. Much critical globalisation and international political economy literature, with a few notable exceptions, tends to focus on macro-economic data trends. These demonstrate the rising power of transnational corporations (TNCs) and global economic institutions, relative to national economies, thus undermining national sovereignty and pulling nations into the global economy on their terms. A similar approach characterises much of the financialization literature. For Epstein (2005), Palley (2007), Stockhammer (2010) and others, the role of nation states is either ignored or assumed to be in reactive compliance with wider economic forces. As Krippner (2011: 13) remarks, ‘In short, there is a kind of instrumentalism lurking in some of these accounts that supplants the interests of the financial sector for the interests of the state or simply assumes these interests to be identical’. Krippner (2011) is one of a few financialization scholars (see also Seabrooke, 2006, Schwarz, 2009 and Koenings, 2011) who has looked more closely at the role of the State. Although, all of these look at the US State and none, with the exception of Krippner (2011), has used more qualitative data sources such as insider interviews and documents.

In the UK there are few, if any, fine-grained, micro-level studies of the State and the contribution of political actors to financialization. There have been many broad histories of the Thatcher-initiated, free-market revolution, which ended the post-war tripartite consensus, deregulated many parts of the economy, and discredited Keynesian economic policy and the welfare state. There are also several accounts (Ingham, 1984, Fine and Harris, 1985, Anderson, 1987) charting the long-term separation of finance and industry in the UK. Of equal significance, these same authors (see also Strange, 1988, Theakston, 1995, Hutton, 1996) have documented the dominant ‘institutional nexus’ that developed between the City, the Bank of England and the Treasury. Such a nexus was mutually beneficial for these institutions but often did little to advance other parts of the economy. Similarly, there have been many studies on the UK’s slow industrial decline and the State’s abandonment of its industry relative to others OECD economies (Williams et al., 1990, Coates, 1995, 2000, Hall, 1995). Consequently, over many decades, government economic policy often proved more favourable to finance than to industry.

In sum, these various literatures say little about the UK State’s more recent role in financializing its economy. Those that look at government actions choose to focus on the US as the primary instigator of financialized capitalism. Those works looking at the UK state, tend to separate the stories of financial advance and industrial decline. More importantly, they generally predate the far larger and sudden changes in UK finance and industry that took place from the late 1970s onwards.

As this article goes on to argue: a) UK processes of financialization and deindustrialization are closely linked; b) the UK state was even more implicated in these linked developments than is usually acknowledged; and c) the shift took place because one part of the state, the Treasury, gained greater influence over another, the DTI, and with significant wider economic consequences.

The UK Treasury and the DTI 1979-2010: The Study

The study presented here collected data from several sources. First, was a close reading of the annual budgets over the period 1976-2010. These recorded cumulative fiscal measures over time, analysed public budget statements qualitatively, and also subjected them to computer-aided quantitative analysis. Second was a series of 19 depth interviews with ministers, senior

officials and advisors of the DTI and Treasury, who served in the period 1976-2010. A third source of data was gathered from several biographies, *Who's Who* entries, published insider accounts, government reports and other secondary sources.

All these sources tend to support a broad historical overview (Young, 1990, Middlemas, 1991, Letwin, 1992, Hutton, 1996). The events surrounding the 1976 IMF loan request, and the arrival of the new Thatcher government of 1979, had far-reaching effects across government. The tripartite consensus, that had balanced the interests of organised labour, the corporate sector and the state, fell apart. A new state free-market economic consensus and policy framework emerged which was then maintained through the years of New Labour (Jenkins, 2006, Toynbee and Walker, 2010). By the time of the financial crisis (2007-08) UK financial services had grown enormously and much of UK industry had gone the opposite way (Elliott and Atkinson, 2009, Engelen et al., 2011).

But, the research also revealed rather more about the institutional shifts that took place within the UK government. In different ways, both the DTI and Treasury were subjected to powerful exogenous shocks. Such shifts both strengthened the Treasury and weakened the DTI relative to central government, at both ministerial and civil service levels. This allowed the Treasury's narrow, finance-linked economic world view to dominate the DTI's wider industrial economic vision. This took place through a mixture of institutional shifts enforced on the DTI by the Treasury. The Treasury not only imposed severe cuts on the DTI but also determined what functions and personnel were to be cut. At the same time Treasury-linked senior civil servants and ministers, sympathetic to Treasury objectives, were put in their place. Ultimately, the DTI was reshaped to reflect the priorities and normative beliefs that the Treasury held in relation to the UK economy. The DTI itself then aided steps to support the financial sector while also distancing itself from industry and, of equal significance, placed greater control of companies into the hands of the financial sector. Thus, the UK State, under both the Conservatives and New Labour, made a significant contribution to the financialization of its own industrial base.

The Treasury and the DTI: A Tale of Two Departments and Economic Visions

From the late 1930s to the early 1970s, the Treasury and the various departments of trade and industry, despite having contrasting economic visions and activities, were both well accommodated within UK governments. The departments covering trade and industry were generally directed by economic thinking which sought to manage and boost UK-based industries, at home and abroad. They were central to the tripartite politics and Keynesian economic consensus that had directed the UK State's policy framework from the late 1930s onwards. Having direct management of many nationalised industries, and in charge of a range of regulatory and financial levers, they had grown to a substantial size (Middlemas, 1991, Pollard, 1992). A number of leading politicians, including Harold Wilson and Edward Heath, had managed them during their careers. By the 1970s, with their links to both union and business leaders, they had become fairly influential in the running of the UK economy.

In contrast, the Treasury's primary function was the control of the public finances. It was an inward-facing department that rarely dealt with real industry or the regions (Pliatzky, 1989, Theakston, 1995, Lipsey, 2000). Its main outside links were with City institutions and the Bank of England. Its staff dealt with these institutions on a daily basis and also moved in similar social circles (Ingham, 1984, Strange, 1988, Theakston, 1995). As a rule they were critical of big infrastructure projects and the large, nationalised industries, which drew on Treasury funds

and were also associated with ongoing industrial relations problems (see also Hall, 1995, Jenkins, 2006, Gamble, 2009).

Consequently, Treasury staff shared an economic view of the world that had much in common with the Bank of England and City. This was anti-state intervention and spending, weary of large public industries, favourable towards free trade and international markets, and supportive of UK financial services. This long-term 'Treasury view' was recently summed up by Sir Nicholas Macpherson, the current Treasury Permanent Secretary in a public speech (2014). The 'view' included: a 'belief in free trade', 'better functioning international markets', 'well functioning capital markets', 'price stability', a 'strong currency', 'limits to what the state can do', and 'spending control'. In effect, liberated efficient international stock markets are best placed to run UK business. This view is very compatible with financial market theory, a pure neoclassical economic account of markets, and has been commonly recorded in London's financial sector (Fama, 1970, Lazar, 1990, Hutton, 1996, Davis, 2007). It is a perspective that takes little account of many of the factors that concern real businesses and the real economy, from high currency exchange rates to long-term R & D budgets. In effect, it mentally brackets out wider market and political conditions, and leaves industrial management to secondary, abstract financial markets.

Until the economic crises of the 1970s both institutions and their economic visions were fairly well accommodated in government for a few reasons. First, although the Treasury was always the stronger, according to Pliatzky (1989), it had lost some of its authority and influence in the post-war period. It had certainly struggled to limit public expenditure under the existing PESC system (Public Expenditure Survey Committee), as spending departments regularly over-ran their budgets (Heclo and Wildavski, 1974, Thain, 1984). Second, because the departments of trade and industry were central to an economic policy based on the tripartite consensus, they were given a significant voice in government. Third, the dominant Keynesian macroeconomic policy outlook of the period, had both supported industry and undermined the long-established pillars of Treasury thinking. As a couple of interviewees recalled, Keynesian officials had come to occupy the higher reaches of the Treasury by the 1970s and, consequently, had weakened its longer-term institutional outlook:

(Alan Budd, former Chief Economic Advisor) 'these [Treasury officials] were people who'd worked with Keynes. It was an aberration in some ways from the traditional Treasury view ... what Keynes was fighting against in the '30s was the Treasury orthodoxy.'

The institutional balance of power changed significantly with a series of weighty economic crises in the 1970s. Things came to a head in 1976 – a 'critical juncture' – when the Labour Government were forced to seek assistance from the International Monetary Fund (IMF). In many accounts (Pliatzky, 1989, Hall, 1993, Mullard, 1993, Jenkins, 2006) it was the Treasury, that was held most to blame for the loss of control over the public finances. For Jenkins (2006) the impact on the department was nothing less than 'traumatic'. What followed, according to interviews, was a series of reviews, personnel changes and restructuring. This proceeded apace when the new Thatcher Government came in in 1979. Peter Middleton, an economist favourable to monetarism, was picked out and promoted to permanent secretary ahead of several more senior ranking staff. Keynesian officials were all pushed out:

(Sir John Gieve, former senior Treasury official) ‘There was a revolution in the Treasury ... the top dogs in the Treasury were under suspicion when the Conservatives arrived ... a couple went very quickly and then two or three more went over the next two years, so that by ‘81 you’d probably got most of the new team in place.’

The Treasury was then given substantially more power across Whitehall (Pliatzky, 1989, Johnson, 1991, Theakston, 1995, Hall, 1995, Chapman, 1997, Lipsey, 2000). The loan rules laid down by the IMF meant greater Treasury control over department budgets. After 1979, the Thatcher Government saw the Treasury as the key institutional means for achieving its monetarist philosophy, thus securing its position even more. In 1981, it was put in charge of civil service pay and promotion, and permanent secretary appointments across Whitehall. Its influence was consolidated through the 1980s and 1990s through a series of new hierarchical structures, accounting tools and annual procedures, all designed to reign in department spending (Heclo and Wildavsky, 1974, Thain, 1984, Chapman, 1997, Thain and Wright, 1990, 1995, Lipsey, 2000). Ultimately, the private, inward-looking and insular Treasury, became one of the most powerful financial departments of any of established democracy in the World (Theakston, 1995, Hall, 1995, Johnson, 1991).

Significantly, the Treasury was also given a more prominent role in developing macroeconomic policy and managing the larger economy (Pliatzky, 1989, Coates, 1995, Theakston, 1995, Lipsey, 2000). As part of the restructuring, there was an influx of economists in the 1970s (Theakston, 1995, Lipsey, 2000). During the 1980s, several Treasury ministers had City backgrounds. Chancellor Nigel Lawson, the widely-acknowledged intellectual economic policy force of the period, had spent many years as a financial journalist in the City. John Major, Norman Lamont, the next Chancellors, as well as several Treasury ministers (Cecil Parkinson, Lord Cockfield, Leon Brittan, Nicholas Ridley and Peter Lilley), had also had established City careers before entering Parliament. These shifts, at both ministerial and civil service levels, helped to re-establish the long-run Treasury-City economic view, as well as giving it far more influence over economic policy:

(Norman Lamont, former Chancellor) ‘My time in the City did inform my disillusionment with the policies pursued by Heath because ... I worked as an investment manager and I could see the problems that were building up, and the harm that was being done, and the distortions that were being created by policies. So I suppose, in that sense, my time in Rothschild’s did have a big impact.’

Just as the Treasury was considerably strengthened by the exogenous institutional shocks of 1976 and 1979, so the DTI was severely destabilised. It was clear after 1979 that Mrs Thatcher and her closest allies viewed the DTI, with its close relations with the nationalised industries and unions, as inextricably tied to past problems. Keith Joseph, Peter Lilley, David Young and other DTI heads, did not hide their contempt for what Young called the ‘Department of Disasters’ (Johnson, 1991, Theakston, 1995). There were regular rumours that it would eventually be abolished. It became a department that most aspirational ministers avoided. Between 1983 and 1990, there were seven Secretaries of State, and junior ministers came and went with equal frequency (Johnson, 1991). The post itself became an unwanted position on the ministerial ladder going to somewhere else. The department was serially cut, restructured and its links to industry eroded during the Thatcher governments (Theakston, 1995). In 1979, the Department for Prices and Incomes was abolished and integrated into the Department of

Trade. The National Enterprise Board was cut loose before being closed down in 1982. In 1983, Trade and Industry were merged into one.

The rise of the Treasury and the demise of the DTI continued, albeit at a reduced pace, into the 1990s and 2000s. Treasury power dipped in the early 1990s but was then reasserted in the New Labour years under Gordon Brown (Jenkins, 2006, Toynbee and Walker, 2010). Despite Michael Heseltine's stronger presence at the DTI, from 1992 to 1995, there were more sales of national industries and rounds of departmental restructuring. The National Economic Development Council and Office were abolished in 1992 (Pliatzky, 1989, Mullard, 1993). Parts of the departments of Energy and Employment were folded into the DTI. Under New Labour, six Secretaries of State came and went over ten years and several more rounds of restructuring took place. Bits of Education, Energy and Environment came and went, with budgets and headcounts changing significantly too. For several interviewees, the reorganisations and rapid turnover of ministerial and civil service staff left a sprawling, fragmented department, low on moral and without clear direction:

(Margaret Beckett, former DTI Secretary of State) 'I spoke to somebody who was a special advisor there ... he had ten secretaries of state. Disastrous ... people were demoralised. We had a huge generation gap in the middle of the department where they'd had to get rid of lots of people and they hadn't been replaced in the Thatcher cuts. And the department had got lots of different bits in it that had never been brought together.'

By 2007, the once powerful DTI department had become a shadow of itself. It was then disbanded, restructured and renamed. Two years later, another large overhaul took place, leaving the rather smaller Department of Business, Innovation and Skills. In contrast, in this same period, many rival economies (US, France, Japan and Germany) had kept their equivalent industry ministries on a more equal footing with their finance ministries (Hall, 1995, Theakston, 1995). Under such circumstances – a strengthened Treasury and a destabilised DTI – the potential for a government-led restructuring of the economy was there. The DTI's economic vision was likely to be superseded by the Treasury's resurgent economic views, and with longer-term consequences for both industry and finance.

The Treasury Reshapes the DTI in its Own Image

The Treasury's intentions for the DTI were made clear quite quickly. It used the tools at its disposal to reshape the Department and redirect its institutional resources. Publicly, this was made clear in the annual budget statements and in a series of fiscal measures which advantaged finance over industry. Internally, changes were imposed through a mixture of budget cuts, personnel shifts and the setting of new institutional priorities. The most dramatic shifts took place under Mrs Thatcher but then continued through the Major, Blair and Brown administrations.

Policy priorities, in favour of finance and against industry, were outlined publicly in successive budget statements. The computer-aided analysis of speeches, from Healey to Osborne, show a steady decline in the use of industry terms: 'industry', 'industrial', 'trade', 'manufacturing', and 'export'. Healey was the last chancellor to talk about 'finance for industry' in 1977. Constructions about industry dropped precipitously from Healey's time, falling almost four-fold by Lawson's, where they have remained ever since. The only time Lawson mentioned manufacturing was when he withdrew its tax-assistance, which he called 'unnecessary reliefs'

(UK Parliament 15 Mar 1984). In contrast, from Howe onwards, there was a steady increase in the use of finance terms: 'share ownership', 'capital markets', 'financial strategy', 'market discipline', 'banking business', and 'private investor'. After Lawson, successive Chancellors from Clarke to Darling, used such terms between three and five times as frequently as they did industry ones.

In terms of hard fiscal and regulatory measures, the Treasury made a series of changes which were designed to free up markets generally (see also Cairncross, 1992, Pollard, 1992, Jenkins, 2006, Toynbee and Walker, 2010) but often worked to benefit financial markets at the expense of UK industry. 1979 and 1980 brought the release of exchange and credit controls and thus initiated a new credit boom. It also meant that big UK-based institutional investors started switching far more of their funds abroad and away from UK industry. Stamp duty on the purchase of shares and bonds was cut in stages from 2% to 0.5%. Dividend payment controls were abolished in 1982. In contrast, although corporation tax was cut for all businesses, this was paid for specifically by removing capital investment allowances for machinery and plants; measures which primarily hit manufacturing. There were steady VAT rates rises on goods and services but financial and insurance services were made VAT-exempt. This doubly disadvantaged industry next to finance as industry made much greater use of real world goods and services than finance. For Lawson, all decisions came back to freeing up markets with little recognition that such measures would both aid finance and hinder manufacturing:

(Nigel Lawson, former Chancellor) 'Transaction taxes do a particular harm because you need to have transactions, that's how markets work ... the reduction in stamp duty [on shares], there were so many more transactions as a result ... [cutting tax relief on capital investment] was entirely my own thinking, obviously having decided that, I wanted ... to have a lower rate of tax on profits, offset by a gradual winding down of all these reliefs, which had no economic rationale.'

The public discourse and fiscal measures were matched by severe Treasury-enforced department budget cuts at the DTI. With little support from the Prime Minister or wider Cabinet, it was difficult for the DTI to resist some of the harshest cutbacks of any Whitehall department in the 1980s (Thain and Wright, 1992b, Mullard, 1993). Mullard's (1993: 24, 35) study of changes in public expenditure patterns noted that the DTI's own budget dropped pretty continuously from 1.35% of GDP in 1979 down to 0.7% by 1987. It edged up later but never above the 1% level again. Capital expenditure programmes, with a direct industry impact, were cut from 4.07% in 1974 to 0.92% by 1988. DTI staff members, as a percentage of the whole civil service, dropped through the life of the Department, from 2.45 to 1.77% (Civil Service Yearbooks).

There were also clear shifts in senior personnel imposed. Thain and Wright (1990, 1992a, 1992b, 1995), in particular, document the procedural, management and accounting tools that were imposed by the Treasury in order to tighten financial controls. This included the machinery of the Treasury's GEP (General Expenditure Policy Division) with its EDs (Expenditure Divisions) in each Department. Thus the Treasury were able to place small staff divisions within each department to oversee and communicate with every financial division.

Most significantly perhaps, a series of Thatcherite allies, most with City and Treasury links, were put in charge of the DTI. There were 12 DTI Cabinet Ministers in Thatcher's time in office. Of the 12, six (Keith Joseph, John Nott, Lord Cockfield, Cecil Parkinson, David Young and Peter Lilley) had part or all of their pre-politics career in the City. Two more, Norman

Tebbit, a former *Financial Times* journalist, and Leon Brittan, had strong City connections. Eight of the 12 (John Nott, Patrick Jenkin, John Biffen, Lord Cockfield, Cecil Parkinson, Leon Brittan, Nicholas Ridley and Peter Lilley) had previously held one or more ministerial positions in the Treasury prior to joining the DTI. Only one of the 12, Paul Channon, had neither City Connections nor ministerial experience in the Treasury. Such links to the City and Treasury have never been so strong, either before or since, in the DTI's history. A related development was the growing tendency to bring in external consultants from the City, to advise on new finance-related activities that were taken on by the DTI:

(Cecil Parkinson, former DTI Secretary of State) 'when I got there we appointed bankers, brokers, engineers, accountants, regulatory advisors. You name it, we got the lot ... I said this is the team that's going to take on privatisation from now ... to companies which have been floated, and I don't want brokers coming along at the last minute.'

Treasury objectives were also conveyed to those civil servants working in the DTI. During interviews, it became clear that the less able ministers and DTI officials stayed working with the nationalised industries and business support. The more able went to work on new privatizations, competition or trade policy, with many going to help develop the European Single Market. In effect, advancement within the DTI meant working on, and conformity with, larger Treasury macroeconomic policy goals: privatization, deregulation, competition, control of inflation and public expenditure, and international free flowing markets (Theakston, 1995: 311). Everything was developed in the service of producing better international, finance-led, market competition, and the conditions to attract inward investment. As one DTI official recalled of her time in the 1980s:

(Anonymous Former Senior DTI Official) 'if you were working on the big privatisations there was complete alignment. That was really pointing the way between Number 10, Treasury and DTI in that territory, so that was a very tight relationship in terms of looking in the same direction, thinking the same things, very tight at ministerial level, tight at official level ... so long as the DTI was driving the big privatisations on energy, telecoms, Rover, the sort of innate tensions between a DTI view of industrial policy and a Treasury-let-the-market-at-it view was perhaps more subdued.'

These trends changed little through the Major or Blair Governments. The computer-aided analysis of budget statements show that Norman Lamont and Ken Clarke spoke a little more about industry and a little less about finance than John Major and Nigel Lawson before them. But New Labour changed tack again. Gordon Brown and Alistair Darling said relatively less about industry and more about finance than Lamont and Clarke. In fact Brown said less about industry and Darling said more about finance than any of their Conservative predecessors (although in Darling's case he was dealing with the financial crisis). Enforced DTI budget and staff cuts also continued. In Labour's first term these figures were stable or went up slightly. They then started to drop again in the second term. For Brian Bender, in charge of the DTI over the period, 'the relationship between the DTI and the Treasury was like the playground bully and the bullied'. Then, with large-scale restructuring, in 2007, and again, in 2009, the DTI was reduced to a quarter of its size to form its eventual successor, the Department of Business, Innovation and Skills:

(Brian Bender, Former DTI Permanent Secretary) ‘I had three quite significant machinery of Government changes in my time as Permanent Secretary. The first was the creation of Defra by Tony Blair in 2001. The second was the creation of the Department for Business, Enterprise and Regulatory Reform when Gordon Brown became Prime Minister. That involved taking science and innovation out of the Department to the newly created (and short-lived) Department for Innovation, Universities and Skills. And the third, in Autumn 2008, was when Gordon Brown created the Department for Energy and Climate Change. The result of the last two changes was to reduce the Department’s budget from over £6 billion to a bit below £1.5 billion.’

Unlike the Thatcher years, under New Labour there was no well-trodden ministerial pathway from City and/or Treasury to DTI. But, there was a marked increase in (GES) Government Economic Service-appointed economists within the department and a continuing influx of consultants from the City. In fact, the GES, in operation since 1964, housed in the Treasury and linked to the Bank of England, expanded significantly during Labour’s term of office. In 2001 there were 607 GES civil servants. Numbers more than doubled to 1295 by 2010, and all during a period of overall decline in civil service head count. The DTI had 60 GES staff in 2002. This had increased to 107 in the new BiS incarnation by 2010, again during a period of cuts (figs supplied to authors direct from GES). Those present during the years also talked of the steady influx of City consultants and the close links with the banking sector that seemed to increase over the years:

(Dan Corry, former Labour economic advisor in DTI) ‘the real issue was the City and getting financial advice ... later on we have the Shareholder Executive ... the people you’d employ there were clearly people who understood the City and financial markets. They became quite useful in all sorts of things around government ... I think it might even have been in the Treasury to start with but it ended up at BIS ... the big bank leaders were much more into the Treasury and into Number 10. And I was aware in Number 10 that the banks had a strong line into the place, not only to the prime minister, but to Jeremy Heywood for instance.’

By the time New Labour arrived, civil servants had cut many of their links with, and traditional means of support for, industry. More than that the Department itself had become entirely anti-interventionist and, according to some interviewees, many were now as hostile to industry as the Treasury itself. The new orthodoxy was to step away from companies and produce a better business environment through infrastructure and greater competition. At the same time, it had come to believe and promote finance as a world-leading ‘industry’ of the UK economy, once that should be supported at all costs:

(Vicky Pryce, former Chief Economic Advisor, DTI) ‘in the process of course the industrial policy that developed was one that basically said there’s very little money for business support ... everyone was under the influence of the financial sector, I think, probably including the DTI ... we were probably all of us far too impressed by how well the financial sector was doing and how competitive it was internationally.’

Ultimately, through three decades, Treasury actions and perspectives were imposed on the DTI, realigning its thinking, processes and goals with those of the Treasury itself. A new state institutional economic consensus emerged. Although many Treasury actions favoured finance

over industry, several of the key shifts that facilitated financialization and deindustrialization in the UK were implemented by the DTI. Three of these are briefly discussed in the next section: deregulation of the City, privatization, and corporate governance.

The Reshaped DTI and the Financialization of UK Industry

At the start of the Thatcher Government, financial services and insurance were regulated by the DTI. It was Cecil Parkinson who, when heading the DTI, led the negotiations with the LSE (London Stock Exchange) for deregulation. The 1986 Financial Services Act ('Big Bang') which followed ended the exclusive, insider networks of the City and opened it up to international players. In a short space of time London's broking companies were almost all bought up by wealthier overseas investment banks. For those involved at the time, policy was driven by the desire to restore the UK's financial sector to a central position in the global economic system by making London more open and competitive:

(Terry Burns, former Treasury Permanent Secretary) 'the world of international finance was changing dramatically, and if London wished to be part of it, it had to change. And if it was going to change you had to allow the British companies to operate in international markets so that the whole system had to change.'

When New Labour came into power in 1997 they altered the regulatory structures. The changes required more regulation but also emphasised self-regulation and a unobtrusive approach (Lipsey, 2000, Moran, 2007, Thain, 2009). The Bank of England was given independence and the new MPC (Monetary Policy Committee) given control of interest rates. The new tripartite system of regulation, consisting of the Treasury, Bank of England and Financial Services Authority (FSA), practised 'constrained discretion'. Liberalization and the influx of international financiers led to huge rises in international finance capital flows in and out of London. Shortly before Northern Rock collapsed in 2007, Labour passed a further reform of the 2000 Financial Services and Markets Act, which made FSA regulatory requirements 'even lighter'. Gordon Brown and Ed Balls continued to advocate 'light touch' regulation in speeches to the financial community, actively encouraging overseas financiers to come to the UK:

(Geoffrey Robinson) 'Ed [Balls] became Minister of the City and he went round preaching deregulation ... "light touch, light touch" everywhere he went ... and the Treasury's light touch idea was to attract as much as we could of these [financial] activities to London, certainly we were successful there ... [but] we definitely took our eye off that ball and paid a heavy price for it.'

Just as the DTI aided the Treasury in the growth of the UK's financial markets so it also actively contributed to the financialization of British industry (see also Johnson, 1991, Hall, 1995, Hutton, 1996, 2011). One way it did this was through the privatization programme that peaked in the 1980s but continued through the 1990s and the New Labour years. Between 1979 and 1996 there were 59 major public sales of government-owned businesses, worth £65 billion, and 88 private sales, worth a further £6.7 billion (Gibbons, 1997). New Labour had rather less to privatize after 1997 but they maintained the policy. Privatizations took place at other departments too, but the DTI took a prominent lead. NATS, the Royal Mint, Tote and the Commonwealth Development Corporation were each privatized. More significantly, the Government entered into Public-Private Partnership agreements and began outsourcing many state services. By 2005, a £100 billion of PPP-related debt had built up and, by 2007, some 20 percent of public expenditure was on outsourced services (Jenkins, 2006: 261, 266).

By many accounts, the privatization programme was initially pushed through to shrink the state and enable the private sector. However, one key point to note was that privatization automatically came to be done through public floatations on the LSE, with various alternative means and mechanisms usually rejected. Another key point was that, as time went on, the Treasury became increasingly reliant on the income from such sales (Pliatzky, 1989, Thain and Wright, 1990, 1995). The public accounts were represented so that the sales were not recorded as 'receipts' but as 'negative expenditure' (Pliatzky, 1989). The Labour Government's PPP contracts were also worked out so they could sit off-balance sheet and make the overall Treasury figures look stronger in the short-term. In effect, the manner and means of privatization, PPP and outsourcing, suited both the City and Treasury. But, what this also meant was that the privatization programme handed over great swathes of UK industry, public services and debt directly into the hands of London's financial sector. The UK government also became a major contractor for financial services companies, many of which then went onto work with other governments on their privatization programmes. Once again, the DTI often acted as the institutional means for achieving such Treasury goals:

(Sir John Gieve, former senior Treasury official) 'Looking back on it, this was a Treasury led programme, even though the Department of Energy, the Department of Industry, and so on fronted the individual sales. It was a consistent Treasury-led programme, under the prime minister's encouragement, to just push state businesses into the market sector.'

The UK State, through the DTI, also did much to hand greater control of public companies more generally to the financial sector. This took place in three areas of legislation overseen by the DTI: corporate governance, trade liberalisation and takeover policy (see Seeley, 2012, Davis et al., 2013). Financial market thinking in the US and UK, since the 1970s, had come to emphasise 'shareholder value' as being central to good corporate governance (see Hutton, 1996, Froud et al., 2006, Davis, 2007). UK corporate governance, as it evolved and was regulated by the DTI from the 1990s onwards, came to be developed according to such financier expectations. Thus governance oriented company director's 'fiduciary duties' primarily towards serving investors over and above other stakeholders (employees, customers, communities) or even the company itself. Following a series of corporate financial scandals a series of committees followed (Cadbury, 1992, Greenbury, 1995 and Hampel, 1998) each setting out new proposals. In each case, the panels were dominated by big City institutions. In each case, corporate governance principles were laid out by and then loosely enforced by the LSE and FRC (Financial Reporting Council); both of which were, once again, dominated by City representatives.

Similarly, trade liberalisation and takeover policy also came to be set through the DTI but according to the financialized economic thinking of the Treasury and City. The DTI led the way in negotiations for the deregulation of international trade, within the EU and beyond. Other EU states agreed such policies, but most of them also maintained more protections and supports for their own key industries (Hall, 1995, Hutton, 1996, Coates, 2000, Hall and Soskice, 2001). Takeover policy in the UK too became increasingly laissez faire and, consequently, handed almost complete control of the process to the London Stock Exchange. After 1979, the tests and scope for government intervention were steadily weakened by DTI Secretaries of State. In 1984, Norman Tebbit made clear that referrals to the then Monopolies and Mergers Commission would be made primarily on 'competition grounds'. Between 1984 and 1991 there was only one referral made for other reasons. Accordingly, the UK became the easiest of all

major economies in which to do takeovers. Between 1991 and 1997, UK takeovers relative to GDP were far higher than any of its G7 rivals, including the US (Jackson and Miyajima, 2007).

Once again, the New Labour years saw a clear continuation of these trends. The 2000 Financial Services Act and 2006 Companies Act, produced by the DTI, officially recognised the FRC and LSE as having legal jurisdiction in the areas of corporate governance and takeovers. This further ensured that company directors regarded their main duties as being to serve shareholders above all else. In the 2002 Enterprise Act, Patricia Hewitt took further powers away from ministers to intervene in takeovers and reaffirmed competition as the key reason for referral. Between 1998 and 2005, despite rises in takeover activity globally, the UK remained the most takeover-prone. In this period, Japanese takeovers equated to 2.5% of GDP, German to 7.5%, France to 9.9%, the US 10.7% and the UK 21.8% (Jackson and Miyajima, 2007). New Labour, as with previous regimes, saw themselves as leaving takeovers to be decided by markets but, in practice, this meant handing more say to financial markets:

(Dan Corry, former Labour economic advisor in DTI) ‘the worry that the Treasury has, and I think it’s legitimate, is that the DTI becomes a defender of British industry ... to start with, ministers still sort of took the final decisions on mergers ... over time we took them out of it completely, and we put more economists in charge of OFT and the Competition Commission.’

In effect, an increasing number of changes, enacted through the DTI, handed control of the bulk of UK industry, not just to the ‘free market’ but to its financial markets. It was a slow, staged coup that made Britain’s corporate leaders and companies direct their larger goals towards the needs of the City and international investors. The profile of UK equity market shareholders changed accordingly. In 1981 individuals held 28% of shares, UK-based pension and insurance funds 47%, and overseas investors 4% (Golding 2003: 23). By 2012, individuals held 10.7%, pension and insurance funds 10.9%, and foreign investors 53.2% (ONS, 2012). Hedge funds and high frequency traders were responsible for 72% of market turnover (Kay, 2012). In the 1960s, the average company share was held for almost eight years. By 2008, it was reported to have dropped to three months (High Pay Commission, 2012). UK companies had become increasingly owned by foreign-based and short-termist financial institutions, both of which treated companies as simple units to be traded on fast-moving secondary markets. As critics and several interviewees acknowledged, UK industry had been handed to the control of anonymous, absentee shareholders and the financialized economy:

(Michael Heseltine, former DTI Secretary of State) ‘By and large if you look at the people who own Britain’s largest companies they’re not British, they’re international investment operations ... The long term interests of this country, the industrial base, the scientific elements, the research and development facilities, the supply chains, all these things have no consequence at all. Well that is unlike any other capitalist economy, unlike any other, starting with America.’

Conclusions

This paper has focused on the role of the UK State in producing a new variation of the capitalist system – financialization. As argued here, the UK state played a very active role in this process. Whether conscious or not of the larger macroeconomic outcomes of its decision-making, government ministers and civil servants reorganised the economy to support its financial sector.

Its interventions were very decisively in favour of finance and against industry and, in many ways, handed greater control of industry direct to financial investors.

The study took a fine-grained and qualitative approach in its research, exploring the institutions, people and ideas operating at the centre of government. Specifically, it looked at the dramatic changes that took place inside the Treasury and DTI after 1976. Such changes enabled a strengthened Treasury to reshape the DTI along Treasury-City economic ideal lines. Much of this was forcibly imposed on the DTI as its budgets were severely cut and its policy goals increasingly set by Treasury thinking. Normative influences were shifted through changes in professional personnel, as economists and City or Treasury-linked civil servants, consultants and ministers were moved into the DTI. Aspirational DTI ministers and officials then responded by attempting to put into practice Treasury economic thinking as a way of achieving institutional stability and personal advancement. Through this process, a new unity of state economic thinking emerged; one developed in the Treasury but enacted through both the Treasury and reshaped DTI together. It was *financial market* thinking as much as *free market* thinking that provided the rational and directive parameters for 'Big Bang', privatization, deregulation of finance and trade, and evolving corporate governance and takeover regimes. These not only shifted economic conditions in favour of international finance and against manufacturing, they helped to pass UK industry more overtly into the hands of the financial sector.

Interviewees Cited

Anonymous Former Senior Civil Servant, Various Positions at the DTI, 10th December 2013

Dame Margaret Beckett, Labour MP 1974-, Various Cabinet and Shadow Cabinet Posts 1989-2006 Including Secretary of State for DTI 1997-8, 26th June 2013

Sir Brian Bender, Various Senior Positions at DTI and Across Government Including Permanent Secretary of DTI and Business Enterprise and Regulatory Reform 2005-9, 6th November 2013

Sir Alan Budd, Senior Economic Advisor to Treasury 1970-74, 1979-81, Chief Economic Advisor 1991-97, Head of OBR 2010, 30th June 2014

Lord Terry Burns, Chief Economic Advisor to Treasury/Head of Government Economic Service 1980-91, Treasury Permanent Secretary 1991-98, 15th July 2014

Dan Corry, Economic Advisor to Labour in DTI, (Shadow) Treasury and No. 10 Policy Unit 1989-2010, 5th August 2013

Sir John Gieve, Senior Treasury Civil Servant 1978-2001, Various Senior Posts Elsewhere 2001-09, 11th July 2013

Lord Michael Heseltine, Conservative MP 1966-2001, Various Shadow and Cabinet Positions 1974-1997 Including President of the Board of Trade 1992-5, 24th June 2013

Lord Norman Lamont, Conservative MP 1972-97, Various Ministerial Positions in Government, in Treasury 1986-1993 Including Chancellor of the Exchequer, 1990-93, 28th June 2013

Lord Nigel Lawson, Conservative MP 1974-92, Chancellor of the Exchequer 1983-89, 20th June 2013

Lord Cecil Parkinson, Conservative MP 1970-92, Various Cabinet Positions 1983-89 Including Secretary of State for DTI 1983, 1st August 2013

Vicky Pryce, Chief Economic Advisor DTI/BiS 2002-10, Joint Head of Government Economic Services, 2007-10, 22nd May 2014

Geoffrey Robinson, Labour MP 1976 -, Various Positions in Labour Governments of 1970s-1990s, including DTI and Treasury, 24th June 2014

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