The Thatcher legacy

Lessons for the future of the UK economy

John Muellbauer, University of Oxford and David Soskice, London School of Economics
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Navigating Economic Change

As the UK is buffeted by the economic shocks and challenges of the 2020s, The Economy 2030 Inquiry, a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics (LSE), funded by the Nuffield Foundation, is publishing a series of essays examining how policy makers from a range of advanced economies, including the UK in the recent past, have managed periods of disruptive economic change. As we seek to reformulate the UK’s economic strategy for new times it is vital that we learn the lessons of these comparative and historic perspectives.

Some consider the trajectory of a national economy following a major shock – for instance, Germany after unification, New Zealand after the UK joined the European Community, Estonia post-USSR and the UK during the tumultuous 1980s. Others examine the experience of particular cities – for instance a group of post-industrial ‘turn-around cities’ - or the adjustment of key features of a national economic system, such as Danish ‘flexicurity’. Together they offer a powerful and timely set of insights on the successes and failures of economic policy makers in the face of economic shocks and structural change.

The essays are written by a range of leading economists and national experts and reflect the views of the authors rather than those of the Resolution Foundation, the LSE or The Economy 2030 Inquiry.

They have been commissioned and edited by Gavin Kelly (Chair of the Resolution Foundation and member of the Economy 2030 steering group) and Richard Davies (Professor at University of Bristol and fellow at the LSE’s Centre for Economic Performance).

The Economy 2030 Inquiry

The Economy 2030 Inquiry is a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics, funded by the Nuffield Foundation. The Inquiry’s subject matter is the nature, scale, and context for the economic change facing the UK during the 2020s. Its goal is not just to describe the change that Covid-19, Brexit, the Net Zero transition and technology will bring, but to help the country and its policy makers better understand and navigate it against a backdrop of low productivity and high inequality. To achieve these aims the Inquiry is leading a two-year national conversation on the future of the UK economy, bridging rigorous research, public involvement and concrete proposals. The work of the Inquiry will be brought together in a final report in 2023 that will set out a renewed economic strategy for the UK to enable the country to successfully navigate the decade ahead, with proposals to drive strong, sustainable and equitable growth, and significant improvements to people’s living standards and well-being.
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1. Introduction

In the next decade, the UK faces major structural changes. The drive to reach Net Zero in greenhouse gas emissions by 2050, with a major interim decarbonisation target of 2035, requires a huge transition in energy generation and use. The UK’s departure from the EU requires shifts in trading and migration patterns. The shocks of the Covid pandemic and of Russia’s war with Ukraine are amongst the most disruptive that have ever struck the UK. The 1980s were the last decade when the UK went through structural changes as far-reaching. It is therefore timely to examine the 1980s and try to draw lessons.

Furthermore, a number of the problems the UK faces are themselves a legacy of the economic and political choices made in the 1980s. While path dependence is important, new paths can also be set with fresh thinking but that requires us to understand how we are arrived at our current position.

Section 2 examines the major shocks and global trends experienced in the 1980s and the challenging legacy the UK inherited from the 1970s. Global trends include trade and financial globalisation; the rise of Asian exporters; new technologies and the shift to services; the interest rate shock of the early 1980s resulting from US fiscal and monetary policy; global disinflation and another oil price shock. Section 3 turns to key aspects of economic policies pursued by the Thatcher governments, examining macroeconomic policy, financial deregulation, labour market and industrial relations reforms, and policies on education and skills, on European integration and on housing.

Section 4 concentrates on different aspects of economic performance including macro and financial stability, unemployment, productivity growth, investment and trade. Consequences for income growth and the structure of employment and inequality between people and places are then examined.

Section 5 examines the long legacy of the 1980s. One of the most profound of these concerns the push for a ‘property-owning democracy’ and how links between finance, housing, instability, and property tax have contributed to low saving and investment rates and impeded productivity growth. Entrenched regional and wage inequality is another long-term legacy. More positively the shift towards high employment levels can be linked to the flexible labour market reforms of that era. And the benefits of the expansion of higher education are another beneficial feature but this must be weighed against the relative neglect of other skills training which was a feature of the 1980s.

Finally, Section 6 draws lesson for the future to help the UK address inherited problems and the coming structural changes.
2. Context: Global forces, external shocks and the legacy of the 1970s

2.1 Global economic forces

Major external shocks and continuing global trends hit the UK in the 1980s. Global trends included globalisation of trade and finance, and shifts in technology and in global consumption patterns towards services. The macroeconomic shocks included the aftermath of the 1979 oil price shock, the interest rate shock of the early 1980s resulting from US fiscal and monetary policy, the Latin American debt crisis, global disinflation and the sharp fall in oil prices in 1986. The decade ended with the breakup of the Soviet Union and the interest rate shock, especially in Europe, stemming from German unification.

For international trade, the 1970s were a decade of increasing openness which, after a reversal in the 1980-82 recession, was a trend that continued through the rest of the 1980s, especially for high income countries (as shown in Figure 1), including the UK. One element of this rising openness related to the further integration of the UK within the wider European project. Mrs. Thatcher was central to the completion of the European Single Market in 1986. Transforming the European Community into a genuinely integrated market without internal barriers went hand-in-hand with her domestic policy of liberalisation and competition.

![FIGURE 1: Total import and exports (constant US dollars) as a share of output-side real GDP (chained purchasing power parity rates)](image)

1 This is implied by openness based on trade relative to GDP measured at constant PPP prices, see Figure 1. Measured in current prices, trade to GDP ratios show little increase between 1980 and the early 1990s, either in the UK or for high income countries. For reasons to prefer the constant PPP measure, see: F Alcala, & A Ciccone, *Trade and productivity*, Quarterly Journal of Economics, 119(2), 613–646, July 2004.

2 She sent Lord Cockfield to Brussels where he became the principal architect of the Single Market Programme and responsible for its overall design, drafting and execution, as seen in the 1985 White Paper, with the SM launched in January 1993. In a 1988 speech, she celebrated “Action to get rid of the barriers. Action to make it possible for insurance companies to do business throughout the Community. Action to let people practice their trades and professions freely throughout the Community. Action to remove the customs barriers and formalities so that goods can circulate freely and without time-consuming delays. Action to make sure that any company could sell its goods and services without let or hindrance”. Brexiteers who have re-erected these barriers but wrap themselves in the mantle of Mrs. Thatcher, would do well to reread the *speech*, see: Thatcher Archive, Margaret Thatcher Speech opening Single Market Campaign, April 1988.

Asian competition was not yet a major issue in the 1980s as the share of East Asian economies in world trade rose moderately in the 1980s but really took off in the 1990s, and rose consistently after the entry of China into the WTO in 2001.  

Financial openness jumped for richer countries in the early 1980s as capital account liberalisation spread (see Figure 2) with Great Britain an early participant.  

Another useful measure is the ratio of net FDI inflows relative to GDP, which rose globally in the second half of the 1980s and remained on an upward trend (in the UK like most other advanced economies) until the global financial crisis. However, relative to the experience of other OECD countries, the ratio of GDP to net FDI in the UK has been on a declining trend since the 1970s contrary to popular beliefs about how relatively open the UK became to foreign investment. This measure of relative FDI was significantly higher in the period 1970-79 than during 1980-90 and sharply lower in 1993-2020, and lower still if we just look at the post-financial crisis era. 

Because of shifts in technology, the prices of manufactured goods relative to the prices of services have fallen consistently in the second half of the 20th century, inducing households to spend far more on services than on manufactured goods. The increasing share of services both in household budgets and in employment has been reinforced by their higher income elasticity of demand, seen for example, in the low elasticity of demand for food (Engel's Law). 

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4 Though there was a temporary setback in the late 1990s in the Asian financial crisis.  
5 The measure shown in Figure 2 comes from the KOF Swiss Economic Institute and is an index based on a weighted combination primarily of foreign direct investment, portfolio investment, international debt and international income payments, see: S Gygli, F Haelg, N Potrafke, & J Sturm, The KOF Globalisation Index – revisited, The Review of International Organizations, 14(3), 543-574, May 2019.  
6 To see a comprehensive picture of how costs have evolved over time for 66 different technologies, see: J Farmer, & F Lafond, “How predictable is technological progress?” Research Policy, 45 (3), 647-665, April 2016. Costs of hardware of various kinds, and especially of computing and IT have fallen enormously, compared to the costs of food and the costs of many services.  
8 The causes of the productivity differentials are, however, controversial. Observations from: U Witt, & C Gross, “The rise of the “service economy” in the second half of the twentieth century and its energetic contingencies.” Journal of Evolutionary Economics, 30 (2), 231-
Even with these global trends towards de-industrialisation, important differences arose between countries. From 1979 to 1993, de-industrialisation in the UK was substantially more extreme than in other countries. Figure 3 compares the share of employment in industry (defined as mining, plus water and energy utilities, plus manufacturing plus construction) for the UK with a selection of other countries.  

FIGURE 3: The share of employment in industry, the UK compared


It is important to note that the share of manufacturing employment had already fallen substantially by the time Mrs. Thatcher’s government came to power in 1979. But that fall then accelerated: in absolute terms, from 1979 to 1993, employment in manufacturing then fell by 39 per cent. In 2021, the employment share of manufacturing in the UK was 7.8 per cent, under half that in Germany.

Much has been written about this crisis in industrial employment and the concomitant rise in the unemployment rate and why the early 1980s were worse in the UK than in most industrial countries despite common macroeconomic shocks. We turn to these issues in section 3, after considering the economic legacy of the 1970s that faced the newly elected government.

2.2 The legacy of the 1970s

A long run historical perspective on UK growth back to the 1870s is offered by Crafts, though he

246, April 2020, find that there are vast differences in the energy intensity of manufacturing and transport services one the one hand, and non-transport services on the other. They argue that in highly energy-dependent sectors, with rising real wages, an increasing energy/labour ratio has been driving productivity growth while this was not the case in the service sector. The relative energy as well as capital intensity of different sectors will have important implications in achieving a net zero economy in the future.

9 It is noteworthy that the ILO Labour Force Survey data, used for example, by Our World in Data and the World Bank, give a seriously misleading picture for the UK, mainly due to a break in the data between 1983 and 1984, showing a spurious rise in the employment share of industry. One could conclude from these data that the UK experience was very similar to that of the US, France and the Netherlands. However, the data from the UK’s annual survey of employment, from 1978, show a far greater decline.

10 See sectoral employment shares of Figure 12, p.44 in: T Bell, et al., The UK’s decisive decade: The launch report for The Economy 2030 Inquiry, Resolution Foundation and Centre for Economic Performance, May 2021.

11 Figure 3 suggests that alternative policy mixes closer to those pursued by countries such as France and the Netherlands could easily have resulted in the share of employment in UK manufacturing being 3 or more percentage points above the current level.
underemphasises the role of industrial relations.\textsuperscript{12} In contrast to the US experience, where the ‘right to manage’ was always paramount, in the UK craft unions maintained control over their work practices notably in engineering. By the 1960s, shop stewards often controlled semi-skilled workers and assembly lines, constraining productivity. Moreover, UK governments long accepted de facto cartels of producers, and protection in imperial markets, formalised as ‘imperial preference’ in the interwar period.\textsuperscript{13}

At the same time, low skill levels of management had roots in the UK school system. STEM subjects were under-represented in the educational background of managers running industry in the 1970s.\textsuperscript{14} In the state sector, the prevalence of selective education into grammar schools was progressively reduced in the 1960s and 1970s, but neither secondary modern nor the later comprehensive schools were funded well enough or designed to provide the quality vocational training widely available in countries such as Germany and France. Firm-led apprenticeship systems were less well developed in the UK than in Germany, so that average skill levels for UK workers lagged behind. The system of industrial relations developed in Germany after the war was designed to support cooperation and dialogue between workers and management, resulting in far lower levels of restrictive practices, and working days lost through strikes.\textsuperscript{15}

Rising inflation, which became a feature of many industrialised economies in the early 1970s, added greatly to fractious industrial relations. The UK situation was aggravated by the misjudged Barber boom under the Heath government, which further stoked domestic inflation just as the Yom Kippur War in October 1973, OPEC’s oil embargo and subsequent quadrupling of the oil price were about to add fuel to the fire.\textsuperscript{16} As a result, RPI inflation peaked at just under 27 per cent in August 1975.

Most union leaders and many managers had little sense of the realities of the economics of a small open economy like the UK facing international competitive pressures, implicitly believing that government would bail out economic failures and excessive wage demands. The wage-price spiral of the mid-1970s seemed intractable, despite the attempts at controls through incomes policy. In 1976, facing a financial crisis, and needing an external justification to bring public sector borrowing under control, the Chancellor went to the IMF for a loan and then used the IMF conditions to justify domestic spending cuts and tax rises. This marked a shift in fiscal policy away from stabilising the business cycle towards controlling deficits and debt and prefigured the mantra of the Thatcher government. The ignominy of the ‘Winter of Discontent’ from November 1978 to February 1979, when a wave of strikes met the Callaghan government’s attempt to impose an income policy, destroyed Labour’s electoral chances in May 1979.

However, the UK did have one important and growing advantage in the late 1970s over most industrial countries: the development of the North Sea oil and gas industry. Gross oil production as a percentage of GDP rose from zero in 1974 to 2.7 per cent in 1979 and to 7.2 per cent by 1984.\textsuperscript{17} Indeed,

\begin{itemize}
\item \textsuperscript{12} N Crafts, “Adapting Well to New Circumstances? UK Experience in Changing Times”, June 2022.
\item \textsuperscript{14} Science, technology, engineering and mathematics.
\item \textsuperscript{15} Paradoxically, British trade unionists played a key role in the post-war reform of industrial relations in Germany.
\item \textsuperscript{16} By the first quarter of 1973, house prices were rising at an annual rate of 50 per cent, preceded by even higher rates in London, driven by a potent mix of record rises in disposable income, inflation fears and hot money, flowing especially into the London market. See: M Holmes & A Grimes, Is there long-run convergence among regional house prices in the UK? Urban Studies, 45, 1531-1544, July 2008.
\end{itemize}
Harold Wilson observed in 1979 that in the 1970s the two main parties played a ‘macabre game of musical chairs, in the hope of being in possession of the chair when the oil began to flow in quantity.’

3. Key aspects of economic policy in the 80s.

3.1 Macroeconomic policy 1979 to 1983.

Macroeconomic policies have medium-term effects on output, employment and unemployment and potentially permanent effects on capacity by affecting investment, innovation and business failures. The Thatcher government embraced free market forces and de-regulation. Capital controls were eliminated in 1979, followed by the ‘Corset’ – the system of domestic credit controls that had kept credit under check when real interest rates were negative for most of the 1970s. The monetarist belief that inflation was caused by increases in the money supply was embedded in the Medium Term Financial Strategy (MTFS) unveiled in the March 1980 budget. Money supply reduction and spending cuts were no longer targets competing with employment and exchange rate objectives, but elevated to being the primary goal of policy. Letting the pound float freely, and hence rise, given high interest rates, contributed to disinflationary policy.

In the June 1979 budget, VAT rose from 8 per cent to 15 per cent, the largest instantaneous increase in indirect tax rates in UK history. Oil prices had already risen by around 30 percent from 6 months earlier and subsequently rose another 80 percent or so by March 1980. In combination with the VAT rise, this increased the price level by about 6 percent with powerful real wage resistance further fuelling inflation. Moreover, the Bank Rate was raised from 12 per cent in April 1979 and was held at 17 per cent from November 1979 to July 1980. Interest rate rises can be a double-edged instrument when interest costs form part of the RPI as well as the cost base of companies. In the event, RPI inflation reached 20.5 per cent in May 1980, only subsiding to single figures in February 1982. The Bank Rate was reduced to 16 per cent in July 1980, 14 per cent in November 1980 and 12 per cent in March 1981. However, as money growth was overshooting its targets, the Bank Rate was increased again to 15 per cent in the autumn, only very belatedly being reduced to 10 per cent by the end of 1982.

In the controversial March 1981 Budget, fiscal policy was tightened sharply and Box 1 discusses the consequences for output and unemployment. Output remained far below capacity for years to come.

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18 Quoted in R Middleton, ‘There is No Alternative’, or was there? benchmarking the Thatcher years, March 2017.
19 The MTFS consisted in planning reductions in the money supply and public spending and forecasting GDP growth, public receipts and public borrowing four years into the future. Its objectives were “to bring down the rate of inflation and to create conditions for a sustainable growth of output and employment”. It was designed by Nigel Lawson, economic advisor Terry Burns and permanent secretary Peter Middleton.
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and industrial capacity was permanently reduced by the resulting bankruptcies and plant closures. While many less well-run companies failed, the effect on average efficiency of the survivors - the supposed ‘cleansing’ effect of this recession - has been exaggerated.

BOX 1: Tightening fiscal policy in a deep recession: drawing the wrong lessons from the 1981 Budget

The 1981 Budget is sometimes thought of as an example of ‘the expansionary effect of fiscal contraction’, such as Giavazzi and Pagano, who argue that fiscal contractions lower expectations of future tax burdens and of interest rates, stimulating private spending. Defenders of the economic record of the Thatcher governments cite it as a triumph, contrary to the conventional wisdom represented by the famous critical letter from 364 economists.

The 1981 Budget was followed output growth year-on-year of 1.6 per cent to the first quarter of 1982 (after a 3.3 per cent fall to the first quarter of 1981) though the unemployment rate rose from 5.4 per cent in 1979 to 11.8 per cent in 1984, only falling below 10 per cent in 1988. Four facts undermine the argument that it was fiscal tightening that mainly boosted growth.

1. Monetary policy had already loosened somewhat in November 1980 and loosened again in March 1981, though tightened in the autumn before easing in 1982. Thus, some of the cash-flow squeeze on mortgage borrowers had already eased. At the time, Bank Rate was still being driven by broad money growth, itself stubbornly impervious to policy, rather than fiscal policy – very different from the policy environment of 2022, when unfunded tax cuts caused a rise in the broad spectrum of interest rates, including mortgage rates. The belated easing under Thatcher had less to do with the 1981 Budget than with severe recessionary conditions and with the gradual loss of faith in monetarist prescriptions.

2. International commodity prices had just fallen sharply, indeed fell to a post-war low relative to prices of manufactured exports in 1981-2. For primary commodity importing countries (like the UK) this acts like a tax cut boosting real household budgets -- the polar opposite of what is happening in 2022.

3. Domestic financial liberalisation was having dramatic effects on credit availability, especially in domestic mortgage markets, which in turn boosted consumer spending. Aron and Muellbauer estimate that this relaxation of mortgage credit added 1.5 per cent to the ratio of consumption to household income between 1980 and 1983.

4. North Sea oil and gas production was surging. According to Bean, Table 3.2, gross oil production as a percentage of GDP rose from 2.7 percent in 1979 to 6.2 per cent in 1982 and accounted for 1.3 per cent of the 1.8 per cent rise in GDP between 1981 and 1982.

Without these factors the recovery of output could not have begun in 1981.

21 In an estimated model of company liquidations, rises in nominal interest rates, in the real wage and in real raw material prices were the dominant factors driving business failure, with smaller effects from international competitiveness and the fiscal stance, see: S Wadhwani, Inflation, Bankruptcy, Default Premia and the Stock Market, Economic Journal, 96 (381), 120-138, March 1986. A detailed study of the cutlery industry also suggested that the more dynamic and growth-oriented firms, therefore carrying bigger proportionate debt burdens, were more likely to go under in the high interest rate, high exchange rate regime of the early 1980s. See: R Grant, Capacity adjustment and restructuring in the UK cutlery industry 1974-84, NEDO Working Paper 21, December 1985.


A small part of the employment loss in manufacturing was a symptom of ‘Dutch disease’, where the rise in the real exchange rate due to oil and gas discoveries drives a re-allocation away from the economy’s tradeable sector. Simulations by Bean, with the same jump in oil prices in 1980, and the same levels of real government spending and tax rates, suggest that by 1983, North Sea oil had raised the real exchange rate by 12 per cent. North Sea oil did shift employment away from manufacturing (a 1.5 per cent fall) towards services (a 2.8 per cent gain). The estimated ‘Dutch disease’ loss of 1.5 percent of employment in manufacturing needs to be seen in the context of the dramatically larger loss of around 22 per cent between the second quarter of 1979 and the end of 1983.

3.2 Macroeconomic policy 1983 to 1990

As growth returned and receipts from taxation, as well as from privatisations, strengthened the public finances, fiscal policy continued its pro-cyclical bias with tax cuts being introduced in 1986 and extended in subsequent years. This was also a decade of unusually favourable demographic trends with the ratio of the working age population to the total population reaching a record high: post war baby boomers were in prime working age helping boost the underlying fiscal position.

Tax cuts added to the demand-expanding effects of the fall in oil prices, equivalent to a large cut in indirect taxes, and the ongoing credit and house price boom (see below). After the ‘flash-crash’ in the stock market in October 1987, interest rates were cut, adding further fuel to demand. With rising domestic inflation, the overheating of the economy was belatedly acknowledged in 1988. Consumption growth outstripped (high rates of) income growth in 1985 to 1988, accompanied by a sharp deterioration in the current account of the balance of payments. Base rates were hiked dramatically from 7.5 percent in 1988 to 15 percent in 1989 in an attempt to curtail domestic inflation and curb balance of payments deficits. House prices fell from 1991 to 1995 and mortgage arrears and foreclosures rose to all-time records in 1991-92. Given the pressure of high interest rates within the European Exchange Rate Mechanism (ERM), the worsening of the UK’s competitive position due to its higher domestic inflation, and a severe domestic recession, the UK was forced to exit the ERM in September 1992.

3.3 Financial deregulation

As noted earlier, abolition of exchange controls in 1979 was a precondition for domestic financial liberalisation. The removal of the ‘corset’ on bank lending in 1980 led to major entry by the clearing banks into the mortgage market: by 1982 they provided 36 per cent of net mortgage advances. Hire purchase controls on consumer durable purchases were removed in 1982 and the removal of controls on building societies soon followed opening the door to demutualisation. This resulted in some societies taking on higher risk borrowers with adverse credit histories, diversifying into commercial real estate and other business such as estate agency, financial advice, stockbroking, and overseas markets, and increasing funding from wholesale markets with potential maturity mismatch issues.

Further, a new breed of lenders, typically offshoots of foreign banks, acquired a rapidly increasing share of the mortgage market from around 1985. Without a High Street presence, they lent through financial intermediaries who lacked skin in the game, and hence did not have sufficient interest in screening the credit worthiness of their customers. Subsequently, rates of repossessions on mortgages financed this way were three times as high as those from the clearing banks.
In the 1989-93 housing downturn, nine building societies ran into difficulties as a result of increasingly risky activities and were forced to merge into larger entities. This occurred despite the major protection offered by mortgage indemnity insurance, which transferred some of the risk to the insurers, who themselves had to be rescued by a Bank of England lifeboat. In many ways, the 1989-93 episode in the UK was a precursor to the far greater Global Financial Crisis, with patterns of regulatory lapses and distorted incentives repeated. Only one building society, Abbey National, took advantage of demutualisation before the crisis hit. But in later years many followed, though none that did so now remain as independent financial institutions.

Mortgage market deregulation also made housing wealth more accessible. Those with wealth tied up in their houses could now access it via ‘home equity withdrawal’ which became an important macroeconomic phenomenon. More widely, easy access to credit became an important driver of the UK’s low rates of household and national saving.

3.4 The labour market and industrial relations

Thatcher’s primary legacy is widely seen as the radical change in industrial relations and the decline in shop floor union power after a decade of great industrial unrest in both public and private sectors. Her successive administrations passed five pieces of industrial relations legislation outlawing sympathetic strikes, and making unofficial strikes much harder. Out-of-work benefits were made less generous and more tightly administered, while in-work benefits became more generous. Equally, her administration refused subsidies to companies in difficulty (with the sole exception of British Leyland), promoted takeover legislation, and tacitly supported management buyouts and the sales of loss-making subsidiaries. It also denationalised industries under public control and strengthened central control over local government, requiring councils to put service provision from direct labour organisations out to tender, restricting funding by capping Rates, and reducing direct government grants. Against Pym, her first Employment Secretary, Mrs Thatcher refused discussions with both the TUC and the CBI and eliminated or reduced official intervention in wage setting and labour standards via wages councils. De facto, she allowed unemployment to rise to control inflation.

This wide collection of reinforcing ‘Thatcherite’ policies took place in a ‘supportive’ environment, with inefficient UK Fordist manufacturing starting to collapse, reflecting Japanese competition. In addition, global trends in rising demand for private services, as well as the faster productivity growth in manufacturing, reinforced the shift towards a rising share of service sector employment. Both trends further weakened the position of unions.

Two areas were partially exempt from the weakening, and the effect remains today: the NHS and state schools on the one hand; and the transport system, notably the railways (despite being privatised) and London Transport, on the other. But the decline of union power clearly underpinned Thatcher’s agenda for increasing productivity: exposure to market competition, allowing closure of uncompetitive companies, and abjuring job protection (see section 4.2 for discussion of productivity growth).

Thatcher, asked in the 2000s to describe her legacy, answered ‘Tony Blair’. Though aspects of Thatcher’s industrial relations reforms were themselves later amended, the fundamental settlement remained the same through the Labour years.

**Human capital and skills**

The UK performed at a low level in both state education and vocational training in the late 1970s in comparison to other advanced economies, for example Germany or Japan. The school leaving age was 16, and only roughly 40 per cent remained in full-time education after 16. In 1980 not much more than 10 per cent of a cohort graduated from university, 63 per cent of which were men. The apprenticeship system of vocational training – largely geared to industry – was run by skilled workers unions, and was primitive compared to other advanced economies. In addition, and equally important, the level of training of management was very weak. Thatcher responded with a significant emphasis on human capital. This came in several different ways:

**Vocational training:** A plethora of different public-initiated institutional initiatives were tried during the Thatcher period, largely unsuccessfully. There were (and are) obvious problems. First, Thatcher was concerned to minimise public spending, as well as public sector activities, so she turned to the private sector initiatives wherever possible. Second, relatively few UK companies were interested in ‘investing’ in this type of training, the financial ‘Big Bang’ and union weakness having, if anything, increased corporate short-termism. Third, young people viewed these routes as lower status than higher education - the familiar ‘parity of esteem’ problem.

**Higher Education:** Arguably Mrs Thatcher’s biggest impact was in the acceptance and promotion of mass higher education. Between 1980 and 1990, the number of students graduating with first degrees rose from 68,000 to 77,000 (mainly among women) and for higher degrees from 19,000 to 31,000 again with an increase in the share of women. There is no question that higher education expansion was necessary for the developing an information revolution, and the shift from an industrial to a sophisticated service sector society. But it was accompanied by a major reduction in resources per student. And major structural flaws have persisted to the current day: despite tight state control over the higher education system, nothing was done to build a two-year, vocationally-oriented (Tertiary B level) system of integrated colleges, as in almost every other advanced economy; nor was there a serious system of professional business schools as in the US to train managers.

### 3.6 Housing policy

Policies that directly affected the housing market include financial deregulation (already discussed), policies on social housing, land use, property taxation and regulation of rental markets. The 1980 Housing White Paper introduced the right-to-buy (RTB) for council house tenants at discounts ranging from 33 per cent for those resident for 3 years to 50 per cent for those resident for 20 years or more.
Around 2.8 million council and socially rented homes had been sold by 2006, almost half of the stock. Indeed, much of the increase in the rate of owner occupation in the UK from 55 per cent in 1979 to 72 per cent at its peak in 2001 was due to RTB. The lack of replacement of the social housing stock lost to RTB sales, seen in the collapse of new building in social housing, accounts for much of the reduction in overall new housing supply, as private sector home building remained at similar levels to those preceding the Thatcher government.

Inadequate housing supply went alongside a weak approach to land development. Since the 1961 Land Compensation Act, it had become increasingly difficult to use land value capture to enhance land supply and fund infrastructure as under the New Towns Acts of 1946 and 1965. Under Michael Heseltine, there was a last gasp of similar policies using the Development Corporation model—for instance in London Docklands and Merseyside. In 1985 the government abolished the Development Land Tax introduced by the Labour government in 1976 as an (admittedly not very effective) land value capture mechanism.

When it came to property taxation, Mrs. Thatcher’s flagship policy was to replace, against the advice of her chancellor Nigel Lawson, a broadly sensible tax—sensible apart from not having had home revaluations since 1971—with the Community Charge (better known as the Poll Tax). The new tax was introduced in Scotland in 1989 and in England and Wales in 1990. Its deep unpopularity, seen in the Poll Tax riots, ultimately led to the resignation of Mrs. Thatcher in 1990.

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33 Since the early 2000s, rates of owner-occupation have fallen, especially among the young, see Resolution Foundation, Hope to buy: The decline of youth home ownership, December 2021.
35 With extended planning powers, derelict land, acquired cheaply or already in public ownership, was brought into use and private finance leveraged in with small amounts of government subsidy.
As far as regulation of private sector rents is concerned, the 1988 Housing Act abolished rent regulation in England and Wales on new tenancies from 1989, and introduced assured short-hold tenancies. This set the scene for high levels of tenant insecurity within the private rented sector.

4. Impact on economic performance
4.1 Macroeconomic and financial stability

Volatile and pro-cyclical macroeconomic policies led to macroeconomic instability. Comparing the coefficient of variation of the annual growth rate of GDP per head of the UK with countries such as France, Germany, Netherlands, Sweden and South Korea for the period 1979 to 1992, it is clear that volatility was higher in the UK than elsewhere, though even higher still in the US. The latter suggests that common patterns in economic policy under Reagan and Thatcher could be part of the explanation. However, in the period 1970-79 the UK also had the highest coefficient of variation, exceeding even that of the US, no doubt the effect of the excesses of the Barber boom followed by the oil price shock, see Table 1.

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SOURCE: Our World in Data.

The unemployment rate rose from 5.3 per cent in mid-1979 to 12 per cent in early 1984 and remained at over 10 per cent until 1987. Credit market liberalisation drastically raised the degree of leverage households could take on, while Domestic Rates were based on outdated valuations, reducing their stabilising potential. Rather than reform Domestic Rates by switching to recent valuations and embedding regular revaluations, Mrs Thatcher's Poll Tax fiasco temporarily eliminated property taxes altogether, giving property values an extra boost at the height of the boom. The re-introduction in 1993 of a property tax by the Council Tax at the depth of the worst housing recession since before the war is a further, great example of a destabilising policy blunder.

The implications of financial liberalisation and of the 1980s house price and credit boom have been extensively researched. House prices became subject to a speculative frenzy as expectation took hold of further rises to come and residential property amounted to more than half of personal sector wealth. Financial liberalisation allowed households to convert this into consumer expenditure financed by borrowing. Overall, liberalisation of housing finance had important effects on personal wealth, consumption and hence the trade deficit. With such high levels of leverage, many households were vulnerable when interest rates spiked in 1988-89 and rates of mortgage arrears and repossessions reached record levels in the early 1990s. Non-performing loans on lenders' balance sheets led to a tightening of lending conditions, further exacerbating the recession of the early 1990s in which unemployment peaked at 10.7 per cent.
4.2 Productivity, investment and trade performance

Measured by GDP per hour of work, the UK, like France and Germany, narrowed the gap with the US from around 1960 to about 1995 (see Figure 5). But until the early 1980s, the UK had been narrowing the gap with the US much more slowly than was the case for Germany and France. Following the early 1980s, the UK’s gap with the US followed about the same trend up to 2010 as that of France and Germany, a marked improvement in relative performance over preceding decades. However, this change in relative performance needs to be carefully unpacked as it is affected by shifts and differences in industrial structure and by measurement issues.40

FIGURE 5: Comparisons of GDP per hour worked across selected countries (as a percentage of the USA)

SOURCE: Analysis of the Conference Board Total Economy Database.

One key part of the context is that after the slowdown in total factor productivity in 1973-79, the jump in interest rates and the collapse of international competitiveness in 1979-80 led to unobserved scrapping, implying a one-off long-term fall in output per head.41 However, from this reduced base, the subsequent trend from 1981-90 is distinctly higher, even exceeding a little the trend from 1956 to

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40 For example, in the late 1970s and much of the 1980s, UK output per head was flattered by the expansion of North Sea oil and gas output, where output per head is extremely high. As productivity growth tends to be higher for manufacturing than for services, the UK’s low manufacturing share is a disadvantage in international comparisons, as argued by K Coutts, & G Gudgin, The Macroeconomic Impact of Liberal Economic Policies in the UK. Cambridge: Centre for Business Research, University of Cambridge, April 2015. Measurement is a particular issue for the service industries and the government sector, see: A Atkinson, Measurement of UK government output and productivity for the national accounts. Journal of the Statistical and Social Inquiry Society of Ireland, 34, pp.152-60, May 2005.

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1972. This supports the view that the many institutional changes of the 1980s had brought about an improvement in productivity growth.43

Another key issue concerns the UK’s poor investment performance. The UK has long had one of the lowest ratios of investment to GDP in the OECD. Indeed, an OECD study showed that the UK had the lowest business investment ratio of any OECD country in the 1980s and the 1990s, although the level was only slightly lower than the USA.44 Household investment and public investment were also close to the lowest of any OECD nation. However, the record relative to countries such as Germany and France in the years 1950 to 1979 was even worse than after 1980. While there is far from a one-to-one connection between the investment rate and productivity growth, for individual countries, innovation and investment are correlated with each other and tend to be followed by productivity growth.45,46

The performance of the UK's trade deficit is another important consideration. The UK’s share of world trade for all goods and services declined from 6.1 per cent in 1980 to 5.7 per cent in 1991 and 5.5 per cent in 1992. This was the continuation of many decades of a declining trade share and, of course, such shares depend on export growth elsewhere in the world. (However, the increase in the Asian export share did not really take off until the 1990s). For services alone, the UK trade share went from 9.3 per cent in 1980 to 7.6 per cent in 1991 and 7.5 per cent in 1992, despite the much-vaunted growth of the UK service sector. The current account was last in surplus in 1983, and from 1984 has been continuously in deficit, despite the benefit of North Sea oil and gas, with record deficit levels relative to GDP reached in 1988 to 1990 (and more recently, post-Brexit). This hardly points to a stellar supply side performance, at least not relative to domestic demand growth.

4.3 The structure of employment

The 1980s were a period of pronounced change in the sectoral and occupational patterns of employment. To put the decade into a longer-term context, we can draw on previous work that unpicks the joint evolution of the sectoral and occupational structure of employment.47 Eight sectors and three occupational groups are explored and within each ‘top’, ‘middling’ and ‘low’ groups are distinguished.48

The 1980s saw a decline in the share of employment most evident in industry, followed by construction and transport and communications, but in each case, this was part of a long-run trend. The decade also saw rises in employment shares in services - most pronounced for financial

45 Italy, for example, has a relatively high investment rate but poor productivity growth in the last two decades.
46 J Haskel, & K Westlake, “Restarting the Future: How to Fix the Intangible Economy”: Princeton University Press, April 2022, have emphasised the role of investment in intangibles, arguing that the recently lower levels of such investment help explain the growth slowdown.
intermediation, real estate, renting, and business activities - plus public administration. In contrast to the story for private services, the increases in employment shares for education, health and social services mainly occurred only after the mid-1990s.

It is a remarkable fact that in the 1980s the decline in the share of industrial employment was largely confined to the middle occupational group, while there were hardly any compensating rises for this group in the share in the service industries, especially when it came to men. Indeed, the employment shifts of the era played out very differently by gender. From 1980 to 1990, the share of total employment of men in the middle occupational group fell from 35 to 28 per cent. This hollowing out is a long-standing trend that began in the late 1960s, and to different degrees, occurred in all industrial countries. Cristini et al., show that in the 1980s there was no hollowing out of jobs in the middle for women, which only began to occur later.49 Indeed, between 1981 and 1991, overall labour force participation by men fell from 77.8 to 73.3 percent, while that of women rose from 45.5 to 49.9 percent.50

When it comes to real wage growth, the 1980s experienced significantly larger gains (4 per cent annual growth from 1979-1991) than the 1990s, though this was only a slight improvement on the norm across the 1960s and 1970s.51

4.4 Income inequality

The growth of median household income after housing costs was particularly strong in the 1980s.52 However, almost all of the rise in the Gini coefficient of income inequality since the early 1960s occurred over this period, and was particularly pronounced once housing costs are taken into account.

The rise in the Gini coefficient is largely due to a rise in the share of income of the highest income households combined with a general fanning out of the distribution, with the bottom fifth most severely affected, followed by the next two quintiles. Those between the 60th and 80th percentile kept up with average income, but not with the top fifth.

52 See Figure 13 in T Bell et al., The UK's decisive decade: The launch report for The Economy 2030 Inquiry, Resolution Foundation and Centre for Economic Performance, May 2021.
When it comes to the impact of changes in the tax and benefit system on inequality it is clear the 1980s were very much a decade of two halves. From 1979 to 1984, when most of the rise in the unemployment rate occurred, the Gini coefficient for original income rose from 43 to 49 per cent while for post-tax and transfer income it rose only slightly from 29 to 30 per cent. In contrast, from 1984...
to 1990, for original income the Gini rose only from 49 to 51 per cent, while for post-tax and transfer income it grew very significantly from 30 to 40 per cent.

The top of the distribution gained the most from these changes. As a study of the main reforms over the decade concluded: “nearly a half of all the money spent on changes to the tax and benefit system accrued to the richest 10 per cent of the population.”

It was also a bad decade to be poor in the UK. According to the Institute for Fiscal Studies, at the 10th percentile, real household income after housing costs rose by only 3.1 per cent over the 11 year stretch from 1979 to 1990. In contrast, at the 90th percentile, it rose a remarkable 56.1 per cent to 1990. Not surprisingly these trends generated a major increase in child poverty.

4.5 Inequality between places

Over the 1980s various measures of spatial inequality suggested a major growth in gaps between places (see Box 2 for a data discussion).

Underlying this, in part, was the huge concentration in job loss arising from industrial restructuring. In 12 local authorities, over 20 per cent of jobs were lost between 1981 and 1991. These were located in areas where manufacturing was devastated, mainly in the North, the industrial Midlands and Wales, but also including Newham, Barking and Dagenham and Lambeth. In many of these locations, the scars were still visible decades later.

The policy response was inadequate. One option was regeneration assistance to the left behind places but in the 1980s this was never a priority for policy despite various initiatives. Then there was individual choice: individuals in a region with declining job opportunities may have migration options. But housing costs and availability can greatly limit these options. Earnings relative to house prices are one of the drivers of net regional migration defined as inflows minus outflows. For example, in the North, there was substantial net outward migration from 1977 to 1986, but then the rise of house prices relative to earnings in the South and in London greatly reduced the rate.

For lower earners living in social housing, a serious constraint was the availability of affordable housing. With such lower cost housing effectively rationed, moving out risks losing this benefit, with a low chance of getting onto the social housing ladder in a region with better job opportunities. Indeed, the decimation of the stock of such housing in the 1980s, particularly in London and the rest of the South, discussed in section 3.6, reduced these chances further.


56 Data from Institute for Fiscal Studies: Living Standards, Inequality and Poverty Spreadsheet. As for the ONS, data refers to individuals where the equivalized household income is imputed to each individual.

57 G Cameron, J Muellbauer, & A Murphy, “Housing Market Dynamics and Regional Migration in Britain”, CEPR Discussion Paper 5832, August 2006.
BOX 2: Regional inequality widened sharply in the 1980s: why the regional accounts data mislead

In the 1980s, regional inequality rose sharply as measured from regional earnings, unemployment rates, employment rates or from (admittedly noisy) Family Expenditure Survey data. However, ONS data on regional GDP and income from employment in the 1980s seriously understate the rise in regional inequality. This led Geary and Stark, for example, to erroneously claim that there was no change between 1981 and 1991 in the ratio of per capita GDP of the South East (including London) to Great Britain.\(^58\) Cameron and Muellbauer, using the New Earnings Survey, show a doubling of the standard deviation across regions of per capita earnings from 1979 to 1990 or 1991.\(^59\) This compares with virtually no change for ONS regional accounts data on per capita GDP and personal disposable income, and only a slight rise in per capita (pre-tax) income from employment, see Figure 8 below.

FIGURE 8: Standard deviation of income from employment, GDP, personal disposable income and earnings (all log per capita) across Standard Statistical Regions: GB

NOTES: The standard deviation of log income for different measures of earnings, namely, Regional Accounts income from employment per capita, personal disposable income per capita, GDP per capita, and New Earnings Survey per full-time employment.

SOURCE: Analysis of ONS, New Earnings Survey; ONS, Regional Accounts.

Cameron and Muellbauer attributed the error to the ONS failing to allocate 12 per cent of tax records to a specific region. These 12 per cent seem to have been mainly in London and the rest of the South East, leading to underestimating the economic share of this region. The error was gradually reduced so that by 1995 only 1 per cent of tax records could not be regionally attributed. A contributing factor is likely to have been a by-product of the tendency of companies to be headquartered in London and the South East. Reported profits, part of the regional GDP and income calculation, from operations outside London and the South East, will then be miss-attributed to London and the South East. This leads to an overstatement of the level of GDP in London and the South East, but an understatement of widening regional differentials when growth is far lower outside London and the South East.

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5. The legacy of the 1980s: the new facts on the ground

The 1980s were a highly consequential, as well as divisive decade, which changed the facts on the ground and shifted the political economy of the country in ways that we are still living with. In this section we briefly discuss this legacy for five inter-related policy areas: financial regulation and the supply of land; housing policy; saving and investment; spatial inequality; the labour market; and training and higher education policy.

5.1 Financial regulation and the supply of land

In the 1980s, the belief that housing wealth, leveraged with high levels of borrowing, could act as a kind of cash machine with life-changing possibilities became more embedded in British middle-class culture.

While one can argue that international trends in removing exchange controls, freeing up capital movements and encouraging a more market-based financial system, to some degree, forced the hand of government in the 1980s, there were regulatory policy options available.  

One of the unintended legacies of the preference for relatively lax financial regulation, which benefitted the growth of the UK's financial services sector for a long time but undermined global regulatory efforts, is the debt burden the government now carries as a result of its 2008 and 2009 bailout of RBS, HBOS and Lloyds-TSB. Arguably, it has also affected the post-crisis performance of the UK financial sector and its capacity to generate tax revenue. The size of the UK financial sector, encouraged in the Thatcher years, is itself one of the key ‘facts on the ground’ that increased the political power of the City of London. This later made it hard for governments to resist its lobbying power in favour of lax regulation and generous tax treatment (for instance, of capital gains and of hedge funds). Another consequence was toleration of the seamy underbelly of the UK financial and property service sector, abetted by the UK's overseas territories. By making international tax evasion easier, it undermined the ability of governments to cater to the needs of their own citizens.

Moreover, there is an intimate relationship between credit-fuelled property booms, high property prices and diminished productivity growth. This has been confirmed by a spate of recent international studies that point to the crowding out of more productive investment during credit-fuelled real estate booms with negative consequences for sustainable growth. Other evidence for a negative relationship between rising real estate values and productivity can be found in the US, China, Spain and other EU nations (including the UK).

60 All lenders could have been required to apply more cautious mortgage lending criteria, e.g. on loan-to-value, loan-to-income; greater constraints were possible on the building society funding model (e.g. limiting more stringently the access to wholesale markets); and on the type of business building societies were allowed to conduct (e.g. excluding commercial real estate); and on the quality of the information required of potential mortgage applicants.


62 The prize-winning study by K. Müller, & E. Verner, “Credit allocation and macroeconomic fluctuations”, October 2021, examines the sectoral allocation of credit in 116 countries since 1940 and inter alia show that greater credit to non-tradable sectors, including construction and real estate, is associated with a boom-bust pattern in output, similar to household credit booms. Such lending booms also predict elevated financial crisis risk and productivity slowdowns.

Another connection with poor productivity growth comes from the house-building industry itself. The speculative nature of the industry in the UK has promoted high levels of concentration in the industry, which helps explain low build-out rates after planning permission. It also tends to reduce productivity growth for several reasons. The volatility of prices for housing and residential land increases the investment risks for house-builders. The high fraction of land costs in UK house-building means that builders need to take on higher levels of debt, which increases risk. Much of management time is spent trying to acquire land in a time-consuming process involving local authorities and planners, and in debt and risk management by building out slowly. Most of the return from house-building in the UK comes from capital gains on land: providing a quality housing product is not the primary focus of management effort.

Higher land costs in the UK also make it an expensive place to do business, another factor tending to impede investment and hence productivity - unless exchange rate depreciation compensates. The record rise in UK land prices—far greater than the rise in house prices—relative to incomes means that a large fraction of the benefits of growth have accumulated to the owners of land – and to the financial sector, a key enabler. A good deal of entrepreneurship in the economy has been diverted into rent seeking and overcoming land constraints, at a cost to more productive activities.

Around two thirds of land in the UK is owned by fewer than 6,000 individuals. The enormous prices of residential land owe much to the exorbitant privileges given to land owners by the Land Compensation Act of 1961 which prevents land value capture for the benefit of the wider nation. They have made infrastructure investment in the UK, for example in high speed rail, far more expensive and slower to complete than in other European countries. Not only do high land prices impede home building they also result in far too many homes built close to air and noise pollution hotspots where land is less expensive, and in homes that skimp on quality and environmental sustainability to keep down costs. Among major northern European economies, the UK has the highest average commuting times and the least well insulated homes. Distortions in the land market and the tax system explain the sheer waste of time and energy implied by such comparisons. Some of these problems predated the 1980s, of course, but choices made in that decade did much to institutionalise these distortions.

5.2 Housing policy

The collapse of investment in social housing, the selling off of the stock without replacement, the Poll Tax fiasco, and poor financial regulation of the mortgage market were among the key housing blunders of the 1980s. In different ways they have contributed to current levels of social exclusion and poverty, as well to regional and intergenerational inequality.

The overall housing affordability problem most affects those on lower incomes, who have had little rise since the mid-2000s in real income after housing costs. High house prices relative to income – the UK experienced the largest increase since 1970 among G7 countries - generally increase social

Hericourt, & F Tripier, “Real estate booms are behind Europe’s productivity divergence”, CEPR: VoxEU, September 2022.
65 One consequence is the tendency to ‘residualisation’ of the remaining social housing stock to less desirable housing lived in by more marginal households, C Jones, & A Murie, “The right to buy: analysis and evaluation of a housing policy”. Blackwell: Oxford, 2006. At the same time, many poor and vulnerable households live in insecure private rentals, more expensive for local authorities to fund and often poor quality, where they have an obligation to house those otherwise homeless, L Judge, and D Tomlinson, “Home Improvements”, Resolution Foundation Intergenerational Commission Report, April 2018.
exclusion as access to locations with better work opportunities, healthier environments, and better education and transport systems becomes ever more restricted. Since the early 2000s, rates of owner-occupation have fallen, especially among the young.67

This context of high levels of house prices relative to income and still high (even if lower than the recent past) rates of owner-occupation represent major ‘facts on the ground’ creating a powerful political constituency for the status quo that appears to narrow policy options to improve both fairness and efficiency in the UK economy.

One of the policy interventions later governments have been reluctant to reverse concerns property tax. The Council Tax that replaced the Poll Tax perpetuated old errors by remaining anchored to 1991 valuations and by its individual and regionally regressive nature.68 It remains one of the burdens on the left-behind regions and is an important obstacle to improving their performance.

The property tax on housing favoured by the UK government since the 1980s is Stamp Duty. High rates of such transactions taxes impede labour market mobility and the ability of households to make housing choices that suit themselves, as well as benefiting society more widely.69 One example is down-sizing by people of retirement age, which would release housing for younger households. This is discouraged both by high transactions taxes and by the single-person Council-Tax discount. Moreover, the regressivity of the Council Tax encourages the conversion of large properties from multi-occupancy into single family homes for the most affluent. It also encourages new construction of luxury housing relative to housing that would meet wider needs. In short, the cumulative legacy of tax choices made on housing since the 1980s has been harmful to poorer homeowners, disadvantaged regions and younger people, as well as acting as an overall impediment to mobility. Together with restrictions on land supply, it amounts to a major policy failure.

5.3 Low saving and investment, poor infrastructure

The UK has run a current account deficit on the balance of payments ever since 1984, reflecting the low rate of national saving – and investment. This was set in train in the Thatcher years and largely persisted ever since. Policies on financial regulation, property rights, housing, land use, and fiscal rules affecting public investment and privatisation, all underlie the low national rate of saving, which in turn mitigates against public and private investment.

While the US has also run deficits for many years, it has been able to finance them by obtaining far higher returns on its foreign investments than foreigners gained on their US investments. As a result, US entities have retained a high degree of ownership and control over domestic assets. The UK has been rather less successful. In 2016, among major industrial countries, the UK government’s net asset position relative to GDP was the second worst (after Italy).70 Moreover, private debt relative to GDP is amongst the highest, and UK ownership and control over domestic assets has fallen very considerably. Foreign investors own a large fraction of the market capitalisation of the London stock market and foreign investors, including foreign state-owned enterprises, own much of the UK’s infrastructure.

68 Data for England in 2016 from Fairer Share illustrate the dual regressivity of Council Tax. Households in Council Tax band A paid between 0.82 per cent and 0.94 per cent of value in tax, while those in the most expensive properties (band H) paid between 0.0003 per cent and 0.11 per cent of value in tax. Moreover, average Council Tax as fraction of value was 0.77 per cent in the North East and 0.28 per cent in London. See Home Affairs for property tax reform options.
70 IMF Fiscal Monitor, Managing Public Wealth, Table 1.4, page 7, 2018.
While this may mean that these assets are sometimes more efficiently managed, the asset returns accrue to investors and governments abroad, which tends to perpetuate the low national saving rate. Domestic policies, including those affecting wealth and income inequality, are constrained by the need to continue to attract foreign finance to prevent a serious currency depreciation.

5.4. Regional inequality

Much of the 1980s rise in regional inequality discussed earlier remains with the current ‘levelling up’ agenda trying to address the consequences of deindustrialisation and its long-term mismanagement.

Regional dynamics are complex. Thatcher governments emphasised individual ‘get on your bike’ and ‘leave it to the market’ options. But housing constraints in prosperous regions made that hard except for the more affluent and better educated. The migration of these groups tended to weaken the skill base of the left-behind locations, making it even harder to achieve economies of agglomeration in new types of jobs, reinforcing a cumulative process of decline. Cutting the central government support grant to local authorities in the 1980s, and again in the post crisis austerity era, further disadvantaged left-behind places.

The UK’s dysfunctional housing market tends to accentuate cumulative processes widening regional inequalities. In theory, rises in land prices in growth hotspots should deter inward migration and growth at those hotspots, acting as an automatic dampener of widening regional inequality. However, many potential migrants to the hotspots will keep coming in anticipation of further capital gains, and residents sitting on large capital gains will postpone moving to cheaper locations to cash in those gains. Moreover, in the UK, more than in most of continental Europe, rising property prices result in higher spending. These mechanisms tend to extend relative upswings of population and economic growth in UK hotspots, widening regional inequalities.

Even if one argues that because of economies of agglomeration, there is less to be gained from regeneration subsidies scattered over a wide range of locations, the major Liverpool-Manchester-Leeds conurbation could have been turned into a ‘northern powerhouse’ with an appropriate policy mix, including land value capture. With improved transport infrastructure, this could have been a major regional attractor for many communities in the area. This was – and still is – an opportunity missed.

5.5 The labour market legacy

Some of the reforms of the industrial relations system under Thatcher, though controversial and sometimes overly aggressive, were necessary, and subsequent Labour governments did not attempt a comprehensive reversal. Combined with diminished job protection and lower replacement rates for unemployment benefits, they created a flexible labour market with the balance of power shifted to employers, and greater wage inequality. These reforms had their costs but arguably put the UK on a path to sustaining high employment levels and established the model we now have of wages (and hours) rather than unemployment tending to take more of the strain from adjustment. However, this

71 Early migration research ignoring the role of housing had shown remarkably small effects of earnings and unemployment differentials on migration in the UK. However, when the effect of housing cost differentials and expectations of relative house price appreciation were included, relative unemployment rates and real earnings became far more relevant for migration, G Cameron, J Muellbauer, & A Murphy, “Housing Market Dynamics and Regional Migration in Britain”, CEPR Discussion Paper 5832, August 2006.
72 See section 3.3 on how deregulation promoted home equity withdrawal and 5.3 on the use of housing collateral for access to credit by small businesses.
73 Though as mentioned in section 3.6, the Merseyside Development Corporation, launched in 1981, was a small step in this direction, but far from the scale needed.
strategy is one of the reasons the UK has such a large swathe of low-wage, low-skill, low-progression service-sector employment, often with poor labour standards. Very little was done in the 1980s to mitigate against this.

One of the other reasons, and a fundamental failure of the whole period, was the lack of an effective education and training system to complement the new flexibility of the labour market. To remedy this, the term ‘apprenticeship’ has been much bandied about especially in the last decade; it has appealed to Conservative governments as a cheap route to training, subsidising employers to employ low cost labour. It works in countries where long-term employers need skilled workers and are prepared to train them seriously (as in Germany or Switzerland), though now, even there, employers are switching to hiring from second level university systems, given the need for deeper ICT and management skills. Indeed, in nearly all advanced economies – apart from the UK – there are increasingly important ‘Tertiary B’ college systems: a comprehensive Tertiary B system is needed in the UK.

5.6 Higher education and innovation

The UK’s transition to a knowledge-based service economy has, in important respects, been aided by the rapid growth of higher education which itself was spurred on by decisions taken in the 1980s. But contemporary impediments to expanding the role that the university sector could be playing in our knowledge-based economy can also be traced back to that decade.

To see why, recall that (i) the UK has an exceptionally high proportion of laggard companies; (ii) the UK lags in productivity growth and innovation; and (iii) the quality of UK-trained management is low. 74

If our leading sectors are going to be increasingly in knowledge-intensive services (including health, caring and education), then a clear implication is that the participation rate in university education needs to grow over time.

But a barrier to the necessary expansion lies in the education and research structure of UK universities. Thatcher-era reforms encouraged universities to compete for students, to choose what degrees to market to them, and then offered sharply diminished resources to teach them. This has been subsequently augmented (under various governments) by monitoring of both (academic) research and student satisfaction. Overall, UK universities teach via highly specialised disciplines, and produce competitive students with very limited, if any, management skills, and software understanding mainly by accident.

This trajectory differs in five key ways from that of US universities, particularly higher-level ones. US universities are largely autonomous as far as Federal (and substantially state) control is concerned; they have substantial endowments; they tacitly compete by promoting newer areas (notably bio-genetics and IT) with close links to start-ups; undergraduates experience multi-disciplinary education in their first two years - and requirements generally include quantitative as well humanities and social sciences - before specialisation occurs; and lastly, professional schools are central to developing management, leadership and social skills in business, public policy, law, medicine, IT and engineering.

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Taken together this means that leading US universities play a much more central role in generating the human capital needed across a range of service sectors and tend to be more embedded in their metropolitan innovation systems.

This legacy problem in higher education also relates to innovation policy. Thatcher failed in two ways, just as did Blair and Brown and subsequent Conservative governments. First, there was no real strategy for promoting innovation or diffusion: the comparison with the US is glaring. And second, despite Heseltine’s efforts, no coherent development strategies were worked out for the ex-industrial areas, especially in the North. In both cases, Thatcher believed in the power of market competition.

One can ask why the dysfunctional legacy of the Thatcher period in areas of financial regulation, land use, housing policy, taxation and skills has persisted. In other words, why did subsequent governments not exercise more agency? A full answer would extend well beyond this essay. But some of the reasons were alluded to in Section 5. One of them is Thatcher’s success in creating a ‘property-owning democracy’, which aligned more of the electorate’s interests with those of land-owners, as expressed in NIMBYism and resistance to tax reform. Other factors include shifts in political economy arising from the larger footprint of the financial sector and associated business services and hence the enhanced lobbying power of the City.75

6. Lessons for the future

One of the conclusions of the evaluation of 1980s macroeconomic policy by Allsopp et al., has a haunting contemporary relevance after the fleeting experiment with Trussonomics in 2022: “It is to be hoped that the simplistic use of economic models to justify ideological positions and wishful thinking—which seems a not unfair characterization of at least some of the policy-making process of the early 1980s—will never be repeated”.76

Though financial regulation improved after the global financial crisis and banks are better capitalised, the high levels of house prices together with household debt are once more a major source of vulnerability for the UK in the face of rising mortgage interest rates and falls in real income, just as they were at the end of the 1980s. Outsourcing these issues to the Bank of England when holistic, cross government policies are required, was – and still is – a major failure of the UK’s political class.

The current economic crisis is hurting the poor and those in the left-behind places the most. The failure to respond to the huge structural changes of the 1980s with appropriate cross-departmental spatial policies is turning old scars into fresh wounds.

Looking across vital areas of policy that will, or should, shape much of government response to the shocks of the 2020s – skills and human capital, housing and land policy, and investment and fiscal rules – there are clear lessons to learn from the experience of forty years ago and its aftermath.

The comparative advantage of the UK economy lies rather clearly in high value-added knowledge- and increasingly software-intensive services; these are both in the private sector, but also very much in health and education. This implies a high-skill future in which higher levels skills and a university education become more and more important.

75 Other political economy factors highlighted by some authors include the privatisation of many public services and the resort to PFI, A. Offer, Understanding the Public-Private Divide, Cambridge: Cambridge University Press, 2022, ch. 3.
Yet, as discussed, UK universities, for all their quality, fail to provide the right pattern of skills. Rectifying this means tackling a legacy of the 1980s. For these knowledge sectors this requires relational work, in particular the growing capacity for horizontal working groups to combine creatives, IT engineers, and flexible managers, together with strong social, emotional and networking skills. In contrast to good American universities, with their multidisciplinary undergraduate requirements, and the huge strength of their professional skills, UK universities produce competitive students with narrow disciplinary degrees. We suffer from low-level management in the contemporary knowledge-economy environment. Major changes in our universities – not least the most elite – are required if we are to begin to match the role which top American universities play.

UK higher education has also critically failed to develop a comprehensive Tertiary B system, with close qualification-based links to careers with ‘signed-up’ employers. This would be highly effective in developing qualifications in the public sector for different specialist occupations across health and care services, as well as education, by including relevant IT, management, technical and social skills. Such a system provides bridges from school into careers. It can play a major role in levelling-up, with colleges located outside major cities, hence with low housing and travel costs. And its qualifications can then lead to shortened university degrees.

With the new economic priorities of achieving net zero carbon emissions and reducing dependence on Russian and Chinese supply chains, it is clear that green industrial strategies need an urgent boost – all the more so due to the potential to boost intermediate level roles and in the immense synergy that exists with regional levelling up. For carbon capture, utilisation and storage, County Durham and South Wales are the premier locations, given existing or previous extractive industries. For offshore wind, the port of Blyth, and Hull and the nearby coast, and the coast near Aberdeen have ongoing developments. Floating off-shore wind projects are in the planning stage for the Shetlands and the Cromarty and Moray Firth. A tidal energy scheme off the coast of Anglesey and a tidal lagoon in Swansea are among recently approved projects, while the North Wales Tidal Lagoon from Llandudno to Prestatyn has great potential. Electric vehicles in Sunderland, batteries in Coventry and hydrogen in the Tees Valley and in Orkney are other green industrial developments all hold great promise. A 1980s policy of ‘leave it all to the market’ would be a grievous error. The climate crisis is the most serious market failure of all time since the damage to the planet is not priced by fossil fuel users and market short-termism leads to wrong investment choices. Alternative energy technologies are already cheaper than fossil fuels in many applications and will become cheaper across almost all applications in the years to come. If we accelerate the transition, they will become cheaper faster, resulting in a virtuous cycle whereby the net zero agenda boosts living standards rather being seen as a cost.

Policies on financial regulation, land use and property taxation set in the 1980s have cast a long shadow over the UK economy. The damage from the global financial crisis and the government debt burden incurred by bailing out the major banks is closely connected with lax financial regulation in the UK. A comprehensive reform programme to address these problems is urgently needed. A starting point is a primary fiscal rule that focuses on the net asset position of the government rather than the deficit.

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77 The Tees Valley currently produces half of the commercially available H2 in the UK, and BP announced the UK’s largest H2 project in Teesside, with the intention to develop an industrial hydrogen cluster. The North East region has great potential for reversing its earlier industrial decline. We are grateful to Nick Stern for pointers to these synergies.

78 R Way, M Ives, P Mealy and J Farmer, Empirically grounded technology forecasts and the energy transition, Joule 6, 1–26, 13 Sept 2022

than on gross debt. Together with the repeal of the 1961 Land Compensation Act, this is essential to empower land value capture to fund infrastructure and affordable housing and help relax constraints on economic activity.\footnote{While acquiring land banks for the public domain at prices below those with full development rights adds to gross debt, they improve the net asset position after revaluation with development rights. This planning gain then accrues to society and not primarily to land owners.} The contrast in land supply between Germany and the UK is a factor in the relative economic success of Southern Germany: there, public authorities have ensured adequate land supplies for development, which in turn has helped to achieve economies of agglomeration and transfer of advanced technologies. The UK, belatedly, needs to follow suit.

The replacement of unfair Council Tax with fair, current land-value based property taxes with green discounts for low carbon buildings and gardens, would put right one of the most iniquitous legacies of the 1980s and 1990s. Taxing land has the least distorting effect on economic activity and such taxes reduce social exclusion, intergenerational injustice, regional inequality and financial instability.

Finally, while the European Single Market and university expansion are to the credit of Thatcher governments, the chosen form of Brexit has resulted in new barriers that Mrs Thatcher had been so keen to remove, while UK universities face new handicaps, especially in science. Damage limitation should be a high priority.

It has become increasingly clear that UK economic performance is stuck in a rut, lagging behind other major economies, with serious social consequences. Many of the causes are part of the legacy of the 1980s. A concerted and holistic policy programme across the many dimensions we have highlighted could lift UK performance onto a new long-term path to the benefit of the economy and society more widely.
Navigating economic change: lessons from abroad and history

As the UK is buffeted by the economic shocks and challenges of the 2020s, The Economy 2030 Inquiry, a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics (LSE), funded by the Nuffield Foundation, is publishing a series of essays examining how policy makers from a range of advanced economies, including the UK in the recent past, have managed periods of disruptive economic change. As we seek to reformulate the UK’s economic strategy for new times it is vital that we learn the lessons of these comparative and historic perspectives.

Some consider the trajectory of a national economy following a major shock – for instance, Germany after unification, New Zealand after the UK joined the European Community, Estonia post-USSR and the UK during the tumultuous 1980s. Others examine the experience of particular cities – for instance a group of post-industrial ‘turn-around cities’ - or the adjustment of key features of a national economic system, such as Danish ‘flexicurity’. Together they offer a powerful and timely set of insights on the successes and failures of economic policy makers in the face of economic shocks and structural change.

The essays are written by a range of leading economists and national experts and reflect the views of the authors rather than those of the Resolution Foundation, the LSE or The Economy 2030 Inquiry.

They have been commissioned and edited by Gavin Kelly (Chair of the Resolution Foundation and member of the Economy 2030 steering group) and Richard Davies (Professor at University of Bristol and fellow at the LSE's Centre for Economic Performance).