Boom and gloom

Labour's changes to financial regulation were to blame for the post-2008 economic crisis in the UK, argues **John Redwood**

The City – with its banks, financial service businesses, legal and consultancy firms and a range of businesses serving the needs of industry and commerce – is a crucial contributor to the UK economy. It creates a large number of jobs, generates substantial activity and pays a lot of tax.

The growth of the Square Mile took off following the liberalisation of crucial City markets in the 1980s. The old cartel of stockbrokers and jobbers was pushed aside, allowing many major multinational banks and financial service businesses to locate here, expand and compete. They brought in new talent and plenty of new capital.

The London markets soon became the largest in Europe, and in some fields like foreign exchange and shares traded outside their home territory they became the biggest in the world, including New York. The UK prospered on the back of this.

In 1997, the incoming Labour government decided to change the way the City was regulated. They took most of banking regulation away from the Bank of England and gave it to the newly created Financial Services Authority (FSA). They set up a tripartite regime of the Treasury, the FSA and the Bank of England to regulate the banks, which turned out to be a disaster for London and the UK economy. No one felt in charge of commercial banking regulation.

The FSA allowed the large commercial banks to expand massively, lending too much and making large, ill-judged acquisitions in the case of RBS. They allowed the prudential rules of the old banking regime of the 1980s to be relaxed, permitting banks to lend many more times the cash and capital they had at their disposal.

Those of us who warned against this were told we were out of date. According to Labour's regulators, the commercial banks and larger markets were able to handle risk better than before, so would be fine operating with such slender capital and reserves.

In 2008-09 the regulators and government decided they had gone too far in allowing the overexpansion of lending. They had inflated asset prices, especially property, too far. They reversed the policy dangerously, bringing about a collapse. Banks struggled for liquidity. People withdrew deposits from weak banks. Property values crashed, only to undermine many of the loans the banks had extended.

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Labour's boom and bust soon spread from the City to the rest of the economy, scything through living standards and pushing many people out of work. Most commentators now criticise Labour's regulators for allowing an insufficiently tough regime prior to 2008. Few criticise arguably the bigger mistake of bringing the whole structure down too rapidly when they switched policy in 2008.

It has taken a long time to mend the banks after such a rollercoaster ride from the regulators in the previous decade. The Bank of England is back in charge. Let us hope it is a better judge of the cycle than the FSA. Let us hope it finds that Goldilocks balance, where banking regulation allows banks to extend enough credit to keep the economy growing, but not so much that the stability of the economy is threatened again.

John Redwood is Conservative MP for Wokingham