# The City of London

RANALD C. MICHIE

# THE CITY OF LONDON

*Also by Ranald C. Michie*

MONEY, MANIA AND MARKETS: Investment, Company Formation and the Stock Exchange in Nineteenth-Century Scotland

THE LONDON AND NEW YORK STOCK EXCHANGES, 1850–1914

# The City of London

## Continuity and Change, 1850 – 1990

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To my wife, Dinah Ann Michie
and to our son, Alexander Uisdean Michie

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# Preface

A financial centre of world importance does not happen just by chance.

The Queen, Speech to mark the 800th Anniversary of London's mayoralty, 8 February 1989

History is relevant. We cannot understand an institution unless we know something of the circumstances of its origin, and, even if those circumstances have changed, we are still liable to be influenced by ideas formed under their influence.

Sir Henry Clay, 'The Sterling Area' in Institute of Bankers, *Current Financial Problems and the City of London*, London 1949, p. 210

The aim of this book is to present a long-term perspective on the City of London, seeking to examine, explain and evaluate the combination of trends and circumstances that have made it what it is today. Within this, events of recent interest, like the Big Bang, the crash of October 1987, the JMB affair or the Guinness scandal, pale into insignificance in comparison with the transformation of the world economy or the altered role of government. History is not simply the collection of yesterday's news, but an attempt to use hindsight to focus upon what has turned out to be important. The past can be seen as a giant battleground over which a war is being forever waged, as the conflicting groups of each generation seek to justify the world they want by citing their version of historical precedent. Few debates involving politicians, commentators or the public do not contain references to these past precedents, which are then used for or against a particular viewpoint.[1]

To win or lose the historical debate may have no immediate consequence, but in the long run it creates attitudes and establishes opinions which, in a democracy, translate eventually into votes, policies and actions. It would be a pity if the future to be aimed at was based on such a poor understanding of the past that the policies implemented to achieve that end acted to prevent its happening. Unfortunately, among those with power in Britain, such as Members of Parliament, there is no evidence that more than a tiny minority have any knowledge of the detailed workings of the City, let alone its

historical development. However, it is from that position of ignorance that the legislative programme stems under which the City of London has to operate. The City of London, by reason of its very scale and complexity, and the degree to which it has changed over the last hundred years, defies easy generalisation. It is no simple matter to explain what the City of London actually does, how it does it and why it does it. Most of those working in the City itself do not seem to know! Consequently, this book will have achieved its object if it contributes to a more informed discussion on the City among those who are interested in both its present and its future. Those in the City have certainly done little to convince the public at large that what they do has ever been of value.[2]

The material upon which this book is based was read largely in the Guildhall Library in London. Without its collections, and the staff that assemble and maintain them, it would be impossible to write a worthwhile book on such a diverse topic as the City of London. The City should feel proud of the library/archive service made available, at no cost, to the scholar and should encourage its greater use by those who, genuinely, want to understand the City better.

The other great source of material is the British Library of Economic and Political Science, for its collections in the economic/financial/commercial fields usefully supplement the more specialised holdings of the Guildhall Library. As usual, I relied on the University of Durham for the time and money to conduct the necessary research in London, as well as the long vacations and research leave required to write it up.

Much of the structure and content of this book was tried out first on my students at Durham who took the Special Subject on the City of London. They were brave to venture into such an untried area of historical scholarship and I hope their understanding has profited them in their subsequent careers, including a number in the City. Perhaps a course on the modern history of the City should be compulsory for all who work in it, or seek to reform it!

Among academic colleagues, I benefited from the advice of Avner Offer (at York) and Michael Thompson (at the Institute of Historical Research) who both read the first draft of the book and encouraged me to complete it. Peter Wardley and Philip Ollerenshaw, at Bristol Polytechnic, also engaged in discussion. Within Durham, Philip Williamson helped me to understand the political world within which the City operated. Needless to say the faults that remain are my own – I am only too aware of the unread material in the Guildhall Library

and the need for a more sophisticated technical knowledge of the complexities of City operations.

Finally, I would like to thank my wife for her support – and her editorial and keyboard skills – and I do not blame my son, born in December 1989, for the delays he caused to the final production of this book.

RANALD C. MICHIE

# Introduction: Comment and Criticism

> As far as I can say without searching the Newgate Calendar, the man Bickersdyke's career seems to have been as follows. He was at school with my pater, went into the City, raked in a certain amount of doubloons – probably dishonestly – and is now a sort of Captain of Industry, manager of some bank or other, and about to stand for Parliament.
>
> On his side, it must be admitted that Mike was something out of the common run of bank clerks. The whole system of banking was a horrid mystery to him. He did not understand why things were done, or how the various departments depended on and dovetailed into one another. Each department seemed to him something separate and distinct. Why they were all in the same building at all he never really gathered. He knew that it could not be purely from motives of sociability, in order that the clerks might have each other's company during slack spells. That much he suspected, but beyond that he was vague.
>
> P.G. Wodehouse, *Psmith in the City*, London 1910, pp. 11, 128

These two extracts from P.G. Wodehouse's book, based on his time in the Hong Kong and Shanghai Bank's London office, probably summarise the general view of the City of London – a place where money and influence were acquired but with no comprehension of why, how and with what implications.[1] Novelists have found it easy to use the City as an explanation of where fortunes were quickly made or lost, while events in the City, like booms, panics, crashes, manias and frauds, provided dramatic backgrounds for such stories as Anthony Trollope's *The Way We Live Now* (1873), H.G. Wells' *Tono-Bungay* (1909), J.B. Priestley's *Angel Pavement* (1930) and Margaret Drabble's *The Ice Age* (1974). In none of the fictional literature that touches on the City of London is there any sign that the authors had much comprehension of how the City regularly conducted its affairs. The City, like the rest of British business, was not an area of serious literary study, rather an occasional arena for exploring personal relationships or the nature of contemporary

society. The consequence for the City of London is that the public has been presented with a one-sided view which stresses the untypical and episodic, and ignores the normal and routine. It is not just the novels of the past which follow this practice but current popular media, such as plays, films and television. Also the City and Wall Street have become increasingly interchangeable, with each characterised by greed and dishonesty so that it is not necessarily events in London that provide the factual basis for the fictional characterisation. As such, much of what the public knew, and knows, about the City at any time is and has been culled from fictional accounts of sensational events and revelations concerning malpractice.[2]

What interest there has been in the City among serious scholars has generated two types of study. Firstly, there has been a succession of histories of various City institutions, like the Bank of England, Lloyds, the Stock Exchange and the Baltic Exchange, and of individual businesses such as banks, insurance companies, stock and insurance brokers, and legal and accountancy firms. These give detailed accounts of the historical development of various businesses or sectors of the City, but do not generate any comprehensive overview of the City as a single unit. Secondly, there have been contemporary accounts which try to give the reader a general impression of the City of London at the time of writing. Naturally they are concerned with the interests of the moment and lack any historical perspective or insight. What is completely absent is any detailed work covering the development of the modern City of London as a single entity.[3]

The problem was, and is, that those who possessed an intimate knowledge of the City rarely had the time or inclination to make that knowledge available to a wider public, or if they did it was very much an insider's viewpoint. Conversely, those who had the time and desire rarely possessed the knowledge.[4] Academic historians, for example, have exhibited little enthusiasm for, or expertise in, financial and commercial matters unless encouraged in that direction by the payment that accompanies a commissioned history of a specific firm.

Generally, the public perception of the City has changed little over the last one hundred years, and it was never a favourable one. E.A. Vizetelly, writing in 1894, a time of active speculation and company promotion which included a number of fraudulent activities, complained that:

> We are overrun with rotten limited liability companies, flooded with swindling 'bucket shops', crashes and collapses rain upon us,

> and the 'promoter' and the 'guinea-pig' still and ever enjoy impunity.[5]

In a similar view, Richard Lambert could summarise for the readers of the *Financial Times* the popular image of the City in 1987, again after a series of scandals. He felt that the City was seen as:

> a self-interested, class ridden oligarchy, which exerts enormous and more or less uncontrolled influence over Government and which is layered through and through with dishonesty.[6]

This image certainly comes across in much of the current writing on the City.[7]

In the nineteenth century, this distorted perception was of little consequence because it was never translated into actions through government legislation serious enough to affect the City. The scandals of the 1870s, for example, did lead to two public enquiries but neither resulted in any significant changes being imposed on the City. Governments were largely non-interventionist and were disinclined to legislate unless forced to do so by constant pressure, and that was largely absent. This mood began to change in the 1920s with the difficulties encountered in adjusting to the consequences of the First World War. Serious shortcomings were felt to exist in the City's response to the needs of the economy owing to the commitment of the City to an international role. For example, the Royal Commission into Finance and Industry, which reported in 1931, accused the City of neglecting the finance of small business – the 'Macmillan Gap'.[8]

Though there continued to be a pride in the City's international significance, the world depression of the 1930s, when countries turned in upon themselves, undermined the importance of that role. Increasingly, the City was being judged upon its direct contribution to the domestic economy not on the work it did to facilitate international exchange and specialisation, and the indirect consequences of that for Britain. This highlighted areas of the economy with which the City was little involved, and led to a questioning of whether the City's priorities were identical with those of the country as a whole. A general feeling developed that the City could not be left completely free both to make its own judgements about competing demands and to police its own operations. Only some kind of state involvement would ensure that the interests of the public at large would be catered

for by the City.[9] In the 1930s, the Labour Party went so far as to suggest that a National Investment Board should be established that would supplant many of the functions of the City by directing finance as determined by the national interest, rather than leaving the process to the interplay of the markets, institutions and firms.[10] Nevertheless, nothing really emerged from these murmurings of discontent before the Second World War intervened.

From being little more than a sense of unease, combined with dissatisfaction in particular areas, the criticisms of the City became more widespread and serious after the Second World War. Most of the functions of the City had been suspended between 1939 and 1945, and the public had become used to a more regulatory and centrally directed regime in its place, though operating under wartime conditions. At the same time, the government that came to power in 1945 was an avowedly interventionist one and represented a political party which had been hostile to the City in the 1930s, namely the Labour Party. The transfer of the Bank of England to public ownership and the formation of the Industrial and Commercial Finance Corporation (1945), along with the establishment of nationalised industries and state boards, all reflected a belief that the government and its agencies could perform certain activities better than the markets and that the operations of the City needed to be, at the very least, supplemented by central direction if not entirely replaced by publicly appointed bodies. Although the Labour Party lost power in 1951, and the Conservative Government slowly began to de-regulate the markets in the 1950s, much of the new apparatus of intervention and control remained intact. The public's faith in the judgements of the City, which had never been strong, had been largely destroyed by two world wars and a world depression. State control and/or state management offered a safer alternative.[11] Even in 1973 a report by the Inter-Bank Research Organisation, noted that:

> It is a fact that many people in the country doubt if the City is making a good enough contribution to the economy as a whole. The City is not generally well regarded by industry, by educated and professional people, or by the populace at large. Even in the City itself sober people say privately that some of our financial institutions are sluggish and complacent and in certain cases overpaid.[12]

When the Labour Party returned to power in both the 1960s and 1970s one of their first measures was to create further state bodies to

supplement or replace the work being done in the City. The Industrial Reorganisation Corporation (1966) and the National Enterprise Board (1975) were both formed to regenerate the economy by providing the finance and active intervention of which City institutions and firms appeared to be incapable. As the National Enterprise Board itself stated in 1977: 'The decision to set up the NEB rested on the assumption that there was a need to supplement existing sources of finance for industry.'[13]

It is only since 1979, with the abolition of such bodies as the NEB, the ending of exchange controls and the privatisation of nationalised industries, that the discipline of the market has again come more to the fore in government policy. As a result the markets of the City of London have regained some of the importance they once possessed but they have not yet convinced the public of their worth.

Obviously the Labour Party remains most damning in its attack, seeing little role for the services provided by the City in an economy where a National Investment Bank would have prime responsibility for directing resources. A report presented in 1982 expressed the view that:

> The sophistication of the City lies in its facilities for speculating in commodities and currencies, for gambling on the movement of share prices, for channelling money overseas, and for circulating a vast array of secondary securities.[14]

Accompanying this traditional Labour Party perspective and suggested remedy was a growing belief in the 1980s that the City was not simply a diversion from the 'real' economy but represented a positively harmful impediment to long-run economic growth. In the same report they suggested that:

> there is substantial evidence that the poor performance of UK industry is due in part to the dominance of financial interests over policy making . . . A strategy for economic recovery must entail a challenge to the power of the City.[15]

While the degree of criticism was not shared on the other side of the political divide, many in the business community continued to feel that their interests and those of the City were not always the same, and they were losing out as a result. Sir Clive Sinclair, a pioneer of the consumer electronics industry, questioned in 1985

whether 'it is possible to become a world leader from a British base when the City is so reluctant to give the necessary support'.[16] In this he was voicing the views of many of his fellow industrialists, who saw the City being interested only in short-term financial gains while their businesses required a strategy of long-term planning and investment. Pressure from members eventually resulted in the CBI setting up their own commission of enquiry in 1987 to investigate business/City links. This found no evidence to suggest that attitudes in the City had contributed to the long-run decline of manufacturing industry, but they also concluded that neither could the City be credited with assisting any recovery in that sector. Hence the uneasy relationship between the two branches of business continues. In 1990, the City was even blamed for the poor design of British manufactured products.[17] Even in the City itself many were not sure what their role was, in the face of the criticism which blamed them for many of the economic difficulties that beset the British economy.[18]

The verdict of historians has been equally unkind. Though none have sought to investigate the City of London directly, those whose researches have touched upon it tend towards the view that the City did make a major contribution to Britain's slow economic decline from about 1870 onwards. The City's commitment to an open international economy, free of exchange controls and barriers to the movement of goods, capital and labour is now thought by many not to have been in the best interests of the British economy. That would have been better served by a greater degree of government direction and planning at home and restrictions abroad. Economic historians have drawn a distinction between provincially directed finance, which went into local industrial developments so as to provide a continuity of growth, innovation and employment, and City-controlled finance which siphoned money away into exotic overseas adventures, property, utilities and government deficits. As the City came to dominate the utilisation of savings, whatever their origins, manufacturing industry saw itself deprived of the funds required for re-investment in existing plant or for new ventures, such as motor vehicles, electrical goods and chemicals.[19]

> the operations of British capital markets played a central role in first creating, and then maintaining an industrial structure capable of only limited growth

is Kennedy's recent assessment of the pre–1914 position.[20] Even though foreign investment tended to fade after 1914 until its rapid

growth in the 1980s, the perceived reluctance to invest in British industry remained. In particular the City-based banks were felt to be overly conservative in their attitude towards industrial finance, failing to provide the funds and the managerial support necessary to foster new enterprise, which were available in other European countries.[21]

Social historians have added support to this viewpoint by stressing the long-standing division between an industrial/entrepreneurial/provincial culture and a landed/financial/commercial/Home Counties culture. The former was a product of the Industrial Revolution and was strongest in the North, while the latter was of much greater antiquity and centered on London. From the second half of the nineteenth century onwards, the new industrial culture gradually lost its separate identity, being absorbed into the more dominant mercantile strain through common schooling and inter-marriage, with the result that Britain lost the dynamic element that had pioneered its early economic development.[22] Ingham sees the roots of Britain's economic decline in this social division or 'Capitalism Divided', in which the City came to dominate society, and through that the economy. The result was that the City's cosmopolitan composition and international orientation prevailed over the more British-based and interventionist-minded attitude of the industrial North, irrevocably altering the nature of the British economy. Ingham's view was that:

> Britain's movement towards modern mass production industry was impeded by the structure of the domestic financial system. This was not simply a matter of the export of capital, but also the absence of any close institutional links between finance and industry.[23]

Finally, in the arena of political history the same divide between the City and the rest of the country has been observed, with similarly damaging results for the economy. Both Newton and Porter, and Boyce have noted the ability of the City to influence the government of the day, whatever its political complexion, so that policies beneficial to its continuing role as an international financial centre were maintained. In contrast, due to a lack of unity of purpose, the rival industrial grouping generally failed to persuade governments to pass the legislation they required, and so their position in the economy was gradually undermined. It was only briefly during the First World War, and again in the 1940s with the Second World War and the following Labour Government, that the City lost its power over

the government. However, that era came to an end in 1951 and, despite the election of Labour governments since, the economy was run to suit the interests of the City and to the disadvantage of industry.[24] Newton and Porter, for example, conclude that by the 1980s:

> Taken together the expansion of overseas investment and the growing volume of foreign currency business transacted in London was testimony to the City's increasing detachment from the fate of the productive economy in Britain. It did indeed take the form of an offshore island, handling vast amounts of money as industry declined.[25]

As such the City of the 1980s had returned completely to the position it held in the early 1900s, with the government subordinate to its requirements and with the same detrimental consequences for the economy.[26]

Thus, though the City of London remains a marginal area of historical scholarship, the consensus that emerges from the work that has been done in the economic, social and political field, is that a deep division of interest existed in Britain between the City on the one hand, with its financial and commercial bias, and the rest of the economy, which was more concerned with production and manufacturing. Thanks to the greater unity of the City interests, and their social and political dominance, the policies followed by government were those that favoured the continuing economic success of the City, at the expense of other sectors of the economy, especially industry. The result was a steady decline in the relative and absolute importance of manufacturing industry while the City grew from strength to strength.

> With markets expanding rapidly all round the world, the international role of London has enabled the City to become rich and powerful as never before

reported the *Financial Times* in May 1987.[27] This can be contrasted with the serious decline of many of the basic industries which had dominated Britain since the Industrial Revolution, such as textiles, iron and steel, shipbuilding, heavy engineering and coal mining, as well as newer areas like motor vehicles and consumer electronics.[28] The contrast has been recognised for some time but what the recent

research has done is to link the two together and build up a convincing thesis, which suggests that the decline of the industrial sector was not inevitable, but a direct consequence of the growth of the City and the conditions which fostered it.

A final sting to this argument is the widely held belief that Britain's economic survival can be achieved only by production, whether it is agricultural products, minerals or manufactured goods, and that in the long run the health of the service sector, including the City, is itself dependent upon that. The implication is that if the productive sector is left to decline, the decline of the City will inevitably follow.[29]

However, there are a number of important flaws in this thesis and the research upon which it is based. Firstly, the City emerges as the by-product of the investigations which are focused elsewhere, such as the slow rate of technological progress (Kennedy), the economic consequences of social development (Ingham) or the determination of government policy (Newton and Porter). None are sufficiently interested to study the City itself, using the term indiscriminately as a proxy for high finance or corporate business. Like the fiction writers, academic historians present a superficial view of the City which sees its composition and orientation as unchanging over a century in time, while the rest of economic, social and political life is transformed. Secondly, there is never any recognition that the City was anything more than an adjunct to an economy whose purpose was physical production. Thus the only criterion applied to judge the City is the contribution it made, or did not make, to the finance of industry, while its ability to generate employment, high incomes and wealth is not considered. It is acceptable, and even desirable, for a manufacturing industry to be a successful exporter but not for a service sector like the City. Thirdly, there is the implicit assumption that while the economy as a whole declined, the City was at least able to maintain its position in the world. No attempt is ever made to measure either the relative importance of the City within Britain over time or the share it held in the provision of international financial and business services at various dates.

The problem is that none of the work seriously examines the question of a causal connection between the City and economic collapse, but the belief that there is one continues to prevail. Witness this statement by Harris in 1988:

> The radical, but now widespread, argument that industry has been starved of funds or that the supply of funds of the right type

> (long-term capital) has generally and chronically fallen short of industry's sustainable demand for them does not have strong empirical support and there are sound theoretical reasons for doubting it. However, that is not to deny that the City has had a significant and deleterious effect upon industry in Britain.[30]

As few are willing to define what is meant by 'The City', except in the most general and usually ambiguous terms, it is difficult to see how a search for the existence of links, and their significance, could even begin. It is impossible to accept at face value a hypothesis that blames difficulties on a mysterious group – the City – who managed to dominate economic, social and political life for at least a century, despite all the changes that took place, including two world wars and a world economic crisis. That is surely stretching conspiracy theory to the utmost level of credulity.[31]

There are, clearly, strongly held views on the City of London. Some see the City as central to the operation of a sophisticated market economy and one of Britain's few enduring areas of international success. Others are not convinced, considering most of its practices to border on illegality and its activities to be either irrelevant or positively harmful to the rest of the economy. The City itself never expresses a collective viewpoint and has no real means of doing so. Its defence is left to particular individuals or groups, who can voice an opinion from a particular standpoint, such as the Chairman of the Stock Exchange or the Governor of the Bank of England.[32] The very diversity of the City exposes it both to criticism and praise from all directions and on all counts, as each will contain at least an element of truth. The City is both too speculative and too cautious, too interventionist and too *laissez-faire*, too open and too closed, too domestic and too international. However, it is necessary to ask how representative of the whole each of these is before condemning the entire City and demanding a radical reform.[33]

The performance of the City of London over the last one hundred years, and the changes that it underwent, provide a means by which it can be judged before its demise is demanded or its continued existence blindly supported. The City is caught in the crossfire of a war being fought between those who believe in the sovereignty of the market and those who do not believe in the market at all. It is not being investigated for its own sake. Consequently, it is necessary to return to fundamentals and try to understand what the City is, and

what it has been at various times, before even trying to assess what role it has played in Britain's economic decline. There is the possibility that the City is not part of the explanation at all but a symptom along with other areas of economic life when its position is placed in long-term perspective.

# 1 Composition and Chronology

The City is a world within itself centered in the heart of the metropolis . . .

*The City, or the Physiology of London Business*, London 1852, p. 1

The City of London is a function, no longer a postal address. The function is finance and it does not have to be applied only in the square mile.

*Financial Times*, 27 February 1987

Although this [the City] cannot be defined with precision, it is interpreted here as a group of institutions and not as a geographical place. The institutions concerned are located largely within the geographic City and account for a large proportion of its economic activity, but there are exceptions, for example, some insurance companies, pension funds and miscellaneous financial institutions although included . . . are located outside the City, while some overseas earnings generated within the City are excluded. Examples of the latter are those of professions such as accountants, actuaries, solicitors and barristers.

*UK Balance of Payments: the CSO Pink Book*, London 1989, p. 36

Before any attempt can be made to examine and assess the City, it is necessary to define the term in reasonably precise language, and in a way that covers its existence from the mid-nineteenth century to the present. To the Victorian such a definition was simple for they associated the City with a particular part of London, and so the City was the collective term for all the activities that took place there. Such was the diversity of these that it was necessary to employ a geographic term, as no other sufficed to encompass them all and their apparent lack of unity. However, even at that time the ramifications of the City could not be confined to one part of London, as it was ceasing to be an area where people lived and worked and becoming one where they only worked. In order to accommodate the

expansion of business in the City, residential accommodation was gradually replaced by offices, warehouses and other premises. It was no longer possible for people to afford rents in the City and so homes were turned over to other uses or removed to make way for commercial premises. By the 1860s it was estimated that only 113,387 people lived in the City of London while 283,520 worked there for at least part of every day and another 509,611 were regular visitors as clients or customers.[1] This trend continued so that only 27,000 lived in the City in 1901 compared to 359,000 who worked there full-time. Thus, even before the First World War the City could no longer be regarded as 'a world within itself', for it relied totally on the rest of London and vicinity for its daytime population. This pattern continued into the twentieth century so that by 1981 only 2 per cent of the City's daytime population lived and worked there (see Table 1).

As long as the City only called upon the surrounding areas for residential accommodation for its workforce, it remained possible to refer to it both in terms of the place and the functions performed there. The City could be described by the tasks carried out by the various groups of people who worked there and those who visited them in the course of business. In 1908 it was estimated that at least a million people a day flowed into and out of the City at a time when the telephone was only slowly becoming an accepted means of conducting business.[2] However, as telecommunications reduced the need for a physical meeting, it became increasingly possible for the occasional or brief business contact to be made without a visit to a City office, although much discussion and exchange could still not be accomplished in that way, such as complex and simultaneous negotiations with more than one party.

It was the Second World War that brought a fundamental division between the geographical term 'City' and the functions performed by the 'City'. As a result of this war and its aftermath, there began a dispersal of 'City' activities to other parts of London and the South-East and, eventually, further afield. No longer did the City workforce merely live elsewhere, they now worked elsewhere, remaining in contact through the telephone, telex and computer links. By 1981 there were 200,000 fewer people employed in the City than at its peak of over 500,000 in the 1930s, and the numbers were continuing to fall. Judged solely by the number of people who worked in there, the period since 1945 has seen a dramatic decline in the importance of the City, after a century or more of steady and substantial growth (see Table 1).

*Table 1* City of London: population, 1866–1981

| *Year* | *Residential* | | *Working* | | *Total* | *Total as % of* |
|---|---|---|---|---|---|---|
| | *Number* | *%* | *Number* | *%* | *number* | *Greater London* |
| 1866 | 93,000 | 35 | 170,000 | 65 | 263,000 | 7.4 |
| 1871 | 75,000 | 27 | 200,000 | 73 | 275,000 | 7.1 |
| 1881 | 51,000 | 16 | 261,000 | 84 | 312,000 | 6.5 |
| 1891 | 38,000 | 11 | 301,000 | 89 | 339,000 | 6.0 |
| 1901 | 27,000 | 8 | 332,000 | 92 | 359,000 | 5.5 |
| 1911 | 20,000 | 5 | 364,000 | 95 | 384,000 | 5.3 |
| 1921 | 14,000 | 3 | 437,000 | 97 | 451,000 | 6.0 |
| 1931 | 11,000 | 2 | 482,000 | 98 | 493,000 | 6.0 |
| 1935 | 10,000 | 2 | 500,000 | 98 | 510,000 | 6.0 |
| 1951 | 5,300 | 2 | 339,000 | 98 | 344,300 | 4.1 |
| 1961 | 4,800 | 1 | 390,000 | 99 | 394,800 | 4.9 |
| 1966 | 4,900 | 1 | 361,000 | 99 | 365,900 | 4.8 |
| 1971 | 4,300 | 1 | 341,000 | 99 | 345,300 | 4.6 |
| 1981 | 4,700 | 2 | 299,210 | 98 | 303,910 | 4.6 |

*Note*: The total will include some over-counting with those who both lived and worked in the City being counted as both residential and daytime. In 1981, 2070 both lived and worked in the City.

*Sources*: J.H. Dunning and E.V. Morgan, *An Economic Study of the City of London*, London 1971, p. 34; *City of London: Population Census 1981*, Department of Architecture and Planning, Corporation of London, p. 7.

Consequently, up to 1939, it is possible to use the terms 'physical City' and 'functional City' as interchangeable, identifying the growth and nature of the City with those who worked within the boundaries of the City of London. After 1945, though, a restriction to the physical City would fail to capture the developments that were taking place since it was exporting many of its secondary or ancillary functions to other areas while retaining their direction in the City. Whereas one can ignore the export of accommodation, and all the staff and services associated with it, it is not possible to ignore the export of related tasks, as they were integral to the operation of the functions performed in the City itself and not merely the domestic comfort of its workforce. In discussing the functions of a bank, for example, one can ignore the residential arrangements of the staff but not the contribution made by individual departments as each exists to service the other. Obviously a line has to be drawn somewhere for the City's ramifications are so widespread that a link could be shown

to exist between it and most of the rest of the economy. Should every public company be included because it is quoted on the Stock Exchange, or obtains loans from a clearing bank, or takes out insurance via a Lloyd's broker? Too narrow a definition would omit much that was traditionally the preserve of the City and continued to be operated from there, while too wide a definition would mean that the City could be said to include almost everything, and so make the use of the term valueless.[3]

Since the Second World War, and to some extent beforehand, the use of the term 'the City' has become ambiguous, meaning to some the activities taking place in one particular part of London and to others the world of finance. Plender and Wallace, for example, employed both in 1985, when the term the City was 'used both in its precise geographical sense and as a shorthand for the financial markets'.[4] However, in the popular mind the two have become so closely identified as to be indistinguishable. As Coakley and Harris note in 1983: 'When people talk of "the role of the City" they mean the role of finance, and we do the same.'[5] Historically, the City never had a monopoly of financial services. In 1851 only 20 per cent of national employment in financial services was in London, with another 7 per cent in the adjacent counties. This proportion did rise steadily, so that by 1971 50 per cent of such employment was in London and its environs, but, even if the City is credited with being responsible for all this employment, it suggests a large and continuing contribution from other parts of the country.[6] Even in 1987, one estimate suggested that at most a quarter could be attributed to the City.[7]

There always existed a financial sector independent of the City, located largely in the other major British cities. Most Scottish financial concerns, for example, were not established as offshoots of City-based institutions or created to serve the interests of the City in that part of the country. They owed their existence to the needs of that region for financial intermediaries and while becoming integrated into a national network continued to retain a large degree of independence.[8] By 1990, around 180,000 were employed in financial services in Scotland, and Edinburgh was a major financial centre in its own right with funds of £80 bn being administered by locally-based banks, insurance companies, investment trusts and fund managers.[9] Similarly, Wales had some 70,000 employed in financial services by 1990, while within England there were many autonomous financial centres of long standing, such as Birmingham, Bristol and

Manchester. The building societies, which increasingly challenged the London-based banks for deposits, had their head offices in places like Halifax, Leeds and Bradford.[10] Consequently, to equate the City with the financial sector is a gross simplification that ignores the vitality of provincial finance and the role played by non-City-based institutions at all times. One might as well abandon the term 'the City' and refer simply to the financial sector, but that would fail to capture what was so special in the role played by London-based institutions and individuals. Such a definition would also be unfair on the City, for much of what took place there was not directly related to financial services, especially in the era before the Second World War. Again, taking London as a whole, only 0.1 per cent of employment was in financial services in 1851 and this had only risen to 7.8 per cent in 1961.[11]

The problem is that it is hard to discover the nature of the actual business undertaken in the City and how it changed over time. Without that information it is difficult to know what the City did and thus formulate a definition for the term 'the City' that could be carried forward into the post-1945 era. The national census taken every ten years (except 1941) should provide a rough indication in terms of the occupations of those employed there. However, it only counted the night-time population, and most of the City's workforce was, by then, dispersed all over London and the surrounding counties. Aware of this weakness in the census, the City of London conducted its own occupational censuses, of which those of 1881 and 1911, especially, provide usable results.

From an analysis of this data it is clear that the City was still a mixed business community in 1881, engaged in manufacturing and retailing as well as the provision of legal, financial, commercial and other services. In 1881, over one third of all the firms were in the field of commercial services, where there were numerous merchants, factors, dealers, brokers, importers, exporters and agents. Another third were engaged in manufacturing with a large number of printers and garment makers, while around 10 per cent were engaged in serving the needs of the population of the City, whether retailing goods or providing services. Finally, around a fifth provided services for the wider community in such specialist fields as law, insurance and accountancy as well as numerous architects, engineers and advertising agents. Financial services represented only 4 per cent of the City's business population at this time and was very much the junior partner. In the mid-nineteenth century, the City's principle role was

*Table 2* City of London: changing composition, 1881–1964/6

| *Year* | *Total* | *Manufacturing* | *Internal services* | *Commodity* | *Credit* | *Capital* | *Client* |
|---|---|---|---|---|---|---|---|
| 1911 | 357,361 | 65,113 | 98,436 | 95,402 | 13,451 | 18,785 | 66,174 |
| 1964/6 | 261,452 | 23,950 | 42,864 | 43,715 | 50,005 | 74,101 | 26,817 |
| *Year* | *Total (%)* | *Manufacturing (%)* | *Internal services (%)* | *Commodity (%)* | *Credit (%)* | *Capital (%)* | *Client (%)* |
| 1881 | 100 | 30 | 10 | 38 | 4 | | 19 |
| 1911 | 100 | 18 | 28 | 27 | 4 | 5 | 19 |
| 1964/6 | 100 | 9 | 16 | 17 | 19 | 28 | 10 |
| *Year* | *Total* | *Proportion of overall total (%)* | | *Commodity (%)* | *Credit (%)* | *Capital (%)* | *Client (%)* |
| 1881 | – | – | | 63 | 6 | | 31 |
| 1911 | 193,812 | 54 | | 49 | 7 | 10 | 34 |
| 1964/6 | 194,638 | 74 | | 22 | 26 | 38 | 14 |

*Notes*: Manufacturing: production of all goods and materials including printing, publishing, clothing, etc.
Internal Services: servicing the needs of the City – retail, transport, secretarial, maintenance, etc.
Commodity: wholesale commodity markets, merchants, dealers, agents, brokers, etc.
Credit: banks, discount houses, etc.
Capital: merchant banks, finance houses, stock exchange, investment companies, etc.
Client: insurance, accountancy, law, architects, engineers, etc.
(NB: the 1881 data is based on a survey that identified only the distribution of firms or separate units. This would under-count credit, in particular, as it had the largest units with the joint-stock banks. In 1911, the number of people in each unit was: Manufacturing – 16; Internal services – 14; Commodity – 10; Credit – 48; Capital – 10; Client – 9.)

*Sources*: *Corporation of London: Report of the City Day – Census, 1881*, London 1881; *Corporation of London: Report of the City Day – Census, 1911*, London 1911; J.V. Dunning and E.V. Morgan, *An Economic Study of the City of London*, London 1971, pp. 130–1.

the handling of trade not the provision of finance (see Table 2).

By 1911 the relative importance of the various components of the City's economy had altered but the transformation was not that dramatic. Both commerce and manufacturing experienced substantial decline, while finance experienced rapid growth, as did the provision of the internal services to meet the needs of the ever-increasing daytime population in the City.

*Table 3* Floor space in the City of London, 1939–68 (percentages)

| | *1939* | *1949* | *1968* |
|---|---|---|---|
| Industry | 12 | 9 | 7 |
| Retailing and services | 6 | 6 | 5 |
| Warehouses | 26 | 18 | 13 |
| Public buildings | 8 | 10 | 10 |
| Residential | 1 | 1 | 1 |
| Offices | 45 | 56 | 62 |
| Miscellaneous | 2 | – | 2 |

(Excludes Inner and Middle Temple.)

*Source*: J.H. Dunning and E.V. Morgan, *An Economic Study of the City of London*, London 1971, p. 32.

As the City of London did not conduct its own census in the inter-war years, it is not possible to see in detail what changes took place during and after the First World War. However, what evidence is available suggests a maintenance of the diverse nature of the City throughout the 1920s and 1930s, though with a continuance of the previous trends, namely the growth of financial services and the decline of manufacturing.

From the survey of the use of space in 1939 almost half was devoted to offices, which would cover the provision of all kinds of services, but a quarter remained devoted to warehouses, and thus indicated the continued importance of the City as a centre of trade (see Table 3).

During the Second World War the City of London suffered enormous destruction at the hands of enemy bombing, with around one third of its buildings destroyed. This forced many firms to relocate in order to stay in business.

> The areas intimately associated with certain trades have been practically razed to the ground but the majority of the businesses displaced have continued to trade and to find accommodation where they could, often – perforce – outside the City,

reported the City of London Improvements and Planning Committee in 1944.[12] In particular the warehouses and commercial offices nearest the river were the most heavily affected as they presented both

desirable and easy targets to the aeroplanes following the course of the Thames. The post-War era did see much rebuilding in the City but it was heavily circumscribed by planning controls and building regulations. There was a desire both to disperse activity away from London in the interests of regional policy and to create a more balanced community within the City involving both more residential accommodation and recreational facilities. In 1949 the floor space available for business in the City was 33 per cent less than in 1939 and even by 1968 it was still 9 per cent less.[13] Though there had always been competition for space in the City, this large contraction in availability made the position very difficult in the post-war era, forcing traditional activities to re-site their operations elsewhere. Warehouse space, for example, fell from 26 per cent of the total in 1939 to only 13 per cent in 1968, in contrast to offices which rose from 45 per cent to 62 per cent over the same period.[14]

In many ways the Second World War, and the restrictions that followed it, represented a major and sudden divide in the history of the City of London. Before 1939 the City had expanded rapidly. Its workforce had doubled, rising from 263,000 in 1866 to 510,000 in 1935 (see Table 1). This increase was accommodated by a substantial rebuilding of the City as the residential population moved out, and was replaced by offices and warehouses, which in turn were redeveloped to provide even more space.[15] Consequently, the City could continue to grow on a number of fronts with the expansion of such activities as finance being accommodated within the growth of general employment and office space, with only the residential population declining absolutely in numbers.

Faced with an acute shortage of accommodation in the City at the end of the Second World War, and the implementation of planning policies designed to prevent it being met, which were only relaxed in the 1980s, it was inevitable that the City would only be able to retain those activities that could justify the highest rents, apart from privileged groups like the residents and cultural pursuits of the Barbican. Prime office rents in the City were double those in provincial centres in 1989, for example. The result was that long-established City activities, such as wholesale distribution and warehousing were forced to find alternative homes. Even within financial services, which were willing and able to pay the rents, not all components could justify a City location, and so were moved out, such as the clerical sections of the clearing banks or almost the entire operations

of insurance.[16] The physical City was not merely coming to focus exclusively on finance but upon the most specialised branches of it, notably, those requiring highly trained experts backed by a heavy investment in expensive technology, while the support staff were dispersed to ever more distant, but cheaper locations. Between 1981 and 1988, for example, while banking and finance took up 56 per cent of the new floor space available in the City, insurance took up only 12 per cent. Consequently, in 1987, whereas almost all the 60,000 jobs in Greater London in foreign banks and securities houses were in the City, only half the 90,000 insurance jobs were so located.[17] Altogether, the City's workforce only recovered to almost 395,000 in 1961, when it was still 23 per cent less than in the 1930s, before beginning a slow but steady decline, reaching only 280,000 in 1986, which was almost half of its peak level (see Table 1).[18] The result has been that the City of today is both much smaller than it was in the past and less diverse, and this trend is continuing. An increasing proportion of the City's offices was occupied by financially related services, and they were using that space for equipment rather than simply people, though as the profitability of securities trading faltered in the late 1980s, accountants, lawyers and management consultants began to take up more space.[19] Thus, the City became devoted to, and reliant upon, a limited and highly specialised range of tasks connected to finance, plus the essential capital-intensive services they required. In turn, whereas before the Second World War the City drew in a vast army of workers on a daily basis from the surrounding area, that takes place less so today. Instead the City draws on the efforts of many in the South East of England and further afield, working in their own locality, to provide essential components of the business it undertakes.[20]

Therefore, in the course of one hundred years the physical City of London changed substantially both in size and nature. By the late twentieth century the physical City had become a specialised financial centre, having shed not only most of its other activities but also many branches of finance. In the process, reference to the physical City was no longer an adequate description of what the City of London did, for dispersal and communications had created a much wider community united by function not by proximity.

It is, consequently, not possible to comprehend the role and importance of the City of London if the fundamental changes of the last hundred years are not understood. However, in one sense the basic functions performed by the City remain the same.

Essentially the City was, and is, a series of markets. These were markets not where initial producers and final consumers met and exchanged, but those which acted at some remove from that simple level. Within the growing complexity of both the national and international economy there developed a need for specialist intermediaries to act between these intermediaries themselves, plus a vast expansion of those who possessed the particular expertise required to service these intermediaries. In the same way as the Bank of England became the bankers' bank, rather than conducting a commercial banking operation for the public at large, and City merchants became increasingly wholesalers to other merchants rather than meeting the immediate requirements of ordinary customers, so the City of London as a whole distanced itself from the areas of trade, finance and services which were recognisable and familiar and followed those that were not. Since the mid-nineteenth century what can be traced in the City is the creation of a group of inter-related markets and services that facilitated the ever more complex flows between producers and consumers, lenders and borrowers, experts and the ignorant.

Thus, the only definition which captures the actual role performed by the City of London throughout the last one hundred years is the one which describes it as a national/international clearing house, whether it was for goods, finance or expertise. That is the continuity of the City. Though this definition omits certain of the activities carried out in the City at various times it is far more satisfactory than seeing the City as nothing more than a financial centre and identifying the entire British financial system as the City, which is the present-day tendency. It also gives coherence to the apparently random collection of businesses that have inhabited the City over the century, including as they do not only banks, insurance companies and finance houses, but also brokers and dealers of every kind. It also explains why not every financial institution needed a presence in the City for, unless they were directly involved in the central markets for money and finance, they could perfectly well accomplish their tasks from another location. Therefore, the City has to be seen as a central marketplace which catered not for the public but for those professional intermediaries who, in turn, served the public or yet more intermediaries. It is not, and never has been, every high street insurance agent or branch of a bank, building society or multiple retailer, but it is the mechanism which allows these agents and branches to communicate with each other to form a market through which goods and services are supplied to the public not only in

Britain but abroad. However, this lack of direct contact with the public underlies the general lack of comprehension which surrounds the activities which the City performs.

Defined in this way, the functions of the City can be judged by reference to five simple market criteria – time, place, type, amount and price. If the City was operating efficiently, goods and services would flow between sellers and buyers at times, places, types, amounts and prices satisfactory to both. The criticism of the City can, therefore, take two forms.

Firstly, if it can be exhibited that the City was consistently failing in one or all of these criteria because of its own inadequacies, then the criticism is justified and the consequences of the City's poor performance assessed. The 'Macmillan Gap' for example, in which the City was felt to have ignored consistently the financial needs of small businesses, implies that the City was failing to provide the *type* of investment required through directing the savings of willing investors to the most attractive opportunities available. Similarly, the large scale of overseas lending at times when developing industries in Britain were felt to be under-funded, suggests that the *place* to which finance was directed was mistaken. Of course, the circumstances under which these flows did or did not take place have to be carefully examined before any condemnation is made, because at no time was the City entirely free of outside influence, especially after 1945 when government intervention helped to determine the level and nature of supply and demand through controls of prices, interest rates, ex change rates, etc.

Secondly, the criticism can take the form of recognising that the markets of the City were operating efficiently, but regarding the results as undesirable. An efficient market may produce an outcome that society does not countenance and thus uses the political system to alter. The wealthy will be able to pay prices for food and housing that leaves the poor hungry and homeless, though at the same time stimulating an increase in supply and a contraction in demand. However, society may be unwilling to wait until that adjustment takes place, or accept the means by which it is achieved. If the role and performance of the City is to be judged fairly it is essential to separate the consequences of a poorly functioning market and the unacceptable results of its efficient operation. The former questions whether the City had performed as well as it might while the latter casts doubt on whether the market is the best way to allocate goods and services. Inevitably, those who doubt the value of markets will

question the contribution made by the City of London to the economy and point to its weaknesses, but these may be weaknesses of any market system and not peculiar to the organisation of the City of London. Spiegelberg, for instance, writing in 1973 sees the problems of the City in terms of its mechanisms and its practitioners, referring to the fact that 'so much power resides in the hands of individuals with such myopic vision'. In contrast, Coakley and Harris, ten years later, find little to fault in the actual way the City operated but feel that this has been detrimental to the rest of the economy.[21] One is an attack on a poor performance, while the other dislikes the consequences of a good performance. It is essential to distinguish between the criticisms that are directed towards particular failings in the City of London and seek explanations for these, and those that really condemn the operation of a market economy. If that distinction is not made then it is impossible to make any judgement whatsoever on whether the City was, or was not, responsible for Britain's economic decline because one is not identifying the specific role played by the City as opposed to the general operations of a market economy.

Essentially the City of London has to be recognised for what it was – the central clearing house of a market economy – and increasingly an economy that encompassed not just the British Isles but the whole world. Before the First World War, the City was evolving from being the principal intermediary in the organisation and finance of international trade, into occupying a similar position in credit and capital, and also services and expertise, such as shipping, law, accountancy or consultancy. However, while certain activities were being lost before 1914, like the physical handling of bulky goods, and others were undermined between the wars, as with trade credit and international loans, it was after 1945 that most disappeared, leaving the City with an important role in only a restricted range of financial activities. Nevertheless, because the City is confused with the entire UK financial sector, and the need for financial intermediation expanded as the economy became more sophisticated, it is perceived to have grown steadily in importance within the whole domestic economy. Similarly, because the value of certain areas of business that the City conducted internationally continued to rise dramatically, with the City's invisible earnings becoming a major element in Britain's balance of payments, its importance in global terms is also believed to have continued to increase.

McRae and Cairncross, for example, in an otherwise objective account suggest that:

> On almost any measure you care to take, the City of London is the world's leading international financial centre. More international insurance passes through London than anywhere else. There are more foreign banks in London than in any other city. More international security business is done in London than any other centre. If anything in the 1960s and 1970s London's dominance increased.[22]

Forgotten in this catalogue of success are the areas in which the City was once pre-eminent but has now lost its position, as in the organisation of international trade. By concentrating solely on finance and looking at the expansion in terms of absolute, rather than comparative, volumes or values, a deceptive picture of the City's performance is obtained.

Domestically, the UK financial sector as a whole grew in importance in the post-war years. By 1978 it employed 628,300, or 2.8 per cent of the labour force, while by 1986 this had risen to 758,900, or 3.6 per cent.[23] However, as previously suggested, not all of this can be attributed to the City of London. Much was happening unrelated to the City, as with the expansion of the building society movement. In fact, membership of major City institutions, like the Stock Exchange or the Baltic Exchange, was either declining or stagnating as the services they provided were relatively less used. Much economic activity was undertaken by the state at a national or local level and made little direct call on the facilities provided by the City. Similarly, within business there was a growth of scale, with the formation of large integrated companies that had little need for intermediaries as goods, services and capital could all be internally distributed. Whether nationalised or private, big businesses like the railways, coal mining, steel making, chemicals or multiple retailers could undertake their own purchases and sales, transport their own goods, carry their own insurance and finance their own operations to an extent that was impossible when these activities were undertaken by numerous competing companies, as had been the case before 1914 and even before 1939. Though a few of these new companies were based in the City, most were not for they chose a London location nearer to where the centre of power now lay, and that was close to Whitehall and the Government. The opportunities for the City to provide intermediation in the domestic economy were largely confined to finance and related services after 1945, and so a concentration on that aspect of the City may suggest an increasingly important role, especially if the

City is equated with the entire financial sector, but a study of other aspects of the City indicates a reverse trend.[24] What is required is an analysis that takes a comprehensive overview of the City and does not simply concentrate on the areas of success but also acknowledges failure.

In terms of Britain's relationship with the rest of the world, the performance of the City is seen as a great success, especially since the Second World War.[25] Generally, Britain's net invisible earnings did rise from a mere £740m in 1965 to £12bn in 1986, by which time they more than compensated for a deficit of £9bn on visible trade. Within that, the net earnings attributable to the City increased from only £49m in 1946 to a peak of £9350m in 1986, though that was partly due to growing income from overseas investment. They then began to fall back, as Britain borrowed heavily at high interest rates to finance the trade deficit and the profitability of the insurance sector entered one of its periodic downturns (see Table 4, and especially the comment on the problems of estimating the City's net external earnings). However, figures of such growth and magnitude tend to mislead as they make no allowance for either the declining value of money or the rapid expansion taking place in the international exchange of services, including those provided by the City. By the mid-1960s, it was already clear that British trade in services was rising less rapidly than the world total, thereby slowly reducing the UK share.[26] The Bank of England *Quarterly Bulletin* reported in 1985 that: 'The United Kingdom has lost share in the value of world exports of services at a rate similar to that at which it has lost share in the value of world export of manufactures.'[27] Over the longer term this decline would have been even more marked. There is every reason to believe that Britain was the dominant force in international services before 1914, with the provision of financial, commercial and shipping services netting the economy £107m in 1907 compared to only £12m for the United States.[28]

It is clear that there was a strong inter-connection between international success in selling both goods and services and so, as Britain became less competitive in manufactured exports after 1950, so demand for services lagged behind that of major rivals. By 1989, with world trade in services reaching approximately the $600bn level, the UK proportion had fallen to 8 per cent as compared with 18 per cent in 1952. In contrast, France's share rose from 4 per cent in 1952 to 9 per cent in 1989, while West Germany's increased from 3 per cent to 7 per cent.[29] The City was not immune from this decline. In

*Table 4* City of London: net overseas earnings, 1946–88

| *Year* | *Total* | *Commodity* | | | *Credit* | | | *Capital* | | | *Client insurance* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *£m* | *Total* | *trade (1)* | *ship (2)* | *Total* | *Inv*[a] *(3)* | *Serv*[b] *(4)* | *Total* | *Inv (5)* | *Serv (6)* | *Total* | *Inv (7)* | *Serv (8)* | *LReg*[c] *(9)* | *Law*[d] *(10)* |
| 1946 | 49 | 14 | 8 | 6 | 8 | – | – | 4 | – | 4 | 23 | – | – | – | – |
| 1956 | 145 | 39 | 28 | 11 | 28 | – | – | 8 | – | 8 | 70 | – | – | – | – |
| 1963 | 179 | 36 | 23 | 13 | 48 | – | – | 10 | – | 10 | 85 | – | – | – | – |
| 1965 | 200 | 49 | 33 | 16 | 32 | 16 | 16 | 38 | 35 | 3 | 81 | 31 | 50 | – | – |
| 1966 | 230 | 50 | 33 | 17 | 22 | – | 22 | 49 | 37 | 12 | 109 | 31 | 78 | – | – |
| 1967 | 282 | 53 | 33 | 20 | 27 | 1 | 26 | 52 | 37 | 15 | 150 | 35 | 115 | – | – |
| 1968 | 388 | 63 | 33 | 30 | 65 | 29 | 36 | 63 | 42 | 21 | 197 | 36 | 161 | – | – |
| 1969 | 512 | 78 | 43 | 35 | 110 | 69 | 41 | 67 | 42 | 25 | 257 | 43 | 214 | – | – |
| 1970 | 602 | 134 | 87 | 47 | 90 | 42 | 48 | 71 | 37 | 34 | 307 | 92 | 202 | 4 | 9 |
| 1971 | 622 | 125 | 100 | 25 | 71 | – | 71 | 66 | 38 | 28 | 360 | 109 | 236 | 4 | 11 |
| 1972 | 745 | 160 | 125 | 35 | 122 | 29 | 93 | 75 | 42 | 33 | 388 | 136 | 234 | 6 | 12 |
| 1973 | 831 | 218 | 165 | 53 | 159 | 44 | 115 | 87 | 48 | 39 | 367 | 139 | 208 | 7 | 13 |
| 1974 | 1016 | 323 | 220 | 103 | 180 | 30 | 150 | 105 | 58 | 47 | 408 | 140 | 243 | 10 | 15 |
| 1975 | 1048 | 445 | 299 | 146 | 7 | –181 | 188 | 113 | 66 | 47 | 483 | 138 | 312 | 14 | 19 |
| 1976 | 1553 | 456 | 309 | 147 | 118 | –115 | 233 | 123 | 72 | 51 | 856 | 317 | 493 | 17 | 29 |
| 1977 | 1557 | 385 | 230 | 155 | 61 | –229 | 290 | 137 | 80 | 57 | 974 | 332 | 585 | 21 | 36 |
| 1978 | 2179 | 476 | 323 | 153 | 398 | 77 | 321 | 134 | 91 | 43 | 1171 | 417 | 690 | 20 | 44 |
| 1979 | 2048 | 549 | 349 | 200 | 95 | –484 | 389 | 176 | 127 | 49 | 1228 | 456 | 702 | 18 | 52 |
| 1980 | 2054 | 453 | 272 | 181 | 153 | –282 | 435 | 267 | 203 | 64 | 1181 | 447 | 650 | 23 | 61 |
| 1981 | 3233 | 604 | 317 | 287 | 892 | 336 | 556 | 298 | 239 | 59 | 1439 | 436 | 901 | 32 | 70 |
| 1982 | 3920 | 613 | 367 | 246 | 955 | 371 | 584 | 587 | 505 | 82 | 1765 | 646 | 1002 | 37 | 80 |
| 1983 | 5296 | 687 | 441 | 246 | 1425 | 762 | 663 | 825 | 730 | 95 | 2359 | 1037 | 1194 | 33 | 95 |
| 1984 | 6371 | 769 | 499 | 270 | 1959 | 1145 | 814 | 999 | 869 | 130 | 2644 | 1136 | 1361 | 27 | 120 |
| 1985 | 6684 | 740 | 511 | 229 | 1445 | 310 | 1135 | 1053 | 914 | 139 | 3446 | 1068 | 2198 | 25 | 155 |
| 1986 | 9350 | 736 | 515 | 221 | 2257 | 1071 | 1186 | 1241 | 1063 | 178 | 5116 | 1734 | 3168 | 24 | 190 |

| | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1987 | 8413 | 764 | 537 | 227 | 1324 | 38 | 1286 | 1404 | 1055 | 349 | 4921 | 1641 | 3017 | 22 | 241 |
| 1988 | 7214 | 889 | 555 | 334 | 966 | –294 | 1260 | 1269 | 1052 | 217 | 4090 | 1633 | 2139 | 18 | 300 |

*Notes*: (1) Net income of commodity traders and export houses.
(2) Net income of the Baltic Exchange.
(3) Net income of banks and leasing companies: receipts from overseas lending minus payments on overseas borrowing.
(4) Net services provided by banks to overseas customers.
(5) Net income of Investment and Unit Trust, and Pension Funds.
(6) Net income of brokers (securities, foreign exchange, etc.).
(7) Net income of Lloyd's and insurance companies on overseas investments.
(8) Underwriting profits and brokerage income.
(9) Lloyd's Register of Shipping.
(10) Earnings of solicitors and barristers.
(NB: between 1965 and 1969, brokerage income was split between commodityshipping and capitalservices in the same proportion as 1970.)

*Sources*: W.C. Clarke, *The City's Invisible Earnings*, London 1958, p. 93; W.C. Clarke, *The City in the World Economy*, London 1965, p. 137; Central Statistical Office, United Kingdom Balance of Payments, London 1970–89 (Pink Book).

*Comment*: These figures give only a very rough approximation of the City's overseas earnings. This includes financial activities many of which are located elsewhere in Britain, like many insurance companies and pension funds, while excluding other activities many of which took place within the City, particularly with the accountants. Consequently, though it measures a particular grouping of activities most of which can be said to be encompassed by the term 'The City of London' it is by no means either sufficiently specific or comprehensive. Further, the measure that is used attributes an income to the City that is not properly earned by it. For example, the net investment income of the investment trusts, unit trusts, pension funds and insurance companies should be largely allocated to those who have provided the savings for investment rather than the intermediaries who have directed it. More appropriately they should be credited with the value added, if that could be measured, rather than the entire income. Conversely, income earned by many of those in the City is ignored, such as the profits made by many bankers, brokers, dealers and others as they buy in one market and sell in another, whether it be foreign exchange, securities or futures contracts, or their earnings through borrowing at one interest rate and investing or lending at a higher. Finally, it is difficult to allocate income between the principal components of the City as all banks, and most brokers, are grouped together, though the functions they perform differed widely in terms of dealing in credit or capital or providing expertise. Altogether, the result is that the balance-of- payments figures provide a crude and unreliable picture of the City's international accounts and how they originated.

insurance, for example, which provided the City with most of its overseas earnings (see Table 5), though the volume of business done expanded rapidly, London's share of the international insurance market was falling.

Even in an area which grew spectacularly in the post-war years – international bank lending – the City's share fell from 27.5 per cent in 1973 to 20.9 per cent in 1988, by which time it had been overtaken by Tokyo.[30] Put into the context of the world economy, the City of London has fared almost as badly as the rest of Britain since 1945, even if certain components, like reinsurance and the money markets, have managed to preserve for themselves a continued importance out of line with the domestic economy.

Thus, to see an unchanging City thriving and expanding at the expense of the rest of the economy is to misread the facts by failing to take account of developments elsewhere in the world. As within Britain herself, certain elements of the City of London have proved successful and enduring while others have not, but it would be inaccurate to say that the City had done so, comprising as it did not only finance but also commerce and services. Any historical account which ignores what the City has been in the past for the sake of a simple but inaccurate definition reflecting the present-day position, and then makes judgements based on that, does not recognise that the City itself has been transformed. On the eve of the First World War the City of London was the most important commercial and financial centre in the world and was without peer in the range and depth of services it provided. By the end of the 1980s the City of London, including its dispersed activities within Britain, remained the most important financial centre within Europe, but it had lost most of its other specialities to other centres in the world. Even in the areas it still dominated, there was a heavy reliance on foreign finance, personnel and expertise and strong competition from other centres.

*Table 5* City of London: distribution of net overseas earnings, 1946–88

| | | *Total* | | | | *Services* | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Year* | *Total £m* | *Commodity* | *Credit* | *Capital* | *Client* | *Total* | *% Overall Total* | *Commodity* | *Credit* | *Capital* | *Client* |
| 1946 | 49 | 29 | 16 | 8 | 47 | | | | | | |
| 1956 | 145 | 27 | 19 | 6 | 48 | | | | | | |
| 1963 | 179 | 20 | 27 | 6 | 47 | | | | | | |
| 1965 | 209 | 23 | 20 | 18 | 39 | 118 | 59 | 41 | 14 | 3 | 42 |
| 1966 | 230 | 22 | 10 | 21 | 47 | 162 | 70 | 31 | 14 | 7 | 48 |
| 1967 | 282 | 19 | 10 | 18 | 53 | 209 | 74 | 25 | 12 | 7 | 55 |
| 1968 | 388 | 16 | 17 | 16 | 51 | 281 | 72 | 22 | 13 | 7 | 57 |
| 1969 | 512 | 15 | 22 | 13 | 50 | 358 | 70 | 22 | 11 | 7 | 60 |
| 1970 | 602 | 22 | 15 | 12 | 51 | 431 | 72 | 31 | 11 | 8 | 50 |
| 1971 | 622 | 20 | 11 | 11 | 58 | 475 | 76 | 26 | 15 | 6 | 53 |
| 1972 | 745 | 22 | 16 | 10 | 52 | 538 | 72 | 30 | 17 | 6 | 47 |
| 1973 | 831 | 26 | 19 | 11 | 44 | 600 | 72 | 36 | 19 | 7 | 38 |
| 1974 | 1016 | 32 | 18 | 10 | 40 | 788 | 78 | 41 | 19 | 6 | 34 |
| 1975 | 1048 | 42 | 1 | 11 | 46 | 1025 | 98 | 43 | 18 | 5 | 34 |
| 1976 | 1553 | 29 | 8 | 8 | 55 | 1279 | 82 | 36 | 18 | 4 | 42 |
| 1977 | 1557 | 25 | 4 | 9 | 63 | 1374 | 88 | 28 | 21 | 4 | 47 |
| 1978 | 2179 | 22 | 18 | 6 | 54 | 1594 | 73 | 30 | 20 | 3 | 47 |
| 1979 | 2048 | 27 | 5 | 9 | 60 | 1949 | 95 | 28 | 20 | 3 | 40 |
| 1980 | 2054 | 22 | 7 | 13 | 58 | 1686 | 82 | 27 | 26 | 4 | 44 |
| 1981 | 3233 | 19 | 28 | 9 | 45 | 2222 | 57 | 27 | 25 | 3 | 45 |
| 1982 | 3920 | 16 | 24 | 15 | 45 | 2398 | 61 | 26 | 24 | 3 | 47 |
| 1983 | 5296 | 13 | 27 | 16 | 45 | 2767 | 52 | 25 | 24 | 3 | 48 |
| 1984 | 6371 | 12 | 31 | 16 | 42 | 3221 | 51 | 24 | 25 | 4 | 47 |
| 1985 | 6684 | 11 | 22 | 16 | 52 | 4392 | 66 | 17 | 26 | 3 | 54 |
| 1986 | 9350 | 8 | 24 | 13 | 55 | 5482 | 59 | 13 | 22 | 3 | 62 |
| 1987 | 8413 | 9 | 16 | 17 | 58 | 5679 | 68 | 13 | 23 | 6 | 58 |
| 1988 | 7214 | 12 | 13 | 18 | 57 | 4823 | 67 | 18 | 26 | 4 | 51 |

*Source*: see Table 1

# 2 Commercial City

The facilities, indeed, which London enjoys for buying and selling, chartering and financing, are unique, and one cannot, therefore, see anything to disturb its importance as the commercial centre of Europe.

J.A. Findlay, *The Baltic Exchange*, London 1927, p. 42

The long years of control had one positive result. However necessary or desirable in the exigencies of war, the limitations of government trading in time of peace had been fully demonstrated. Indeed, it may be said that from the post-war experience came a general realisation of the advantages that stemmed from the presence of a free and active market in London, both as a commercial asset to the British economy and for its services to the world metal industry.

Economist Intelligence Unit, *The London Metal Exchange*, London 1958, p. 163

Few parts of the City have changed so radically as the commodity markets.

W.M. Clarke, *The City in the World Economy*, London 1965, p. 79

The prime purpose of futures markets is to provide protection against unpredictable price fluctuations – thus enabling forward trading with reduced risks.

*Financial Times*, 26 July 1985

In the beginning there was the Commercial City. Over the course of a century the City of London has been transformed from a commercial centre into a financial one. However, it is little recognised how recent this change has been, for modern writers on the City tend to ignore the commercial aspect entirely or suggest that it was of little importance by the mid-nineteenth century. McRae and Cairncross, for example, omit any mention of trade in their brief review of the City of London in the nineteenth and twentieth centuries, though considering it important in the eighteenth.[1] However, in Victorian times the City was still regarded as much for its position in domestic

distribution and international trade as for its ability to mobilise and organise capital and credit.[2] During the inter-war years, the financial components of the City began to dominate public perception, much to the annoyance of the many who were not engaged in that business. One was Percy Hartley, a shipbroker, who complained in 1938 that:

> It is remarkable how some country and even suburban folk think that the City is the Stock Exchange and the Stock Exchange is the City – and the chief or indeed only occupation for City men – that is gentlemen – is stockbroking.[3]

Such a view was much more legitimate in the post-Second World War era, though it has never been an accurate one. Generally, there is an acceptance of historical inevitability in that the City's connection with trade would gradually give way to finance, typified by the progression from merchants to bankers of firms like Baring Brothers; Brown, Shipley; and Anthony Gibbs & Sons. Forgotten is the example of Twinings, which chose to concentrate on the tea trade in 1892 and so abandoned its banking division. Those who chose the financial path were to enjoy the greater success but, possibly, they had two world wars, a world depression and a revolution in the way trade was organised, to thank for that.[4]

Domestically, the City's importance in trade was beginning to wane by the 1850s with the development of an integrated railway network and telegraph communication. In the coal trade, for example, City merchants and factors had acted as intermediaries between the numerous coal vendors in London and the equally numerous northern collieries. They arranged and bought entire shiploads of coal which they then sold in lots to retailers. While this practice continued, the coming of the railway facilitated direct contact between the retailers and the colliery companies, bypassing the City entirely. As W.E. Hooper noted in 1907:

> The Coal Exchange of to-day is not the all important centre for the trade that it was in 1800 – the smaller markets held at the termini of the great coal-carrying railways have robbed it of its unique position.[5]

In 1850, London received 3.6m tons of coal, of which 98 per cent came by sea and only 2 per cent by rail. By 1905, when 15.7m tons arrived, only 54 per cent came by sea compared to 46 per cent by

rail.[6] At the same time amalgamations among both the colliery companies and the coal retailers replaced the need for independent intermediaries in the domestic coal trade. With the formation of William Cory & Son in 1896, involving an amalgamation of eight firms, an organisation was created which handled 6m tons of coal a year, or almost half of London's requirements, and controlled its movement from the pithead to the consumer. With the nationalisation of the coal industry after the Second World War, there was even less need for the intermediation of City merchants as there was only one supplier.[7]

The City's position in other areas of domestic distribution was also undermined in a similar manner to coal, as it became progressively easier to arrange delivery direct from source to consumer. In 1928, Billingsgate was handling approximately 25 per cent of all fish landed in Britain, but that proportion was already on the wane and the decline continued after 1945, reaching only 7 per cent in 1969. Smithfield also lost share in the meat trade. In 1882–6 it handled two thirds of imported meat but this had fallen to 41 per cent by 1910 and was only 13 per cent in 1970. Within London the markets moved away from the City either to better port facilities downstream or to locations more convenient for rail, and later, road and air transport. Elsewhere in Britain, markets were also established nearer the source of supply, such as in the fishing ports themselves for fish.[8] Consequently, the City's once dominant position in the domestic distribution of goods and commodities commanding more than a local market, was gradually undermined by a series of transportation developments which created an integrated economy that was not dependent upon one focal point.

Increasingly, it was not necessary to bring goods into London for re-distribution to the rest of the country, as this could be done by direct shipment. The growth of the multiple retailers, for example, which began in the mid-nineteenth century, provided a system that could collect goods from the producer, or the most convenient port, and then distribute it directly to the consumer through a chain of shops. Whereas in 1875 large-scale retailers controlled only 2 per cent of total retail sales, by 1920 their share had risen to 20 per cent and then to 35 per cent in 1950 and 70 per cent in 1990. In the food trade, for example, the major groups like Sainsbury's, Tesco, Argyll, Gateway and Asda accounted for over 70 per cent of sales, and they organised their own supplies, eliminating much of the intermediation between producer and consumer in the process. Consequently,

though the producer/retailer, like the cobbler, slowly disappeared after the mid-nineteenth century, and this did create opportunities for the London-based wholesaler, developments in retailing allowed new linkages to be created which increasingly eliminated the middleman in the twentieth century. That, in turn, spawned new specialists like the distribution experts with their depots and vans, who could keep the multiple retailers' shelves perpetually supplied no matter the fluctuations in the volume and nature of demand.[9]

The result was that, within Britain, the City was largely bypassed in the distribution of goods from 1850 onwards, though it did find respite in the changes that were taking place in the means of production, as these created a growing need for a distribution system to handle mass-manufactured goods. Thus the City was continually losing certain areas of internal trade and gaining others as it responded to the new developments taking place. However, the really dynamic element for the Commercial City at this time was its involvement in international trade.

Between 1850 and 1914, world trade grew rapidly with Britain being the largest trading nation, and this created enormous opportunities for the City of London.[10] As one American writer, Van Cleef, wrote in 1937, 'London's hinterland extends to the limits of the British Empire', so impressed was he at the extent of its trading connections.[11]

The City's direct involvement in international commerce, as opposed to indirect involvement through finance and insurance, can be divided into three distinct but closely related components. Firstly, there was participation in the *physical trade*. This involved handling the goods that actually passed through London, including warehouses in the City itself, whether they had been produced in Britain or elsewhere and whether they were destined for consumers at home or abroad. Secondly, there was the *office trade*. This was concerned with the organisation of the movement of goods which never, physically, passed through London. It encompassed both British exports and imports which were shipped to and from the most convenient port, and trade between other countries which never touched Britain at all. Thirdly, there was the *future trade*. This related to the organised markets in which were traded commodities in advance of either production or demand. Essentially, these markets attempted to anticipate supply and demand and so send signals, via the price mechanism, to both producers and consumers about future conditions. As the scale and complexity of trade grew, so it became both possible

and desirable to separate the physical, office and future components into specialist tasks handled by different groups at an increasingly sophisticated level. At the same time the changes that took place in each of these components, and their relative performance, reveal much about the reasons behind success and failure in the City.

By the mid-nineteenth century, London had been Britain's main port for centuries, dominating the import/export trade as well as the re-export of colonial produce. However, it was not well situated to serve the expanding manufacturing industries of the North, and so increasingly lost business to the northern ports. Liverpool, for example, became the premier port for the cotton trade, both in terms of importing raw cotton and exporting finished cloth, despite London's early role. By 1913, London was handling only 19 per cent of British exports and 33 per cent of imports, and that was measured by value. The trend in bulky commodities was definitely away from London and towards other British ports, whether it was imports of wool and wheat or exports of textiles and iron and steel. Only in re-exports was London still dominant, with 54 per cent of the total trade in 1913, by which time they were running at £107m per annum (1910–13) as compared with a mere £19m per annum in the 1850s. Nonetheless, there was a growing ability to conduct direct trade between producers and consumers through improvements in world transportation, with the steamship, and communications, with the telegraph, supported by the growing volume of world trade which could justify bilateral shipment. Increasingly continental Europe, for example, drew its supplies of wheat, wool, rubber and copper directly from the producing countries and not via London, thus avoiding the costs and inconvenience of trans-shipment. Ports such as Antwerp, Amsterdam and Hamburg were all major rivals to London in an international competition for handling the world's trade, especially Europe's exports and imports.[12]

Nevertheless, the trends in the physical trade were not universally against London. Continuous improvements in internal transport within Britain did allow London to retain a position as a major redistribution point for both imports and exports. This was especially so in the higher value goods where transport costs were of less importance than marketing and specialised knowledge. In imported commodities like gums, drugs, feathers, furs, platinum, diamonds and quicksilver, much of the physical trade continued to pass through London as that was the only place with the organisation and expertise capable of handling them. Rather than diminishing over time, the

variety of imports continued to expand, providing ever greater opportunities even though bulk trades like cotton and wheat were lost to other ports.

Also, as imports of manufactures expanded, such as speciality chemicals from Germany, they too came to pass through London. A similar pattern was also observable in exports, for only in London was it possible to assemble sufficiently large cargoes of miscellaneous goods for shipment to specific destinations. Again in re-exports, London's combination of expertise, organisation and convenience made it a popular entrepôt to which goods could be shipped and stored before despatch to a final destination, as was often required for seasonally produced crops. Many bulky commodities required careful inspection and quality testing before sale to users, such as in the case of wool or tea, and London was one of the few centres where such a facility was available. More specialised goods, like African curios or Oriental carpets, commanded a very limited number of buyers and, again, it was only a centre like London that could offer vendors a suitable market-place in which to display their wares. Consequently as London lost one re-export trade, because its volume and popularity could justify a full organisation at source or destination, another quickly appeared. The re-export of rubber, for example, rose from approximately 50 tons in 1850 to 45,000 tons in 1913, with London drawing in supplies worldwide, but especially from Malaya, and directing them to continental Europe and North America.[13]

The result was that even if London was losing trade to other ports, both at home and abroad, it was continually acquiring new specialities. In the bulk trades, like tea or rubber, this success was very dependent on the Port of London's charges *vis-à-vis* other centres, as frequently neither London nor Britain was the final destination. The London Chamber of Commerce observed in 1898 that 'one penny or two pence per ton often decide whether the goods come here or be shipped by the direct Foreign Lines'.[14] London retained its competitive position throughout the inter-war years, with its share of UK trade rising from 29 per cent in 1913 to 38 per cent in 1938. However, its ability to compete effectively after 1945 was, along with other UK ports, progressively reduced as its charges rose more rapidly than other ports, especially those on the continent, such as Rotterdam. In particular, the National Dock Labour Scheme, established in 1947, created a cost structure that limited the savings which could be obtained from port mechanisation, the means used between the wars to maintain London's competitive position.

Though the volume of goods handled by the Port of London continued to grow until 1960, before experiencing an absolute decline, major trades like tea, wool, butter, cheese and timber were already being diverted elsewhere, especially abroad. Even within Britain London's share of the tea trade fell from 76 per cent in 1962 to 39 per cent in 1971, for example. In general, the physical trade in bulky commodities came to bypass London completely after 1945 owing to the Port's inability to adjust its costs to those of its competitors, largely as a consequence of the government legislation introduced at the end of the war, and subsequently reinforced. Prior to that London had been able to command an important position as a major entrepôt.[15] The result was that, within Britain, it was ports such as Felixstowe, which were not covered by the Dock Labour Scheme, that gained an increasing share of the trade through their lower cost structure and more flexible arrangements. Whereas in 1965, 95 per cent – by volume – of all UK non-oil trade passed through ports in the scheme, like London, this had fallen to 70 per cent by 1988.

Within Europe, it was developments like that of Rotterdam's Europort that ousted London as the focus of Western Europe's seaborne trade. Even goods destined for Britain were being landed at Rotterdam, Antwerp or Zeebrugge and then trans-shipped to the UK by ferry. Although London's smaller docks were located too far upstream for the container trade, it was costs not physical barriers that prevented the others from remaining competitive. Similarly in air traffic, though, for example, while London maintained its traditional position as Europe's premier passenger transport hub, it lost that role in freight to Frankfurt and was closely challenged by Paris. Planning controls and a lack of investment undermined its ability to respond to the new and growing demands of the international air traffic market. Nonetheless, whatever the benefits of direct transit by land, sea or air, there continued to be a need for strategic centres to which freight and passengers could be fed to and flow from and London remained well placed to hold a premier position.[16]

Of course, this did not mean that the City's involvement in the physical trade remained unchanged until 1945. Even before the Second World War, when around a third of the City's warehouse space was destroyed, the storage of goods had largely moved down the river. Increasingly, it was only the highest value goods, like gold, furs, diamonds, oriental carpets and foreign curios that were actually accommodated in the City, while the other commodities and

manufactures coming to London were stored elsewhere. Nevertheless, though the warehousing was slowly being driven out of the City, owing to competition from offices that could afford higher rents, much of it remained in close proximity, allowing easy inspection by City merchants. In that sense the handling of the physical trade still remained an important City activity until the Second World War, though the actual storage of most goods was no longer there.

The real demise of the City's participation in the physical trade came with the decline of the Port of London as an import/export/re-export centre, especially in competition with such continental ports as Rotterdam, Antwerp and Hamburg, and that can be dated from the Second World War.[17] This was not only due to the restrictive practices the war ushered in, but also the diversion of trade away from London during both world wars as producers avoided the war zone and sent their products to neutral markets, as happened with spices, wool and metals. The First World War did bring some compensations, such as London's increased importance in fur owing to the Russian Revolution, and sugar due to the disruption of the European sugar-beet trade, but some trades were irretrievably lost. The Second World War brought only losses. Although some trades did return to London after 1945, even more gradually disappeared as the loss of the Empire led to the ending of the system whereby colonial produce was automatically sent to London for re-sale on the world market, whether it was South African gold, Indian tea or Malayan rubber. UK re-exports of rubber, for example, which had stood at around 50,000 tons per annum in the inter-war years, recovered to reach 82,000 tons per annum between 1955 and 1959, but by 1968 had slumped to a mere 9000 tons, by which time they had been largely replaced by direct shipments from Malaysia and Ceylon to world markets. In wool, while there was some recovery after 1945, it never reached post-war levels, with 114.3m lbs in 1950 compared to 197.1m in 1939 or 449m in 1922. However, by 1967, a mere 15.2m lbs was re-exported. Similarly in tea, in 1934–8 London's share of the sales held in Britain, India and Ceylon was 64 per cent of the total, whereas by 1951 it was a mere 18 per cent, and though some recovery did take place, London had lost its position as the centre of the physical trade to markets in the producer countries.[18] One of the last to leave was the international fur trade, which moved out in 1989. With fur sales now being made mainly in Scandinavia and Leningrad, the expense of a City of London location could no longer be justified. Of the few commodities for which the City is still the

physical market, two are gold and diamonds, despite competition from Zurich and Antwerp respectively. Other valuable goods, that commanded an international market were handled elsewhere. Most notably the trade in precious works of art, which London took from Paris after 1950, was dominated by the firms of Christie's, Sotheby's and Phillips who had international sales of £1.5bn by 1986–7; yet their salerooms were not in the City but in the West End.[19]

While a number of the trends in the physical trade meant that the City would, inevitably, decline in importance, especially with regard to warehousing, the large downturn that did take place can also be ascribed to the general demise of London as a port. That was due to a combination of the temporary effects of two world wars, the ending of a privileged position in Imperial markets and the loss of competitiveness because of the difficulties of modernising the port and profiting from the investment under the Dock Labour Scheme. In addition, the ending of free trade and the growth of protection, from the 1930s onwards, reduced the attractions of London as a free port, after almost a century of development in that field.[20] The result was that whereas before 1914, and even before 1939, the City of London was a major trading centre for both commodities and manufactures, its relative importance diminished rapidly from the 1950s onwards. This seriously curtailed the role that City merchants had been playing in the physical trade until then, largely ending the City's connection with the type of commerce upon which its prosperity had been originally founded.

With or without two world wars, and the changes they brought, the importance of the physical trade to the City would have undergone relative decline. As it became progressively easier to transport goods direct in an integrated world economy, the relative need for intermediate storage points diminished. However, the very changes in communications that were continually undermining the City's role in the physical trade, also allowed it to play a greater role in the organisation of that trade on a world scale. Previous to the telegraph, cargo and the documentation that it required travelled at much the same pace and even on the same ship. In contrast, with the telegraph, information and orders could be transmitted much more rapidly than the goods themselves. By the late 1870s London was connected to all the major commercial centres by telegraph so allowing rapid communications worldwide. By 1903, for instance, the telegraphic office at the Baltic Exchange was sending or receiving an average of 2.4 telegrams a minute during the working day. In addition, international tele-

phone links which began in the 1890s provided instantaneous contacts while the use of air travel, from the inter-war years onwards, allowed the rapid movement of both samples and agents, further facilitating the central organisation of international trade.[21]

The result of this communications revolution was that it became possible to conduct a global trading business from an office in the City, maintaining constant contact supplemented by rapid visits and the receipt and despatch of samples and catalogues. Ships' captains, for example, were transformed from being independent agents, trusted to conduct the best business they could with the firm's assets, goods and finances, into extensions of central office, receiving instructions and advice in every port at which they called. From 1901 onwards, the ship at sea was not immune with the introduction of wireless telegraphy. The office in London was now responsible for the details of assembling cargoes, the ship's loading and unloading, bunkering, provisioning and manning, arranging passage, handling customs, organising insurance, etc. Specialist firms emerged in the City concentrating on particular types of ships, particular cargoes or particular routes. Erlebach & Co. managed ships for the sugar and mineral trades, with connections in Hamburg and Paris, while Gellatly's linked branches in Manchester, Liverpool, Glasgow, Antwerp, Hamburg and Marseilles with agencies in Jeddah, Suakim, Port Sudan and Khartoum in order to build up an extensive European/Middle East shipping business. Firms like these also moved into air freight and travel agency when opportunities in these areas opened up in the inter- and post-war years.[22]

The City established itself at the very centre of this world communications network with such success that shipping firms from other parts of Britain either opened offices or appointed agents there, so as to gain access to the London shipping market, and this was followed by numerous ship owners from other countries, such as those of Scandinavia and Germany. Thus, even though Britain's share of the world shipping fleet experienced a relative decline, falling from 40 per cent to 34 per cent between 1850 and 1913, then falling further between the wars, and again after 1945, reaching a mere 3 per cent of the world's fleet by the mid-1980s, the City of London dominated the movement of international shipping for much of the period. It was the only centre with all the information all the time, and it was important to be represented there if cargoes were to be picked up.[23]

As *The Times* noted in 1928:

> Every day owners in many continental cities are kept in touch by telephone with the changing conditions in the freight markets in London.[24]

This resulted in much business for the City as Maughan noted in 1931:

> A large amount of the business carried through in the London freight markets relates to vessels of foreign nationalities which are fixed to and from foreign countries, and the business does not otherwise touch this country.[25]

Even as late as the mid-1950s an estimated two thirds of the world's ship chartering business was done at the Baltic Exchange, though this was declining owing to competition from New York and later Hong Kong. The proportion was down to half by the mid-1960s and by the 1980s the Baltic was more a place to gather information than to arrange business. However, there was some compensation in the growth of a world air charter market which was also centred on London. This had been started in 1938, closed down during the Second World War, and then restarted in 1949.[26] Thus, although the British registered fleet proved itself increasingly uncompetitive, especially after 1945 with regulated manning levels, the City not only retained a major, if diminished, position in shipping but also moved into allied areas like air freight.

As in shipping so in trade itself the organisation either continued to be done in the City even after the physical movement had gone elsewhere or even gravitated to London from elsewhere. In grain, for example, although Liverpool became the principal centre for importation and flour milling in Britain, London remained the organisational centre not only of the British but the international grain trade. This included the maintenance of links with other grain producing or consuming centres in the operation of a 24-hour global market.

'It is possible for dealers in London to carry through transactions with one or other of the world's markets at every moment of the day or night,' reported Maughan in 1931.[27] Firms from all over the world, and from within Britain, gravitated to the City as an ideal place from which to organise their business. Harrison and Crossfield, for instance, had been established in Liverpool but moved to London in 1854. By the 1890s they controlled from the City an international

distribution network in tea and coffee extending from producers in India and Ceylon to customers in Europe, USA and South Africa. Other firms that moved to the City from Liverpool included John Swire & Sons (1877), Balfour, Williamson & Co. (1909) and Booths (1946). Similarly, plantation companies producing tea, rice, spices and rubber, whatever the origin of their founders, found it convenient to establish either branches or connections in London, through which their products could be marketed and their supplies obtained.[28] Though the First World War did hamper the ability of City firms to manage a worldwide trading business, the structure was left largely intact and London soon recovered its position, continuing to attract firms from other parts of Britain, especially Liverpool. However, the Second World War, and the changed circumstances that followed it, was to undermine the basis upon which the City's supremacy in the organisation of world trade had been based.

This supremacy was based firstly on a continuous and easy access to information concerning world trade and the conditions affecting it, such as crop statistics, harvest conditions, stocks and prices. Beginning with the telegraph and progressing through a series of technological developments, and supported by a network of contacts and agents, the City was able to maintain a commercial intelligence network unrivalled anywhere else in the world. This network was to be of immense value in two world wars. However, improvements in communications was a two-edged weapon. Not only did it give the City increasingly instantaneous access to information previously restricted to local markets and so allow it to direct operations at great distance, but it also reduced the necessity of a physical presence in the City itself. As long as access to the international communications system could be gained, businesses could be managed from almost any location, and that became progressively easier with the technological developments of the post-1945 era. As a result, faced with rising rents, City merchants began to locate all or part of their operations in other centres, such as the shipping firm Turnbull Scott & Co.'s move to Farnborough in 1970 or Ralli Trading Group's switch to Liverpool in the 1960s. Two world wars also taught many merchants elsewhere in the world how to do without the City's central direction, forcing them to develop their own lines of communication.[29]

Though the access to a commercial intelligence network was of major importance in the City's ability to dominate the organisation of world trade, it was the way in which that information was used that

was all important, and that rested on the expertise and contacts of the City's merchants. Of major importance for London's position as a world trading centre was the number, experience and flexibility of these mercantile firms in the City for, as they themselves recognised, the business was becoming more and more competitive. As early as 1896, Richard Foster, of the City firm of merchants Knowles and Foster, observed that:

> In these days of railways, steamships and telegraphs, merchants have to work more cheaply than they did forty or fifty years ago, and they have to do more work to make an equal, perhaps a smaller amount of money.[30]

With motor transport, air travel and telecommunications, the level of competition increased even further. Successful City firms were always willing to take up new commodities, products or markets and become experts in them, if there was the prospect of gain. There was a rapid response, for example, from London merchants to the new opportunities in rubber trading. Lewis and Peat, who began as spice brokers, had by 1909 most of their turnover of approximately £6m per annum in rubber. Similarly Churchill & Sim began as general merchants but by the 1880s they concentrated on timber, specialising in such varieties as walnut, ebony, satinwood, cedar and rosewood, and acted as intermediaries between the large producers and either the large consumers, like builders, or the smaller retail timber merchants. Long-established City firms were continually changing in response to new needs and opportunities, gradually shedding the business of general merchants to concentrate upon serving the trading requirements of a particular region or country, such as Blyth, Greene, Jourdan & Co. in Mauritius, or of a product, like Goad, Rigg & Co. in hair, or of a skill, as with merchant banks in the provision of trade credit.[31]

Equally important was the continuous influx of talent from other parts of Britain and abroad. The metal trade, for example, benefited enormously from the arrival of individuals who were already experienced in the trade through either Cornish tin and copper mining or the Welsh smelting industry, as with Vivian, Younger and Bond (VYB). Shipping drew in many from the north-eastern ports like Whitby, which had a long tradition of shipowning and managing, as with Turnbull, Scott. However, propelling London into the forefront as an international trading centre were the foreigners who arrived

and set up operations in the City. The Greeks, for example, were heavily involved in the shipping and grain trades, having gained their initial experience in the Mediterranean. They were a major component of the Baltic Exchange's membership. Germans were also an important force, being of major significance in both sugar and coffee, reflecting Germany's position as a principal producer of one and consumer of the other. Julius Czarnikow, for instance, came to London in 1854 from Germany and established a worldwide business in both sugar and coffee trading, through not only his existing German clients but also developing new branches in Glasgow, Liverpool and New York. These immigrants, whether from within Britain or abroad, were important not only for the talent, experience and expertise they possessed but also for their existing contacts in other centres. By choosing to base their operations in the City, they brought in their train a ready-made distribution network for either products or areas which could be directed from London offices. In the same way, the production firms that established agencies in London, whether mining companies or colonial plantations, also made London a centre for supplies. The giant German metal mining and refining company, Metallgesellschaft, which dominated world zinc production before 1914, based its trading operations in London, for example. Similarly, the plantation and trading group Duncan Brothers, which operated in India, moved its head office to London in 1919.[32]

Especially before 1914, the City was becoming the world focus of trade. As international commerce became more complex, with more goods being exchanged between more countries more frequently, it became imperative that the flow was organised as efficiently and cheaply as possible. In the past, this had involved the taking of goods to central locations and the holding of regular fairs which buyers attended. Telecommunications allowed these physical markets to be bypassed but necessitated the direction of trade so that the appropriate goods arrived at their destination at the time required, in the amounts needed and at the price agreed. This was the role the City merchants played, and that was why the City attracted so many individuals and firms from other parts of the world who centred their operations there. As Barnard noted concerning the Australian wool trade:

> The marketing process was a long and fairly complicated one, involving the physical transport of the goods over long distances

and the intervention of many skilled market functionaries to bridge economic separation of consumers from producers.[33]

With a bewildering variety of commodities being traded in the world, all subject to the same complications, the need for City merchants to direct operations from their central locations was growing not receding before 1914. It is not surprising that it was a City merchant – Marcus Samuel – who emerged to organise the international trade in petroleum products in the late nineteenth century, naming the company eventually formed – Shell Transport and Trading – after his family firm's earlier speciality, which was shells for trinket boxes. It was not just in commodities that the expertise and worldwide links of the City merchant were required, for they were also important in the sale of British manufactures worldwide. Only a few firms were large enough, with distinct products, to justify their own distribution system. Instead, the majority relied on merchant houses to sell their products internationally, whether it was cotton goods from Manchester or railway chairs, points and crossings from Middlesborough.[34]

However, in the years after 1914, London's attractions as such a centre, and its ability to organise trade, were gradually undermined. Firstly, both world wars led to discrimination against particular groups, especially the Germans, who were excluded from membership of such bodies as the Baltic Exchange. As Hodges reminisced concerning the impact of the First World War: 'At last it was brought home to the Mincing Lane fraternity that a foreigner really had no standing in this country.'[35]

Thus, in both the inter-war years, and for long after 1945, there was a general resistance to foreigners setting up business in London, as they were long excluded from important trade organisations like the exchanges. At the same time the operations of London merchants in foreign countries were being curtailed. In the 1950s it was often difficult to obtain the British staff willing to spend years abroad managing operations, on account of the attractions of easy openings within Britain itself. This broke the continuity of ties that had linked commercial operations abroad to an office in London. This was further worsened by the growing nationalist feeling in countries where British firms had operated successfully in the past, such as India and Latin America. The result was a gradual withdrawal from these countries by City-based commercial concerns. Wallace Brothers, for example, lost its teak business in Burma and gradually

sold out its Indian enterprises. Consequently, many City firms with worldwide trading interests were either liquidated or moved into other activities, such as hire purchase, merchant banking or insurance in the UK, or transferred operations to more hospitable countries like Canada, Australia and the USA.[36]

Generally, the Second World War represented a disaster for the City's trading interests, not so much from the physical damage but from the loss of contacts and expertise. During the war, valuable contacts were lost, while key staff left with many not returning.

As the historian of the metal brokers, Vivian, Younger & Bond, noted in 1959, the staff who returned after the war:

> were completely out of touch with office life and, moreover, had no conception of the vast amount of paper work, forms and official requirements needed to effect a simple shipment of tin from one country to another . . . They had left when VYB was alive and vibrating with energy and enterprise; and on returning it must have been a great shock to see the effects that war and rigid controls had had on the business.[37]

Though the First World War had undermined the City's extensive mercantile contacts, especially the strong Anglo-German links, and given an incentive to the United States to bypass London in both marketing goods and obtaining supplies, it was the Second World War that spelled the end of both firms and contacts that had taken a century to establish. It was not going to be easy to re-establish these contacts, in the face of strong competition from countries less affected by the war, but that task was made more difficult by the trading restrictions that followed the end of the war.

Even after the First World War there were attempts by governments to control trade in order to limit the damaging consequences of rapid oscillations of price due to fluctuating supply and demand. There was a growing unwillingness to trust the market and a greater desire to influence the working of that market through quotas and cartels. In particular, primary producers faced with an oversupply and a falling price tried to restrict output in a wide range of commodities in order to bolster the price. As a special correspondent of the *Financial News* noted in 1934:

> Today we are in a period of restriction and monopoly, with quotas, import boards, exchange regulations, and every conceivable device

> for preventing the free flow of international trade. Competition in industry has given place to amalgamation and semi-public monopolies. In these circumstances, it is only natural that the importance of the merchant should have declined somewhat. Depending on international trade, he finds his source of income dried up; accustomed to deal in goods for home consumption, he finds them delivered direct from producer to consumer. The delicate adjustment of price according to the relation of supply and demand, which was the function of the merchant, has been replaced by crude price-fixing schemes and strife between monopolies of producers and consumers.[38]

In metals, numerous attempts were made to control the market. Between 1926 and 1930, for example, a copper cartel was in operation organised by American mining interests in order to stabilise or raise prices. It bypassed the London market, selling to customers through an agency in Brussels. However, as with almost all cartels, the artificially high prices encouraged new production, in this case Rhodesia, and the cartel broke up in the face of these supplies. However, in 1935 another attempt to organise a cartel was begun. Similarly, government intervention in tin dated from 1920, leading to the formation of the Tin Producers' Association in 1929 and the establishment of a buffer stock in 1934. This again had a detrimental effect on London, as did the zinc cartel from 1928 and lead in 1931. Short-lived as many of these were, they did lead to a temporary bypassing of the London market, replacing the mechanism of the City merchants with inter-government or inter-company agreements and contracts.[39]

It was, of course, not only in metals that the operation of the open market was increasingly controlled. There was an international tea agreement in 1933, for instance, while the grain trade was circumscribed by quotas, output controls, subsidies and other forms of intervention in the 1930s.[40]

With the coming of war, the government quickly took control of supplies, replacing the merchant with government agencies, many of which were run by the merchants with their vast experience of arranging worldwide supplies. Some credit should be given to the ability of those trained in the City to organise victory during the Second World War. When the war was over, after the difficult years of the 1930s, there was no consensus that trade should be immediately returned to private hands. In fact, the feeling was that while the

market economy had failed in the 1930s, state direction had succeeded during the Second World War, and thus the state could organise trade better than firms of merchants.

As a result of this belief, it was only gradually that trade was returned to private hands, with many branches not being restored until the early 1950s. Consequently, over ten years had elapsed between the beginnings of state control in 1939–40 and its being relinquished, worsening the re-establishment of normal peacetime trading links.[41] The sugar trade, for instance, was under government control until as late as 1957, and as James & Sayers, observed in 1963: 'After such a long period of control, the local market was somewhat unaccustomed to free trading.'[42]

However, even after the government abandoned its attempts to organise trade via state run boards, regulations remained. Despite the lack of success of previous arrangements, producers tried continually, through inter-government agreements and agencies, to control the marketing of commodities, bypassing the market mechanisms in the process. This happened in metals such as tin, with the International Tin Council, oil, with OPEC, and other commodities like grain and cotton. There was an obvious desire by producers to control the market in their own interests and this, inevitably, undermined the operations of intermediaries in the City of London.[43]

At the same time, the way trade itself was organised was being transformed. In many cases the state either owned or controlled production while the interests of consumers were served by government purchasing agencies. In the trades that remained independent, multinational corporations took over all the functions that had been the preserve of separate producers, shippers and retailers, and so internalised the intermediary function that had once been performed by City merchants. In tea, for example, approximately 90 per cent of the UK trade had been organised from Mincing Lane in 1926, while by 1970 85 per cent was controlled by four integrated companies. Similarly in sugar where, between the wars, merchants began to acquire plantations and so cut out the broker, they in turn were bought up by manufacturers after 1945, with the market being bypassed altogether.[44] As the *Financial Times* noted in 1986: 'Since 1945, the entire structure of international trade has changed with the emergence of multinational corporations on the one hand and of state traders on the other.'[45]

Generally, after the Second World War, it became difficult for firms to run a successful worldwide merchanting business, while the

high level of taxation in the UK encouraged City firms to site their operations elsewhere. The result was a steady decline in the commercial element of the City as it ceased to be a convenient and attractive place from which to run a worldwide trading operation.[46] Whether they were a product of that development or contributed to it, the large integrated companies had replaced the City merchants by internalising their trading arrangements. Increasingly, international firms controlled the production, transportation, processing and sale of commodities and manufactures, so bypassing the facilities provided in the City. Integrated leather companies, like Barrow, Hepburn & Gale, which were merchants, tanners and manufacturers of leather goods, cut out the City merchant at all stages. Overall, the vertical integration of firms eliminated the middlemen.

Illustrative of the process were the international oil companies like Esso (Exxon), Shell or BP. They controlled the industry from the production of the oil to the sale of the refined product without the need for any intermediaries. It was only with their loss of control over production in the 1970s and the growth of independent petroleum retailers that a role developed again for the merchant, which had existed before 1914, but not subsequently.[47]

Therefore, through a combination of world war, government restrictions, international cartels and integrated firms, the role played by City merchants in organising world trade in 1914 largely disappeared after 1945. Some of the integrated firms and government organisations did establish themselves in offices in or near the City, but many did not, conducting their business from other centres or abroad. None of the major international grain traders of the 1980s, for example, were UK based.[48] Nevertheless, City firms did continue to play a role in the organisation of world trade, specialising in such complex operations as countertrade, which involved the arrangement of complicated barter deals. As the *Financial Times* noted in February 1986, 'London has emerged as one of the premier centres for countertrade'.

Countertrade represented 5 to 10 per cent of world trade (approximately $100–200bn per annum) by the mid-1980s and London had overtaken Vienna as its principal centre. The trade had emerged through the problems of conducting trade between the East and West caused by inconvertible currency. Barter was the solution, and as the problems affected other countries with exchange problems so London became the international centre, attracting firms from all over the world to operate there, such as US firms like Philipp Bros and

Manufacturers Hanover, who both maintained London offices.[49] However, countertrade was a small consolation for the position the City had once held in world trade.

For the City the consequences of this decline were far-reaching for it lost the position it had once held and which, with continually improving communications, it would have expected to continue fulfilling. In fact, there seemed, after 1945, to be a general reluctance to trust unregulated markets, with the result that the market itself was increasingly controlled and supervised or completely bypassed by integrated companies and government agencies. This had serious consequences for the numerous merchants, brokers, agents, factors and others in the City who had flourished in an era when world trade was rapidly expanding and contained vast numbers of unorganised individual producers and consumers. Whether that world would have changed anyway, it is difficult to say but two world wars and the economic collapse of the 1930s ensured that it would not remain unaltered. Though conditions were difficult between the wars, the commercial element in the City continued to be of major importance. It was to be the Second World War and the altered world it ushered in, at home and abroad, that destroyed the commercial element of the City.

This decline of the City's commercial element also had implications for the British economy. Whereas the large companies, that were coming to dominate the economy after 1945, could maintain international distribution networks for the sale of their own products, the numerous smaller companies were provided with a poorer service which denied them easy access to the world market. In 1987 only half of the 12,000 UK companies with a turnover of between £1m and £10m were actually involved in exports. Altogether there were some 125,000 UK manufacturing companies employing less than 100 people. For these firms it was both difficult and expensive to gather the relevant information about the specialised foreign markets they could hope to supply and this could not be justified by the potential sales. In the past this task had been accomplished by City merchants who possessed the economies of scale to support such operations, since they were handling a variety of similar products from different firms or supplying a particular market with a range of diverse goods. It was estimated that in 1950 these merchant houses still handled around one third of UK exports but by 1965 their share was down to 15 per cent and the decline continued thereafter. Consequently, there was a direct causal connection between Britain's poor export performance

after 1950 and the decline or disappearance of those City firms that had once acted as the intermediaries between British manufacturers and their overseas customers.[50]

However, there was one other aspect of the City's involvement in international trade that was even more remote from either the movement of commodities and manufactures or its direction and organisation, and that was the formal markets in commodities. These markets evolved out of the need for those engaged in any particular trade to communicate with each other. One of the problems in the continued growth of the number of intermediaries, and their increasing specialisation, was a means by which they could come together to focus on any particular trade or business. Otherwise, there would be little advantage in having the organisation concentrated in any one particular location. Physical proximity was, of course, a major advantage in this with particular trades concentrated in particular areas of the City, which made contact between neighbouring offices very easy. Mincing Lane, for example, was an especial haunt of firms dealing in coffee, tea, sugar, spices, rubber and other such products. A further development was the formation of organised markets in each of the various trades, as these provided a convenient time and place at which meetings could take place and arrangements made between all who were involved in the various aspects of a trade. The shipbroker, Percy Hartley, remembered in the 1930s that 'it was part of my duty in the rice season to run around the Burma market two or three times daily offering steamers'.[51] Hence the Baltic Exchange developed the market for shipping and grain while the Metal Exchange was established in 1882 to deal in tin, copper and lead. Out of the London Commercial Sale Rooms, which acted as a central market for all types of imported produce, evolved a series of separate markets as the volume of business grew large enough to justify it, as with rubber, while the gold market appeared in 1916 during the First World War. Each of these exchanges and markets had its own peculiar means of operation, reflecting the needs of its membership and the trades they handled, and each served a particular function. In grain, for instance, entire shiploads were traded on the Baltic Exchange for clients worldwide while the Corn Exchange dealt in smaller amounts, splitting up shiploads purchased at the Baltic, to meet the needs of domestic consumers, like the flour millers. As a result there was some overlap in membership and trading between them as customers' needs were met.[52]

Again, within each of the markets there was further subdivision

with some members specialising in buying and selling on commission – normally brokers – others trading on their own account, taking the profit or losses that resulted from ownership – normally merchants or dealers – while others were merely acting on behalf of specific vendors or purchasers – normally agents – or were offering storage facilities, like the warehousemen. For all, the market, however organised, was a means of bringing their diverse interests and skills together so as to focus on a particular commodity or product at a precise time. This could be through an occasional sale, a regular auction, a daily exchange or informal meetings and rounds of office visiting. Out of this also grew the associations which were formed by the participants themselves to supervise the conduct of these markets and arrange the co-ordination of members' actions, whether complementary or competitive. Increasingly, the self-interest of the majority ensured that the various markets were policed so as to make them more efficient and less prone to abuse, such as fraud and corners, though this gave them the ability to restrict entry and limit change as well.[53] However, the need for physical contact, and thus proximate location in the City, was lessened with the introduction of the telephone from 1879 onwards. By 1905 the number of telephone subscribers in the central area of London had reached 10,000 and this number was growing rapidly despite complaints concerning the poor service, Increasingly, telephone communications replaced the need for a physical presence on the floor of the exchange, at the auction or in each others' offices, though the need to maintain an office within a particular area or street in the City remained strong, if a firm was to be closely involved in its chosen trade. Not all business could be conducted without physical contact, though the necessity of meeting became progressively less.[54]

Though these visits/exchanges/markets/associations represented the bonds between the various components of the City's commercial organisation, and allowed it to combine successfully size, diversity and specialisation, some came to mean much more than that, creating a role for themselves even after the telephone allowed the physical market to be bypassed. This added another dimension to the City's involvement in international trade, namely the futures trade.

In many products, owing to the limited scale of activity in any individual item, sales could only be conducted through direct negotiation, with the merchant or agent acting as intermediary and building up an expertise and a circle of clients. Most manufactures were of this kind as well as numerous commodities. In others the volume of

business was such that regular auctions could be held but the wide range of quality meant that each transaction was an individual one, establishing a general price level rather than a specific current price. Until some standards could be established, and they were continually being sought, the trading continued to take place through privately arranged deals and long-term contracts, with the auctions providing a necessary check on prices, ensuring that they were in line with market trends. However, there were a few commodities which quickly lent themselves to classification as to type and quality, and were traded in sufficient volume so as to encourage efforts along those lines in order to facilitate buying and selling. Numbered among these were cocoa, rubber, tin and copper, but others were soon to follow, such as wool, coffee, lead, zinc, aluminium and oil. It was even possible to treat shipping as a commodity and create a standard to be traded. Generally, it became possible, after considerable trial and error, to agree upon a number of standard grades and to fix standard quantities, delivery dates and destinations. As a result, the trading process was reduced to one involving the price determination for multiples of identical lots. Consequently, the public market acquired an importance far beyond the simple mechanism of facilitating the meeting of supply and demand, though even in these commodities private negotiation and long-term supply contracts operated.[55]

With the telegraph it became possible for the first time to trade systematically, and with a fair degree of confidence, in future delivery, rather than taking a gamble on a very risky speculation, since it was possible to anticipate expected supply and demand with reasonable certainty. Forward dealing then became a normal part of business. Firms wishing to guarantee the continuation of regular supplies at current prices could buy in the forward market, thus reducing the risks of both price fluctuations and variations and interruptions in delivery, because they could now find others willing to sell them contracts for future supply, as available information now indicated that these were likely to be forthcoming. Those selling future contracts undoubtedly took a risk, as weather could always affect harvests and shipping, but the level of that risk was now considerably reduced as it depended not on vague possibilities but on measurable quantities, like the likelihood of storms and frosts. However, there was a problem as the consumers wanted delivery of a physical commodity that met their exact requirements for type, quality, amount and locations, while those selling forward desired greater

flexibility, so that they could substitute what was available for what was not. The result was a compromise contract for future delivery which was acceptable to both sides, but one which changed from time to time so as to reflect the realities of production and demand. Through these forward contracts a measure of increased stability was added to both production and supply, and the resulting confidence encouraged consumers to become more dependent upon that supply, and suppliers to become more responsive to demand, further stimulating the growth of international trade, and thus the position of the merchants that handled it. The telegraph, and later the telephone, and their use by intermediaries meant a qualitative change in the degree of risk and the way it was handled in trade, with positive consequences for the quantity of trade being conducted.[56]

Out of these standard contracts there came a further development. Purchasers of commodities did not wish to be left with supplies they did not want, at prices above that prevailing in the spot (or current) market when delivery took place, as this would jeopardise their business. At the same time those merchants selling forward continued to be exposed to risk, though a much reduced one. Thus, for those consumers and merchants who wished to reduce even further the risks they took in obtaining and providing supplies, a further refinement took place, and that was a market in the contracts themselves in which there was no expectation of final delivery of a physical commodity. Standard future or option contracts increasingly represented a proxy for the physical market, and reflected trends in it. Thus, a purchaser of a contract wishing future physical delivery could also take out a reverse contract to sell the same amount. If the price fell, the value of the sell contract would rise and that of the buy contract would fall, while if the price rose, the reverse would be true. Therefore, for the cost of the commission paid on contracts, consumers and merchants could shift the entire risk on to others, leaving them free to concentrate on their own business, whether it was manufacturing, distribution or the organisation of trade.[57]

Consequently, there developed in London in the late nineteenth century a number of terminal markets – from the French word for time – which traded in either options or futures, and though these contracts implied, and could result in actual delivery, their function was to act as a means of spreading the risk involved in trade.[58] Increasingly, in the London commodity markets, most of the deals did not result in physical delivery. By the 1980s, for example, it was estimated that at most only 15 per cent of deals on the London Metal

Exchange resulted in the actual delivery of metal to the purchaser. Thus, there was a gradual divorce between the commodity markets and either the physical trade itself or the organisation of trade, which went on through other routes and by other means, bypassing the City entirely.[59]

The role of these commodity markets was closely related to the level of instability faced by either producers or consumers, and that fluctuated considerably after 1914. During both world wars the government took control of supplies, buying on long-term contracts, and so the need for the exchanges was removed as there was no open market. In addition, the growth of producers' cartels, which set prices and maintained them by restricting output and stockpiling, also reduced the need for a market which would set prices and provide a means of offsetting the risk of price fluctuations. Consequently, these futures markets thrived in times of instability or in commodities subject to rapid price fluctuations, and declined when conditions were stable and price variations moderate. Thus, between the wars, at times when the cartels in metals such as copper and tin had stabilised prices, trading fell away, while the break-up of the cartel and the onset of price competition led to an increase in use. In the immediate post-war years, the incoming Labour Government saw no merit in future trading, regarding it simply as speculation, and so prevented the opening of the exchanges and tried to arrange supplies directly with producers. However, the government gradually realised that it was unable to control world prices and was slowly obliged to free the trade and allow the markets to re-open. This trend was accelerated with the return of a Conservative Government in 1951, but even then with some reluctance as faith in markets had been badly shaken, especially ones whose immediate function was unclear since few actual deliveries took place. Nevertheless, the commodity markets were freed, beginning with rubber in 1946, tin in 1949, cocoa in 1951, lead in 1952 and, finally, coffee in 1958.[60]

The problem was that an interlude of such a length had given opportunities to other futures markets to establish themselves. As early as 1931, Brooks had observed: 'The London markets are not to-day unchallenged in their supremacy in certain trades. In the future, the growth of exchanges overseas will make that challenge more determined.'[61] Though the First World War had destroyed the competition of the German exchanges, as in sugar, it had created even greater competition from New York and Sydney. The position was much more acute by the 1950s with a loss of personnel and

expertise and the entrenchment of rival markets, especially in New York, aided as it was by the strength of the US economy and its increasing need for physical imports and the ability of its companies to organise trade worldwide from American bases. At the same time, the attitude of British governments was not particularly favourable, regarding as they did the commodity exchanges as a means through which balance of payments restrictions could be evaded. Nevertheless, the 1950s and 1960s did witness an absolute recovery of trading on many of the London exchanges, especially metals and soft commodities. However, that recovery was not universal. Some markets never regained the position they lost during the decade of the 1940s.[62]

To an extent, the City's recovery was achieved by London coming to dominate commodity trading in Britain as alternative UK markets disappeared. In particular, Liverpool, which had been the premier British futures market for both cotton and wheat, gaining from London during the inter-war years, failed to re-establish these markets successfully and they gravitated to London. However, London also failed to make them a success and they declined into oblivion. Wheat, for example, only survived on a home-grown wheat and barley contract, which represented a considerable decline from the time when the contract had reflected the world market. Thus London achieved British supremacy but was losing it internationally in many areas.[63] In the wool futures market, London recovered its position *vis-à-vis* New York in the 1950s, having introduced a wool futures contract in 1953, but then lost it to Sydney in the 1960s. In wool (5000lb units), London traded 19,000 in 1954, as compared with New York's 25,000, but by 1963–4 London traded 51,000 and New York 32,000. However, by 1963–4, Sydney was trading 103,000 and though this fell to 69,000 in 1970–1, London had fallen to 5000 and New York to 3000.[64] Similarly in sugar, cocoa and copper. In metals, London gradually improved its position against New York, overtaking it by 1970, though then losing it back. However, it was increasingly markets in producer countries which undermined the position of London as its failure to re-open the markets quickly after the war gave them the opportunity to establish themselves.[65]

As Britain declined as an industrial nation, its share of world consumption of foodstuffs like wheat and tea, or raw materials like cotton and wool, also declined. This created opportunities for the establishment of rival markets in either major producing areas like Australia or India, or other major consumers, especially the United

States. With no longer a dominant market a dominant supplier was better placed to house the most active exchange. Consequently, the City's commodity markets, as well as the physical trade itself, were partially dependent on Britain's economic success, and as that faded relative to other countries after 1945, so did the commodity markets.

However, these markets were left with their insurance role – the minimising of risk for both producers and consumers, and others connected with the trade. This was not dependent on Britain's success as an industrial nation but rested on the ability of the futures markets in Britain to compete with those in other countries, often, in the process, abandoning the pound as the basis of operations and replacing it with the dollar.[66] While never recovering the overall position held before 1914, or even 1939, a number of these markets did re-establish themselves from the mid-1950s onwards, so that the City once again became a major centre of commodity trading.

This recovery did not only take the form of re-establishing existing markets but it also involved the City in moving into new areas when the opportunities arose. The Baltic Exchange inaugurated a futures contract based on the cost of freight in 1985 while the growing importance of both aluminium and nickel in manufacturing led the London Metal Exchange to create contracts in both these metals, as hedges against fluctuations, though producers opposed the move. Similarly, the declining power of the integrated oil companies, and the growth of both independent producers and production not controlled by OPEC, led to the appearance of a market in oil, whose price became much more volatile in the mid-1980s. By 1987, the volume of business on the 15-day Brent crude market totalled $100bn per annum, and had become a key indicator of the world price of oil.[67] That market was providing an important service to all involved in the oil business, according to the *Financial Times* in 1988, for it was: 'able to provide hedges for virtually any size, shape, or maturity of risk for companies that produce, refine, sell, or buy oil in its many forms'.[68] This was followed in June 1988 by a Brent crude futures contract on the London-based International Petroleum Exchange (IPE). In contrast, the spot market in oil, which reflected the physical movement of the product, had grown up in Rotterdam in the 1950s, not the City, as neither London nor other British ports were now attractive intermediary centres for the trade.

The futures market business was itself a fiercely competitive one with rival centres vying for supremacy in individual contracts. As Britain's own requirements for commodities declined, and sterling

disappeared as a major currency, the City markets lost the advantages that had given them a once dominant position. Now it was American centres like New York and Chicago that possessed these advantages, and the City had to become more efficient in operation and more innovative in its contracts if it wanted to retain a position in the market. This meant switching the base for contract, responding quickly to user requirements and opening up its markets to foreign traders. The result was a constant fluctuation in the fortunes of rival centres over a wide range of commodities as each tried to gain an advantage over the other with, for example, new trading systems and contracts, or cheaper commissions. So, for instance, London had to fight New York for the raw sugar market and emerged the victor, and Paris for the refined sugar market and lost. In this London had advantages as contracts based on US conditions were often poor instruments for hedging on the international market, as they were too influenced by local market factors. Nevertheless, where this was the case, London was not left as the only non-US market. In oil, for example, an Energy Futures Exchange was established in Rotterdam in 1989 as an alternative to either New York or London, since Rotterdam already possessed the European spot market and was the world's largest refining and storage centre. Similarly, in the sugar trade, whereas London was the centre of the spot market, New York dominated trading in the raw sugar futures contract, with 73 per cent of turnover as compared with London's 20 per cent and Paris's 7 per cent in 1988. In the white sugar contract, Paris had a slight lead, with 402,000 lots being traded compared to 378,000 on the London Futures and Options Exchange (FOX). Generally, the London-based markets were successful in winning an important share of the world futures market, where it was closely tied to particular commodities. In 1989, the London Metal Exchange (LME) provided virtually the only futures contract in aluminium, lead, nickel and zinc, conducted 80 per cent of the trading in copper and was re-introducing its contract in tin, which it had been forced to abandon in 1985. Altogether, turnover had reached £500bn, most of which originated outside the UK, with the United States, Japan and Western Europe being important sources of business. On the Baltic Exchange, the freight contract – unique in the world – had turned out to be very successful with a turnover of 91,112 lots, worth $1.5bn in 1989. The London Commodity Exchange (renamed FOX in 1987) was also a strong competitor for international business in such areas as contracts on sugar, coffee and cocoa and was moving into new areas with its

base metal contract on behalf of German customers. It was as a dealer in cocoa that Ephraim Margulies built up J.H. Rayner (Mincing Lane) into a major company.[69]

The great strengths of the London markets, reflecting their origins in trade, were that they were not only a means of insuring against risk but also involved the possibility of physical delivery. 'Traditionally, futures markets in London have developed to serve the clear need for trading companies to hedge obvious business risks,' reported the *Financial Times* in 1984.[70] Thus, the markets were extensively used by the trade when either disposing of or acquiring marginal supplies, outside the normal long-term contracts. Before the early 1970s, the risks to be protected against were largely internal to the trade itself, involving fluctuations in supply and demand owing to weather, strikes and other such variables. However, with the ending in 1971 of the fixed exchange rate regime that had largely prevailed since the end of the Second World War, a new instability appeared, namely exchange rate fluctuations. The contract could be priced in one currency – increasingly dollars rather than pounds – but that could be the currency which neither producer nor consumer finally wanted. With currency instability, the price in their own currency could diverge substantially, creating a major new risk.[71] The London commodity markets were slow to develop contracts that allowed this currency instability to be hedged, as were their major rivals in New York, and this created an opening for others, particularly the Chicago traders. The result was that Chicago, already an important commodity market, emerged as the major centre in the world where contracts to protect against currency fluctuations could be hedged, and this attracted not only that particular business to it but, slowly, the other components of commodity trading, including even the market for physical delivery. By 1980, 70 per cent of the world's trading in futures contracts took place in Chicago.[72]

With currency instability becoming the major risk, especially as commodity schemes, government intervention and integrated companies reduced other fluctuations, the differentiation between separate commodity markets became less and less important. No longer was it as vital to understand the complexities of each trade as to comprehend the overall currency position and possess the liquidity to undertake large deals. This worked against London where groups of markets had evolved separately, with their own distinct rules, modes of operation and membership. Consequently, it was not easy for trading members in one commodity to switch readily to another more

active market providing, in the process, the necessary liquidity it required. This was also not helped by a generally restrictive policy on admissions and the physically separate location of many of the commodity markets, such as the Baltic for grain, freight, etc., the International Petroleum Exchange for oil, the Futures and Options Exchange (London Commodity Exchange) for sugar, cocoa, rubber, etc., and the London Metal Exchange for aluminium, copper, lead, nickel, etc.[73] At the same time the commodity exchanges had been rather lax on regulation which resulted in a series of scandals where clients had lost money. The effect was to dissuade potential investors in the commodity markets and so reduce the available liquidity, which was necessary for sustaining an active market.[74]

Altogether, the *Financial Times* expressed a rather pessimistic view of the commodity markets in 1984, saying:

> The challenge for London is therefore whether it can maintain a clearly distinguishable role in the world market. To achieve this will require sensitive product design, constant innovation, and a much greater readiness to go out and sell the facilities of the futures markets to both trade users and investors.[75]

Consequently, the switch to currency risks exposed certain deficiencies in the London commodity markets and the established exchanges were slow to respond, losing much business to other centres as a result. Even within the City a new exchange – the London International Financial Futures Exchange (Liffe) – was successfully established, and soon overtook all the others in turnover as it specialised in hedges against currency fluctuations. By 1989, of the total turnover on the six London futures and options exchanges, 41 per cent took place on Liffe and another 24 per cent on LTOM (London Traded Options Market, set up in 1978), whereas the traditional commodity markets provided only 35 per cent of turnover (LME – 19 per cent; FOX – 8 per cent; IPE – 7 per cent; Baltic – 1 per cent). Nevertheless, the established exchanges did respond by bringing many of the markets together in one location (St Katherine's Dock), liberalising membership, tightening regulations and introducing such innovations as clearing systems, new technology and traded options.[76] In particular, the City commodity exchanges came to a belated recognition that their future lay not just in servicing the needs of foreign business, but also admitting foreign members and institutions into all areas of their organisation, becoming in the

process international exchanges but based in London. On the LME, for example, 70 per cent of turnover already came from outside the UK by the mid-1970s but this then rose to 97 per cent by 1988. It became accepted that if customers found a more hospitable environment in Paris or New York, or terms that were better in London, the business could easily be switched from one centre to another.[77]

Therefore, as in the 1970s and 1980s international commodity agreements collapsed, fixed exchange rates disappeared and the operations of many integrated oil, mineral and produce companies were broken up or lost their market dominance, the role of the open market was greatly enhanced, and this was characterised by increased volatility of prices.[78] This meant an enhanced role for the commodity exchanges and should have meant a growth of importance in the commercial side of the City of London, as it was one of the major centres for trading in metals and produce. However, the City did not fully exploit the opportunities as it failed to perceive the importance of exchange rate risks at the outset and suffered from the fragmentation of its markets, based as they were on trade specialism and physical delivery. It was only slowly, and with much obstruction, that restrictive obstacles were removed and then with an entirely new exchange (Liffe) making the pace. The centre that gained most from the changes was Chicago, but its lead was slowly eroded, with its share of the world futures market down to 50 per cent by 1990 in competition with exchanges in Western Europe and Japan. Within Europe, the London exchanges faced the rivalry of new markets in such centres as Paris, Amsterdam and Frankfurt. In particular, the Paris futures exchange, the Matif, overtook Liffe in turnover in 1989, though this was largely based on one actively traded domestic contract. In contrast, Liffe was more diversified and international with a significant German orientation since that country was slow to develop its own futures market and so made heavy use of London, which spotted the opportunity and created a suitable hedging instrument. A merger of Liffe with the London Traded Options Market should restore its position as the largest futures market in Europe, and make it more competitive by increasing its liquidity. However, the US exchanges still provided 79 per cent of world turnover in futures and options in 1989, as compared to only 8 per cent in the UK, 7 per cent in continental Europe and 7 per cent in the Far East.[79]

The existence of these futures markets was important not only in removing an element of risk from trade, and thus stimulating its growth, but also through the fact that it made it easier to finance

stocks of commodities awaiting sale. The cost of financing stocks of commodities was a heavy burden and also involved the risk that they would remain unsold or could only be disposed of at a low price.[80] One solution to the problem was to make the title of ownership of these stocks transferable so that it could be bought by other than the original producer or final consumer until it was consumed. Warehouse and dock warrants or railway and shipping receipts, which certified a particular amount, type, quality and location thus came to be regarded as negotiable paper to be bought and sold at will. The ownership of a ship's cargo could alter many times during a voyage as could the contents of a warehouse.[81] 'Warrants for tea are like bank notes and change hands frequently,' was the view of the Tea Buyers' Association in 1900.[82] When tea arrived in Britain it was weighed in the warehouse and sampled for quality before being sold. Its terms of sale included 13 weeks' free rent and free insurance in the warehouse which meant it could be actively traded in that period without incurring any additional charges. Thus, those holding the claim to this tea in store could change repeatedly, and include many who had no interest in the tea beyond the expectation that its price would rise and thus return them a profit.

While it was relatively easy to obtain loans secured on such documentation as warrants and receipts, the cost of the finance and the size of the margin demanded could be considerably reduced if an active market in the warrants/receipts existed. Such a market indicated to the lender that the warrant or receipt collateral for the loan could be easily resold if the borrower defaulted or if the loan was called in before the sale of the produce. It also gave the lender confidence in the amount lent as there existed an acknowledged price achieved through regular and active trading, and this price could be continuously monitored. In the mid-1980s, for example, around £300m had been advanced by banks to support the stockpile of 85,000 tonnes of tin, organised by the International Tin Council in its price-support operation. In coffee, and also sugar, the establishment of the London Produce Clearing House in 1888 – copied from the Hamburg Produce Clearing House – was prompted by a desire to improve the financial arrangements in the trade. By registering standard contracts and guaranteeing that they would be honoured, the Produce Clearing House made such contracts much more acceptable for collateral purposes, and thus increased the supply of finance and reduced its cost. By 1914, many speculators held coffee contracts in expectation of selling at a profit, financing their operations by

loans from British merchant banks, like Lazard Brothers, Kleinwort & Sons and Wm Brandt's, and the London branches of foreign banks, such as Disconto-Gesellschaft and Dresdner Bank. Eventually, this became the International Commodities Clearing House but continued to fulfil the same functions.[83]

Hence, the existence of active markets in the City contributed to the ease with which stocks were financed, and the more active the markets were, and the greater the confidence in the contracts and prices, the less the margin and the lower the rate of interest demanded by lenders. The consequence was that a wide range of commodities and trades were financed in London, frequently involving the exchange of goods between other countries. German exporters of manufactures and importers of commodities obtained finance in London, leading German banks to open agencies there in order to participate in the business.[84] This ability to finance stocks in the City at a lower cost than anywhere else attracted not only the organisation of international trade to London but also the physical trade itself. If there was a doubt about when and where stocks of a commodity were to be sold it was easiest to ship them to London. Though dock and warehouse charges might be higher there, they were conveniently placed for transhipment elsewhere, and could be financed at the lowest possible cost. Consequently, rather than driving commerce from the City through competition for space and talent, the financial sector acted as a draw through its ability to provide low cost credit for such diverse commodities as wool, grain, coffee, copra, rubber, pearls, carpets and copper.[85]

In fact, when it became easier to finance stocks elsewhere, as with the increasing availability of colonial finance for Australian wool in the 1890s, the pull of London declined, though the organisation of the trade remained very much a City responsibility before 1914.[86] Conversely, German legislation in 1896 and 1908 banning future transactions because of their speculative element, made financing more difficult there and led to the transfer of much commercial business to London where such facilities were still available. Many Germans settled in the City from where they organised and financed Germany's involvement in such trades as grain, sugar and coffee. Similarly, the London Produce Clearing House actually cultivated German business from 1897 onwards and by 1913 'Hamburg terms' were the standard basis of agreement with most of the contracts involving German clients.[87]

The existence of these future/option markets in the City facilitated

access to cheap finance and this attracted commercial business to London from other centres such as Hamburg in Germany. While competition for space within the City did help to drive warehousing out, there was more a coincidence than a competition of interests among the City's financial and commercial activities, with each complementing and stimulating the other before 1914. Certainly, there is every impression that, though in the long run the City's trading activities led it into the world of finance, in the period up to the First World War the London money market was an important factor in bringing trade to London. Consequently anything that affected London's ability and freedom to finance international trade, and especially the holding of stocks of commodities, would undermine the ability of the London commodity markets to compete with other markets elsewhere. The interruptions of two world wars, when finance was considerably restrained, had thus a major damaging effect. Longer term, however, were the restrictions imposed after the Second World War when a higher priority was given to domestic recovery, and the use of scarce funds for manufacturing industry, housing and government expenditure. This considerably circumscribed the ability to finance commodity holdings in London and so the market drifted to other centres. Although in the long run it was trade that had brought finance to the City, in the short run the ability to finance trade brought it to London and as this ability was undermined so was London's position as a commercial centre.

Before 1914, the City of London was the only commercial centre in the world that possessed the range and depth of personnel, experience, institutions and facilities to handle the increasingly large and complex network of international trade that developed during the period. No other commercial centre could match it apart from in specific areas and it was largely prices determined in London that represented world prices.[88] The 1958 investigation of the London metal market concluded, regarding the pre-1914 era, that: 'No other centre could rival its closely integrated system of commercial activities, its ability to finance transactions cheaply and readily, or its facilities for holding and storing supplies.'[89] The result was that London was the world's premier metal market at that time. Among the three principal European metal exchanges – London, Hamburg and Berlin – the London Metal Exchange handled 58 per cent of the turnover in copper and 94 per cent of it in tin in 1913. A similar position existed in a wide range of other commodities that entered international trade. Certainly, the position of the shipping market

seemed impregnable, aided as it was by London's dominance in marine insurance, ship inspection and classification, and all the other services it required.[90]

Yet, the City was not dominant in every commodity or service even within Britain. Newcastle was the principal coal market, while Glasgow held the same position for iron and Liverpool for cotton. Abroad, there was increasing competition from a number of centres around the world as more and more countries participated in international trade. Undoubtedly, London's relative share of the physical, office and future trade must have fallen before 1914 as cities like New York and Hamburg grew in importance along with their own countries' economic expansion. Much innovation also took place elsewhere, with Chicago developing futures contracts in grain and Hamburg the produce clearing house. Nevertheless, London was quick to copy, as well as to innovate itself, and rapid absolute growth continued to take place. The sugar-beet market, for instance, handled 0.4m bags in 1888 but 31.3m in 1910 and this was done in competition with continental European markets. Generally, London was the principal market in more goods and commodities than any other centre and frequently possessed an active trading element even where the main market lay elsewhere, as with sugar and coffee.[91] The London Produce Clearing House, for example, experimented with contracts in tea, grain, silk, nitrates, maize, indigo, cotton, fruit, rubber, pepper and copra between 1880 and 1913, as well as handling a large and successful coffee and sugar business. The markets in London were very sensitive to changes in the world economy and responsive to new demands.[92]

Essentially, the City's commercial role can be seen as a collector and disseminator of information and risks, a provider of international services and finance, and an organiser of supply and demand. The City possessed external economies on a giant scale because of the concentration of so many related activities in one particular location, and the development of internal means of communication and contact that facilitated specialisation, co-operation and competition. Though there were always new problems on the horizon, such as the growth of direct trading and large integrated firms, there appeared every prospect before 1914 that the City would continue to play a major role. Its expertise was required to move larger volumes of increasingly varied goods between more countries within an integrated world market. Hindsight may suggest the inevitable dominance of finance in the City, and the exclusion of commerce, but

there is little evidence that that was taking place before 1914. Certainly the financial sector was growing more rapidly than the commercial but then it had started off smaller, and the absolute expansion of mercantile activities remained impressive. Through participation in the physical, office and future trade, the City of London continued to play a vital role in international trade before 1914, and international trade continued to absorb a large and growing number of people and firms in the City. International trade itself grew rapidly. It was events from 1914 onwards, and especially after 1939, that were to undermine the commercial element and leave the field for finance. This did not reflect any absolute lack of demand as international trade grew rapidly after 1945, reaching $3100bn by 1989, but a transformation in the way it was conducted and restrictions on Britain's participation, all of which undermined the ability of the Commercial City to respond to these new opportunities.[93]

Although complacency, institutional barriers and a lack of flexibility contributed to the City's decline as a commercial centre, it is clear that the prime responsibility must rest with the general economic environment since 1914. Two world wars, when normal commercial activity was largely suspended, a world depression in the 1930s in which the major casualty was international trade, and a belief since 1945 that governments were better at arranging supplies than the market-place, along with the growth of the multinational corporation that internalised distribution, combined to undermine many of the functions once performed by a myriad of firms and individuals in the City of London in 1914. These people and their companies have had to find alternative occupations in the City, many of which have been in finance, or cease to do business of any kind. What involvement in trade remained was in small and limited niche areas such as countertrade, speciality items like gold and diamonds, or risks, and in all these competition was extreme with the City having no easy task either to retain its position or gain at the expense of other centres. Apart from the continuous development of expertise, however, the one advantage the City did possess, and continued to possess, was the link between commerce and credit, for that did give it a slight edge over many other centres.

# 3 Credit City

The advantages the community enjoy through the agency of banks is that they collect money from those who do not want it and lend it to those who do, to the profit of all.

A. Crump, *The Key to the London Money Market*, London 1877, 6th edn, p. 11

The London money market is the most important and influential in the world. London is the world's financial centre, and is the clearing house for international payments.

L.D. Wilgress, 'The London Money Market', *Journal of the Canadian Bankers Association*, vol. 20, 1912/13, p. 210

It is one of the factors that has made London the greatest financial centre that here credit is more freely given and, more important still, more cheaply given than anywhere abroad.

H.W. Greengrass, *The Discount Market in London: Its Organization and Recent Development*, London 1930, p. 4

One of the characteristics of the London money market is its ability to adapt itself to new situations and develop new techniques to deal with them.

E.R. Shaw, *The London Money Market*, London 1975, p. 163

The Commercial City begat the Credit City. The City of London's involvement in commerce led it directly into finance, which grew in importance as the scale and complexity of trade increased. Between production and consumption there was often a considerable delay as output awaited sale, and thus payment. Throughout expenses were continually being incurred, such as payments for wages, rent, raw materials and equipment. Naturally, consumers were reluctant to pay for what they had not yet received or did not yet want. This position was particularly acute in agricultural products because their output was determined by nature, with production being concentrated in the short harvest months, while consumption was a year-long process. It also became true in mining and manufacturing for, with the increasingly capital-intensive nature of production, there was a necessity to

operate all year but demand was not constant, experiencing marked seasonal variations. Man-made influences, like custom and holidays, also led to seasonal peaks and troughs in demand, creating financing problems in the process.[1]

As a consequence of these chronological imbalances in supply and demand it was necessary to provide a means whereby producers could receive funds to cover the interval before customers took delivery and made payment. As the economy became more sophisticated this interval became more common as goods passed through many stages before finding an ultimate purchaser. Ellinger, writing in 1940, observed that 'during the process of manufacture and distribution every commodity as it passes from hand to hand is financed many times'.[2] In 1988 it was estimated that an average of 75 days elapsed between delivery and payment of goods within British business with £57bn in unpaid invoices outstanding at any one time.[3]

Internationally, the process was even more complex and tortuous, involving producers and consumers in numerous countries, separated by vast distances and chains of intermediaries, along which products flowed. Without appropriate financial arrangements to match the necessary organisation, international commerce would not have been able to take place on the scale which developed in the nineteenth and twentieth centuries, with fundamental consequences for producers and consumers worldwide.[4]

Thus, integral to the City's success as a commercial centre was its ability to provide the credit essential to facilitate the innumerable transactions between vendors and purchasers throughout the whole trading operation. Initially, this meant the merchant's own capital, which would be used to purchase the goods and commodities, and store them until required. However, if trade, and thus the expansion of the market economy, was not to be constrained by a lack of bridging finance, a much larger source of credit had to be found than the personal fortunes of individual London merchants, no matter how wealthy they were. A mechanism had to be created which gave City merchants access to a large and inexpensive source of finance by tapping into the savings of the population as a whole. It was this that London did successfully in the nineteenth century through the development of an unrivalled money market.

The London money market, comprising a mixture of financial institutions and specialist firms, dealt in short-term credit instruments – claims to future payment – whether it was bills of exchange in the nineteenth century or certificates of deposit in the twentieth. It did so

without any central market as trading took place in and between the offices of those involved, initially in the City of London itself but, later, increasingly with others at a distance through evolving telecommunications systems. There was also no formal organisation to this money market as it consisted of a continually changing group of participants whose relationship to each other also altered over time. The one constant in the market was the commodity they dealt in – money, or more specifically claims to money in the form of short-term debt. These claims were not homogeneous but continually varied in terms of type, amount, time, location and price, and it was the market's function to match supply and demand across all the variables. Money was like any other commodity, which was to be allocated to the highest bidder in the market-place, and had to be used as productively as possible.[5]

Within a market economy money was continually being released and absorbed by different sectors and locations in the daily, weekly or monthly cycle of activity, while periodic booms and slumps created fluctuations from year to year. This led to a constant need to redistribute money from one sector or location to another as circumstances altered, in order to make maximum use of the available supply. In particular, there were always substantial balances that were being held idle in order to meet a wide variety of expected needs in the near future, as well as contingency funds for unpredictable demands. Consequently, there did exist a vast potential supply of cheap finance available for short-term use, as in the provision of trade credit, if its particular conditions of use could be met. Increasingly, this short-term money did not remain in the hands of individuals but was placed at the disposal of the financial system, especially the banks. By 1913 there were 8910 bank branches in Britain, providing a dense network that covered the whole country, and this system had collected £1032m in deposits.[6]

Since the banks frequently paid interest on many of these deposits, and did so in a competitive environment, while they also had to cover their own expenses, it was necessary for them to find remunerative employment for as large a proportion of the money they held as was possible.[7] Naturally, a large proportion of these funds was lent out by the banks to their customers by way of advances or overdrafts, while part was invested in property and securities or kept as cash to meet everyday requirements. However, between the cash that was immediately available but created no income, and the loans and investments that were remunerative but took time to convert back into

ready money, the banks maintained a reserve of call-money that was both highly liquid and did produce a return. Thus, in any crisis the bank could quickly call in this reserve and use the money to meet the exceptional demands for cash that had arisen. At all times banks had to steer a course between prudence and profitability, with the over-prudent being taken over and the less prudent going bankrupt.

It was thus important for the banks to find a home for this liquid reserve as otherwise they would have to keep it idle in the form of cash, so producing no revenue, or be tempted into using it for loans and investments with the possibility that it might be tied up there and therefore not be available to pay out to depositors in an emergency, which could lead to the closure of the bank as it lost the trust of the saving public. Therefore, there was every incentive to channel such liquid reserves to London where they could be employed in the finance of trade. Only in London, because of the volume of its business, was there not only abundant openings for their use, but also the near certainty that the reserves could be easily withdrawn. London received such a volume of money for employment from so many diverse sources that, within its daily turnover, loans were continuously being made, recalled or renewed so that any diminution of supply from one quarter was compensated for by an increase from another. The very scale of operations in the City of London created remunerative openings for money available for the shortest of terms, such as on a daily basis, which were completely absent in other parts of Britain.[8]

During the eighteenth and early nineteenth centuries these funds were channelled from the country banks to the London money market via the London private bankers. These private banks, like Jones, Lloyd & Co. of Lombard Street, possessed numerous contacts with other banks throughout the country, from which they received these liquid funds, and on which they paid interest and were always ready to repay at short notice. In turn, these funds were lent out to those who required short-term loans, not only in London itself but also throughout the country, for northern manufacturers used the London money market to obtain part of the credit they required for their operations. The private banks of the City were acting as intermediaries between those with funds they could not employ – at least safely – and those in need of short-term finance, wherever they were within Britain.

Essential to this process was the market in short-term debt because this ensured that the funds coming to London could be quickly and

easily employed while those that were leaving could do so smoothly and without causing major repercussions in obtaining replacement finance. These short-term debts were normally in the form of bills of exchange, which were promissory notes given by the purchaser to the vendor. They were often guaranteed by a bank or other acceptor, which made them more marketable since it provided a guarantor that was better known and trusted than any individual trader or manufacturer. By selling these bills at a discount to their face value – hence the name the discount market – the vendor obtained immediate payment for the goods sold, the purchaser was given time to dispose of them and the holder of the bill obtained remunerative employment for temporary funds, measured by the level of discount obtained. These bills normally ran for 30 to 90 days and represented a reasonably liquid asset which matured at a specified time and at a fixed price (akin to a post-dated cheque). For even greater liquidity, though smaller profit, banks could purchase bills with only part of their term left to run, or simply lend to the bill-brokers or discount houses that specialised in borrowing short term – usually on a day-to-day basis – and used the money to purchase and hold bills until maturity, benefiting from the differential between the cost of borrowing and the return on the bill. These money market intermediaries operated in the expectation that, normally, they would always be able to employ any money lent to them in the bills constantly appearing in the market, and that they would always be able to finance a portfolio of bills, using the money continuously offered to them, for as one loan was recalled another became available. Their faith in this was further reinforced by their ability to borrow from the Bank of England on the strength of their bill portfolio, though at high rates of interest which they were willing to pay because their other sources of finance were so cheap. In turn, the Bank of England gained in being a lender of last resort for though it could be left with substantial idle balances, when it did lend these it obtained a very favourable rate of return. Thus, by the mid-nineteenth century, there was evolving a complex and sophisticated money market in London that could mobilise the nation's idle short-term funds and employ them in providing the credit necessary for the successful operation of the economy.[9]

In the second half of the nineteenth century the fundamental means of operation of this market remained much the same but its scale, importance and connections all altered substantially. Increasingly, the links between the country and private banks were formal-

ised within the structure of national banking systems. A number of London-based banks, such as Barclays, and National Provincial, expanded their operations so that they encompassed the whole country in a banking network, while major provincial banks transferred their head offices to London, as with the previously Birmingham-based Lloyds in 1884 and Midland in 1891.[10] Altogether, by 1913, the London-based national banking groups, numbering only 15, or 14 per cent of all banks, controlled 4716 branches (58 per cent of the total) and had £660m in deposits (64 per cent of the total). By then, these banking groups dominated the inter-regional and inter-sectoral movement of short-term funds within Britain.[11] In this, the principal attraction of a City location was the ability to employ their idle balances remuneratively in the London market, without operating at some remove, and this became more important as those engaged in banking used their knowledge and experience to minimise the amount of money that was left completely idle in the form of cash. Even the Scottish and Irish banks, which remained largely outside the merger movement, opened their own offices in the City, from mid-century onwards, specifically to lend short-term funds. Also, through the London money market, banks were able to equalise supply and demand for money easily between themselves, reflecting the changing economic fortunes of the regions and activities in which they were strongest.[12]

Thus the City of London's need to provide trade credit created opportunities which attracted short-term money from throughout Britain, which enhanced London's position as a commercial centre, because it was easier and cheaper to obtain the necessary credit there than elsewhere. This, in turn, attracted further short-term funds as the openings for their profitable employment grew, bringing in new commercial business in its wake, and so the cycle continued. There was a constant interaction between the demand for, and supply of, credit which greatly enhanced the City of London's ability to employ money remuneratively, even if available for the shortest of times.[13]

The creation of these large London-based banking groups led to the gradual submerging of local influences, such as regional interest rates, into national trends, with fluctuations in the London money market determining general trends. However, these banks also possessed the ability to bypass the London money market itself. With the existence of their extensive branch networks, directed from a London head office, the national banks could link savers and borrowers by means of transfers within the group, rather than by resorting to the

London money market. Domestic bills of exchange, for example, ceased to grow in volume after 1880, even though the expansion of the economy would have suggested a greater need for them. Increasingly each bank was in the position to meet the needs of those merchants and producers among its customers itself by directly tapping into the deposits existing within its entire branch network.[14] Nevertheless, this still left the banks with substantial funds which they either wished to keep as liquid as possible, but still remunerative, or were unable to employ within their own network at any one time. Collins has estimated that banks had around 14 per cent of their assets in the form of money at call or short notice by 1914, and most of this was lent out in the London money market.[15] According to Warren, writing in 1903:

> this stream of credit flows to London, and as demand throughout the country is not sufficiently strong to attract it all back again, a large fund of loanable capital accumulates in the hands of the London banks, and flows from them to the bill brokers, who employ it in discounting bills of exchange.[16]

Important as the London money market was for British banking, most domestic lending and borrowing took place within each banking group, and this became progressively easier as the size and spread of these banks grew. The London money market would have been reduced to a very marginal, though significant, position by the creation of these banks if it had not developed in other directions during the second half of the nineteenth century. However, simultaneously with these changes in domestic banking the London money market was already finding additional and alternative uses for the funds at its disposal and the expertise and facilities it possessed. This was in the realm of international commerce, which expanded rapidly in this period with Western Europe's demand for raw materials and foodstuffs and its ability to supply manufacturers and services worldwide. Consequently, as the London bill of exchange declined in relative importance domestically it developed into the prime means by which international trade was financed, beginning with Britain's own foreign transactions. From the mid-nineteenth century onwards there was a growing international orientation of the London money market. For example, by 1913–14, of the commercial bills outstanding in London, totalling £518m, two thirds were foreign, representing

trade that did not touch Britain at all. The London money market was thus providing the commercial credit necessary to finance not only British exports and imports but also those of countries like the United States and Germany.[17] As the Canadian banker G.I.H. Lloyd noted in 1914–15:

> The bill on London is a better currency than gold itself, more economical, more readily transmissible, more efficient . . . by means of the bill on London not only the vast commerce of Britain herself, but also a substantial share of the purely foreign traffic of the world is financed and liquidated.[18]

Within the London money market the bill brokers and discount houses continued to dominate the process of borrowing money and buying bills. However, they could not exist without the other financial institutions and intermediaries that fed them with a constant supply of money seeking employment and bills of exchange seeking finance. Established London merchant banks like Baring's and Rothschild's, that had built up extensive overseas contacts through their involvement in trade, made increasing use of these in the provision of trade credit for foreign clients. They were joined by newer merchant banks such as Morgan's and Kleinwort's, which, by bringing their existing foreign correspondent network to London, were able to tie it into the commercial credit being provided in the London money market. By 1913, these merchant banks handled around 40 per cent of the trade finance organised in London.

From the 1860s onwards there was also a growing number of London-based imperial and international banks that were established to facilitate the finance of trade, initially between Britain and other parts of the world but then, increasingly, any commerce involving their chosen region. By the early twentieth century, there were over forty British overseas banks in existence controlling a network of 1156 branches, mainly in such areas as Asia, Latin America, Australia, Canada and South Africa. These were also joined by foreign banks, particularly European, which established branches in London, again from the 1860s onwards. By 1910 there were some twenty-eight such branches in the City while numerous other foreign banks operated through existing London banks. The Midland Bank, for example, had 132 foreign and colonial correspondents by 1908. Altogether these foreign and colonial banks were involved in around 35 per cent of the trade finance organised in London in 1913. This left

the British clearing banks with only 25 per cent of the business, reflecting their much greater domestic commitment and their only gradual growth of involvement in international trade finance.[19]

These merchant, colonial, foreign and clearing banks each developed their own specialities in trade finance, either by area or commodity, or a combination of both, giving the London money market a spread and depth of knowledge and expertise that was unmatched anywhere else in the world. They acted not only as passive intermediaries between the City and the rest of the world, bringing to London those seeking trade credit at the best terms, but also filtered this business, using their judgement to vet the standing of customers and the quality of bills. Collectively they were acting as bankers to the international trading community, using their own experience to reduce the risks to acceptable levels. As Robert Kindersley, a director of Lazard Brothers, reflected in 1931: 'until the war the great mass of shipments of goods between one part of the world and another was financed by bills drawn on acceptance houses and banks in London'.[20]

However, these banks and their contacts not only brought business to London they also brought money. As banking systems developed around the world all banks experienced the same need to maintain liquid funds in case of crises and the same desire to employ these funds where they would obtain some positive return, in order to help profitability and competitiveness. For this reason they also began to make extensive use of the London money market in the same way as had British banks.[21] 'In times of strain especially, London is the only place where money can be found at all times for loans,' noted the Canadian banker, L.D. Wilgress, in 1912–13, and he had the alternative of New York easily available to him.[22] By 1914 the deposits of the foreign and colonial joint-stock banks operating in London totalled £1.9bn, or almost twice the level of the UK bank deposits. German banks, like Deutsche Bank, for example, not only used their London branch as a means of financing German trade, but also to employ the short-term funds that their extensive German branch network was continuously producing. Thus, the London money market became the dominant centre for the finance of world trade before 1914, and did so by drawing the funds necessary for such an operation from throughout the world's banking systems. As in the domestic situation in 1850, so internationally by 1914, it was only London that could offer the blend of liquidity, security, mobility and return that allowed otherwise idle funds to be employed, and so drew

them to it even from other major financial centres such as Paris, New York and Berlin. In turn, this reinforced London's position in the provision of trade finance.[23]

Yet, in order to retain its competitive position as a home for short-term funds and as a source of trade credit, the City had to develop new facilities and devices continually for matching the supply of and demand for credit, over all the variables. Closely allied to the City's attraction as a centre for commercial finance, for example, was the continuing development of London's commodity markets, for they played an important role in making it easier and cheaper to finance certain trades by reducing the risks involved. The existence of these markets allowed those providing the finance to be much more confident concerning the value of the collateral provided, since the current price was well established and a rapid means of disposal existed if the borrower defaulted. Without these markets, London would have been a less attractive centre in which to finance trade. This illustrated the integrated nature of London's operations with development in one area, such as commodity markets, having repercussions in another, like trade credit, but all combining to enhance the ability of the City to offer a service superior to any other centre, as a place in which either to obtain credit or to employ short-term funds.[24]

Nonetheless, important as the provision of trade credit was for the City, it gradually ceased to be the principal business of the London money market. International trade could not always absorb the supply of short-term funds that were increasingly directed towards London from throughout the world. The volume of trade fluctuated both throughout the year, with, for example, the seasonal peaks and troughs of agricultural commodities, and from year to year as economic growth accelerated or slowed down, so that the credit needed to finance production, storage and movement was never constant. One of the principal functions of the money market was to equalise the supply and demand for credit so that it was always both sufficient to meet the requirements of commerce and offered remunerative employment to lenders. This forced those in the money market to look for alternative means of employing the funds at their disposal, when the demands of trade were low, if they were to continue to attract short-term money through their ability to pay interest on it. The problem was that though the need for short-term funds was continuing to grow, proportionately there was an even greater need for long-term capital.

Throughout the world there was a progressive development of railway lines, telecommunications networks and urban facilities which all required a very large fixed investment that had to be made at the outset if the systems were to operate successfully. Similarly, in manufacturing industry and mining the scale of operations necessitated a growing initial investment in plant and equipment rather than a slow build-up financed by credit and ploughed-back profits. Even in consumer goods the rise of items like the bicycle and, especially, the motor car created problems of financing a large initial outlay that was absent in clothes and shoes. There had always been a need for the provision of long-term finance but it had been small when compared to the requirements of commercial credit or the use of self-finance in business.[25]

The question was how could the money market, which was abundantly supplied with short-term funds, use these to finance long-term capital-intensive projects, where the funds were required for years, or even decades, and could not be withdrawn in the interim. As with the link to the commodity markets this brought the money market into intimate contact with another City operation, namely the Stock Exchange. The Stock Exchange was the market in securities, such as shares, stocks, bonds and debentures. These represented long-term debt created by governments, often to finance wars, or by corporations, such as the railways, which could not be liquidated on demand, but could be sold to another at the prevailing market price. What was being bought and sold on the Stock Exchange were the claims to these debts. To the issuer of the securities the debt created was a long-term one because any date of redemption was far into the future, if it existed at all. In contrast, as long as the purchasers of these debts were convinced that they were easy to re-sell, without any serious alteration in price, the length of time for which the investment was made depended upon the investor's desire or ability to hold the securities. Thus, though the investment itself could not be liquidated, the owner of the claim to the return on that investment could sell it to another. Those requiring long-term finance could obtain it from those only willing to make short-term loans through the device of a market in the claims to the product of the investment. Consequently, the creation and efficient operation of a securities market removed the distinction between short- and long-term investments, creating instead a single market in assets of varying liquidity.

This opened up the opportunity in London for the placing of short-term funds into long-term securities for limited periods, profit-

ing from the fact that the price would rise as the dividend or interest-paying date approached. This did involve an element of risk as the price could fall in the interim through general economic circumstances or events peculiar to the issuer of the securities. There thus developed a group of intermediaries, particularly jobbers on the Stock Exchange, who made a practice of borrowing short-term money, available at low rates of interest, and investing it in long-term securities, yielding a higher rate of return, and so profiting from the interest-rate differential. Obviously they took the risk that the securities might fall in value and that they might have to realise at a loss if it became impossible to renew the loans during the panic. However, because of the size of the London money market there was every expectation that short-term money would always be available, and as the Stock Exchange grew in size and turnover, it became easier to buy and sell with little variation in price It was only in the safest and most liquid of securities that these operations were conducted, so as to limit the likelihood of price fluctuations and increase the possibility of rapid realisation. At first, these were principally the various issues of the National Debt, because they were the largest and safest securities traded in the market. By the late nineteenth century they had been complemented by the loans raised in London by foreign and colonial governments and, increasingly, the various securities issued by large railway, industrial and mining enterprises, both from home and abroad. In particular, the securities created by the world's major railway companies to finance their operations were available in such magnitude as to make them suitable for temporary investment, especially as the scale and nature of their operations virtually guaranteed their ability to service their debts and make regular dividend pavments.

Thus the London money market became adept at employing volatile funds in long-term investment, with only minimal risk, and so increased its attractiveness as a home for such funds since it could always employ them at some positive rate of return. In the process this also made the City a major centre where governments and companies came to raise long-term finance by way of issues of securities. The result was that a new source of finance for capital-intensive projects was created out of the short-term funds that the banking system possessed, but could not employ directly because of the risks involved of being unable to repay depositors on demand, which would have led to the collapse of the bank. This link between the money and securities markets also comprised a major element in

world liquidity, allowing imbalances between nations to be quickly and efficiently settled. Borrowing to finance holdings of securities could be done both directly from financial institutions and via the money market through the creation of finance bills. Whereas trade bills were based on goods and commodities in existence but not yet finally disposed of, so finance bills represented loans where securities were the collateral. With many securities traded on more than one market, and simultaneous buying and selling made easy with telecommunications contact, a purchase in the securities market of one country and the sale in that of another would produce a transfer of funds in the direction of the sale. The rights to these funds could then be sold in the form of a finance bill, created in response to a demand to make a payment in that centre, while the resulting easing or tightening of credit would produce the desired structural adjustment. By 1913, of the £350m in prime bills outstanding in London, 60 per cent were finance bills, not trade bills, indicating that the London money market was now more concerned with the maintenance of international equilibrium than with the simple finance of commerce. At the same time, of course, its operations did produce the credit that international trade required and, through the link to the securities market, did generate a substantial volume of funds for long-term productive investment.[26]

Therefore, through the continuing development of the London money market, in response to both borrowers and lenders, the City continued to be the world's principal commercial centre before 1914, even though Britain's share of world trade declined, while the Stock Exchange was able to become the premier securities market since it was both easier and cheaper to finance holdings there than anywhere else. This was all being done using a growing volume of overseas money, which was being directed to London by the world's banks, as only London could give them a return on their liquid funds under the conditions they imposed. No wonder the Committee on Finance and Industry reported in 1931, that:

> the exceptional merits of the City of London lie in the facilities given by the short-term money market for the employment of home and foreign funds; in the financing of trade and commerce, also both home and foreign[27]

By the First World War the City of London had become the colossus of credit in its ability to attract funds worldwide and employ them

worldwide, not just in trade but for all purposes.

Although London was not without competition in its role as the central money market of the world, with the likes of Paris for continental Europe and New York for North America being major competitors, it did appear to be gaining in strength as banking systems became increasingly more sophisticated, and thus had idle funds which they wished to employ, and as international transactions of all kinds grew in importance, so requiring the facilities of the City. However, the First World War altered London's position in international monetary operations substantially, as well as the working of the market itself. This was not only during the period of hostilities, when Europe was divided into two warring camps and international transactions were considerably disrupted and distorted, but also for a long time afterwards as countries adjusted to the changed economic and political circumstances, and their relationships to each other. As late as 1930, Greengrass was of the opinion that:

> the financial world is yet in a period of transition between the completely abnormal conditions of the war years and those of ordinary working, and is still engaged in a process of 'clearing up'.[28]

The First World War was extremely costly and the funding had to be obtained if it was to be fought to a successful conclusion by Britain. This put a tremendous pressure on the London money market to provide the required finance. Between 1914 and 1918 the UK National Debt rose from £0.7bn to £5.9bn, or over eight-fold in four years. Much of this debt was in the form of short-dated Treasury bills, which increasingly replaced commercial and finance bills in the discount market. Treasury bills outstanding rose from a mere £15.5m in July 1914 to £1098m in January 1919, for example. At the same time the need to finance the long-dated government debt, in the form of Stock Exchange securities, increasingly absorbed the money lent to jobbers. During the course of the war the London money market was diverted into part of the government's machinery of finance and away from providing a service for the international community. The large German banks, which had played such an important role in making London a centre for the finance of German trade and for the employment of German short-term funds, were closed down completely, while long-established links with customers in other countries were also lost over the war years as the London money market was

no longer an attractive centre in which to obtain credit or a safe place in which to employ funds. In particular, New York's money market became much more important, taking over the finance of US foreign trade from London as well as competing for international business.[29]

After the War was over the need to fund the massive government debt made it difficult for the London money market to compete as effectively as previously in the provision of trade credit. Short-term interest rates were manipulated by the government so as to ensure that it issues of Treasury bills would be taken up, but this had the effect of making London's rates higher than New York's, and so diverted business to that centre. Nevertheless, although never regaining its pre-war importance, London did recover its position in the 1920s as both the principal centre for trade finance and a home for short-term funds. Germany again came to rely heavily on British credit for its international commerce while foreign banks, like the French, made extensive use of the opportunities in the City for employing idle balances remuneratively, though now much went into Treasury bills.[30]

Although there was some recovery in London's position as a centre for commercial credit, the once thriving finance bill business remained at a low level through official disapproval. The Bank of England had never been happy with finance bills, seeing them only as a means of facilitating Stock Exchange speculation, and so restricted their use both during the First World War and throughout the 1920s, when the action could be further justified by a need to conserve funds for the finance of government debt. Altogether, the result of the government's debts and its policies was to make the London money market much more domestically orientated in the 1920s than it had been before the First World War, with the object of easing the government's financing operations and the preservation of the exchange rate.[31] As the City had played such an important role before 1914, balancing transactions between economies through the links between the London money market and the commodity and securities markets, this retreat from its previous position had serious implications for the functioning of the world economy. As Grant so accurately observed, in 1937: 'The working of the international financial system lost in sensitiveness as a result of Treasury Bills tending to displace international commercial bills.'[32] It was this very 'sensitiveness' that had made the pre-war system work so smoothly, but was now absent, having been displaced by domestic considerations in the operation of the London money market.

The Bank of England now had a great deal of control over the financial system, through the existence of such a large volume of short- and long-term government debt and the working relationships established during the war. It was not until 1914 that the Accepting Houses Committee, for instance, was set up. Possessed of this power and influence, the Bank of England tried to ensure that the operation of the London money market was in accord with the government's needs and tried to restrict all developments that made control more difficult, such as bank amalgamation, the extension of the clearing banks overseas or the use of finance bills. Rather than the City acting as a point where international money was received and despatched, the government was relying on short-term credit from abroad for the finance of its debts, and so restricted the use of these funds as a stabilising influence in international transactions. Eventually, all this unstable system fell apart in the early 1930s, symbolised by Britain leaving the gold standard in 1931. Exchange controls, and the Exchange Equalisation Account, quickly followed in Britain, matched by similar developments elsewhere in the world, with the result that the international money market was increasingly compartmentalised. No longer was there one relatively free market for money, largely orchestrated from London, for now all countries imposed barriers on its ebb and flow, thus restricting its employment in the most remunerative and appropriate centre.[33] The rapid deflation of the 1930s, and the depressed level of economic activity, left banks worldwide with deposits which they could not employ in advances to customers, while the low level of international business, fostered by a proliferation of trade controls, reduced the demand for funds to finance either trade or investment. Government-imposed restrictions were preventing the operation of the normal market forces of supply and demand that had stimulated recovery from depression in the past, and were not providing any policy measures of a substantial nature that would take their place. The result was an extended period when economic activity was at a considerably reduced level, particularly the transactions between nations. However, London continued to attract funds both from within Britain and elsewhere, despite the exchange controls, because it was one of the few places where they could be employed remuneratively, though at very low rates of interest, and remain reasonably liquid, which was of particular consideration in the difficult economic and political times of the 1930s. In fact, London attracted funds from continental Europe because it appeared to be a safe haven, and so it was better to receive no return

there than anywhere else. As a result, there were 85 foreign banks with offices in London in 1938, which was more than ever before despite the disappearance of German banks during the First World War and American banks in the wake of the 1929 crash.[34]

The London money market became awash with money which it had considerable difficulty in employing. Commercial bills outstanding in London fell, for example, from £752m in 1928–9 to £275m in 1936–7, or by almost two thirds, while international lending was strictly controlled by the government. As a result, the London money market turned increasingly to the finance of areas of the domestic economy, but there it met the competition of those institutions which were already well established in the field, such as the building societies in mortgages, or the finance houses for instalment credit. At the same time the continued growth of the national banking networks allowed the London money market to be more easily bypassed while the development of large corporate enterprises allowed certain businesses to reduce their use of financial intermediaries altogether by internalising the provision and use of credit. It was not as if areas of the British economy had been left uncatered for in terms of financial provision, and so could be picked up by the intermediaries of the London money market when the international opportunities became less attractive.[35]

The one remaining area was the continuing need to finance the government's huge short- and long-term debt which stood at £8.3bn in 1938. This was a particularly acute problem because the real burden of the debt, and the interest that the government was committed to paying, was rising in the 1930s as the general price level fell, which made money more valuable. However, even here there were difficulties. Faced with a shortage of uses for their funds, the banks were buying both Treasury bills and government stock themselves, making it almost impossible for the discount houses to make a profit on the prices they paid for the same bills and stocks and the rate of interest they were charged by the banks for the money they borrowed. Eventually, the discount houses and the banks, prompted by the Bank of England, divided the government business between them. The banks agreed not to buy new issues of Treasury bills, other than through the discount houses, while the discount houses borrowed the banks' idle balances, and used them to compete for business with Stock Exchange jobbers. These jobbers were prevented by the rules of the London Stock Exchange from expanding their capital by tapping outside funds, and this limited the amount

they could borrow from the banks. Discount houses suffered from no such restrictions and expanded their capital base through amalgamation and conversion into public companies and the issue of shares. They were thus able to operate on a much larger scale than the jobbers, whom they gradually ousted from the market in the shorter-dated government stock, where it was necessary to employ large funds at fine margins if the operation was to be profitable. The consequence was that, by 1938, the discount houses, now considerably reduced in number, devoted 59 per cent of their funds in bills to those issued by the Treasury, while 85 per cent of their operations in securities were in those created by the government.[36]

Between 1914 and 1938, the London money market had been transformed from an international centre for the collection and use of funds into an increasingly domestic institution channelling British savings into the finance of the National Debt. Important as this was, what had been lost in the process was only too obvious to contemporaries. Hobson, writing in 1940 of the pre-Second World War position, noted:

> This artificial functioning of the market stands in sharp contrast to the keen competition which existed when the market confined its activities to business in genuine commercial bills. No skill or knowledge is required in discounting Treasury Bills. The old traditional craft of the London bill broker, his experience, his knowledge of the standing of hundreds of firms all over the world, his uncanny nose for scenting 'something wrong' about a bill – all these go for very little nowadays.[37]

Though London continued to be the most important centre for short-term money, the importance of that function, both to the City itself and to the world economy, declined significantly in the 1930s. This was an era of growing economic nationalism when money was too valuable to be trusted to find its own employment, especially if that was abroad. The policies that flowed from that view inevitably undermined the intermediary role of the London money market, and the substitution of government finance was hardly adequate compensation.

The effects of the First World War were not entirely detrimental to the London money market. Before 1914 the City's operations were almost all in sterling, whatever the amount, period, location or price. Thus the variation of type did not concern the London money market

directly, though it was of vital importance elsewhere in the world as there was a need to convert into sterling, which was the most widely used currency. However, with the war and the growing economic importance of the United States, it was no longer possible to get all customers to accept credits denominated in sterling. In addition, until sterling returned to the gold standard in 1925, and thus fixed exchange rates, its value in terms of other currencies fluctuated, especially as many of them were also not on the gold standard at this time. Consequently, between the end of the war and the mid-1920s, currency dealings offered considerable opportunities for profit to City firms, whose other activities had been badly disrupted. Merchant banks, like Bonn & Co. and Helbert Wagg & Co., thus began at this time to trade in claims to bank deposits denominated in various currencies and located throughout the world, though especially in Europe. The large commercial banks, like the Westminster, became the dealers, as they possessed the deposits, while the merchant banks, such as Kleinwort, performed the role of brokers, for they possessed both the international contacts and the expertise through their involvement in bills and securities.[38]

So successful was this involvement that London became the principal centre for foreign exchange dealing in the early 1920s, and turnover grew rapidly. There was a need to make payments worldwide in different currencies, which the exchange market provided, while it also allowed exporters and importers to cover their risks by buying or selling currency forward. This rapid development of a sophisticated foreign exchange market in London in the immediate post-war years did provide the beginnings of a solution to the currency instability of that period. Following the First World War it had been necessary to abandon the fixed exchange rates of the pre-war gold standard, as economies and thus their currencies had become badly out of line, especially the dollar *vis-à-vis* the pound, franc and mark. However, this foreign exchange dealing was disapproved of by the Bank of England, which regarded it as akin to speculation, while the monetary authorities were wedded to a quick return to the gold standard, with exchange rates fixed at the pre-war parity, as a solution to the international economic problems stemming from the war. Therefore, the potential of a market-based solution to the problem of finding a new equilibrium of exchange for the world's currencies was ignored at this time in favour of a blind faith in the restoration of the pre-war system.[39]

With the return to the gold standard in 1925, and the growing stability of currencies through the actions of central banks, the

foreign exchange business of the London money market largely died away, reaching a negligible level by the late 1920s. Kleinwort's profits from foreign exchange dealing, for example, fell from £138,000 in 1925 to a loss of £1000 in 1926. However, many of the fixed exchange rates imposed in the 1920s, such as that for the pound and the dollar, could never be made to fit underlying reality and so required growing intervention and international co-operation in order to be maintained. In the end the whole system collapsed in the early 1930s, with Britain abandoning the gold standard and fixed exchange rates in 1931. The move towards a more flexible currency regime again provided scope for the foreign exchange dealers, with London emerging as the leading centre in the 1930s. However, the volume of business never reached the levels of the early 1920s as central banks regularly intervened to reduce fluctuations and so limited the need to buy and sell currencies in advance. In 1932, for example, the Bank of England established the Exchange Equalisation Account and employed George Bolton, an experienced foreign exchange dealer, with the object of buying and selling sterling in order to stabilise its value internationally. Funds of this kind were common in the 1930s, representing a general desire by individual countries to insulate themselves from world economic events by the replacement of market forces with government action. Aims and actions such as these inevitably undermined the role and importance of the City, orientated as it had been towards the facilitating of monetary transactions between nations. The growth of a foreign exchange market was but a poor substitute though it did indicate the continued vitality of the London money market as it moved to trade in types of money as a natural progression from the provision of trade credit and the employment of idle funds.[40] It also helped to make the City even more incomprehensible to contemporaries, even to a knowledgeable one like Hobson, writing in 1940:

> To describe exactly what goes on in the foreign exchange room of any of the big banks or foreign exchange brokers who compose the London Foreign Exchange market is beyond me. It is the nearest thing to Bedlam that I know – half a dozen men in a little room, shouting in incomprehensible jargon into Telephones, pushing switches up and down all the time in response to the flashing indicator lights.[41]

As with the First World War, the Second seriously disrupted the operations of the London money market. From the outset, the

government took control of such areas as trade finance and foreign exchange, and became involved in raising short-term finance directly from the public and the banks. The result was that the London money market was largely bypassed, with many firms either closing down or experiencing a period of greatly reduced business. At the end of the war, there was no rapid revival of the money market's functions as the government retained many of its controls and agencies, or introduced others. Symbolising the transfer of power from the City to the government that had taken place was the nationalisation of the Bank of England in 1946. This formalised the Bank's status as an agent of governmental monetary and financial policy, which it had developed between the wars, as its governor, Montagu Norman, had made clear in a speech at the Mansion House in 1936:

> I assure ministers that if they will make known to us through the appropriate channels what it is they wish us to do in the furtherance of their policies, they will at all times find us willing with good will and loyalty to do what they direct us as though we were under a legal compulsion.[42]

There was no obvious role for the London money market in a post-war world where the government fixed such areas as the provision of credit and the rate of exchange, and could make its policies effective through direct ownership of the most central financial institution in the City of London – the Bank of England.[43]

The central concern of the government in the immediate post-war years was to ensure the continued financing of its debt, which had been considerably swollen not only by war expenditure, but also through nationalisation and the welfare programmes. Between 1938 and 1948, the National Debt had risen from £8.3bn to £25.9bn, by which time 25 per cent was still in the form of short-term borrowing requiring constant renewal. Instead of being redeemed, however, this debt continued to rise, reaching £34.2bn in 1968, as new areas requiring government finance were developed. Part of this debt was also owed abroad, being a convenient and remunerative home for the foreign-owned sterling balances that had been built up during the war as Britain purchased essential material on credit. As these balances were gradually expended after 1945 on purchases of goods from Britain, the government found it necessary to arrange replacement

sources of finance. It also had to ensure that adequate foreign exchange was available so that the repatriation of funds by foreign nationals would not provoke a succession of sterling crises. To this end the government, through the Bank of England, employed both exchange controls and domestic credit controls so as to ensure that its own requirements had the highest priority in the London money market. The business of the discount houses, for example, was dominated by the employment of short-term funds, drawn largely from the British clearing banks, in holding either Treasury bills or short-dated government stock. In the process they largely abandoned their long experience in the finance of international commerce.[44]

In the early years after the war, the government was able to find the finance it required without a great deal of difficulty as demands from the rest of the economy were low, after the depression of the 1930s, and with continued government controls. However, as recovery turned into relatively rapid economic growth, and as the economic controls were abandoned, especially with the return of a Conservative Government in 1951, the demand for credit from both business and consumers grew steadily. The commercial banks began to devote an increasing proportion of their funds to the more profitable activity of advances to customers and steadily sold their holdings of government securities in the process. By 1968 the London clearing banks had 52 per cent of their total lending in the form of advances, as compared with 30 per cent in 1956 and 18 per cent in 1946. As a significant part of the National Debt was supported by short-term funds, which were becoming more expensive and less available with the rise of domestic demand and the running down of the sterling balances, the government stepped in to alter the position in its favour, not so much by offering to pay a higher rate of interest but by restricting the access of others to available credit. Banks had to maintain, for instance, higher liquidity ratios than prudence required, so that the discount houses were kept well supplied with funds, while their ability to lend to their customers was periodically curtailed by the government.

The result was a proliferation of financial intermediaries, like finance houses and secondary banks, that were not, initially at least, controlled by the government's restrictions and could thus meet the requirements for credit of those that the banks were prevented from satisfying. The domestic bill market for example revived as a means of business tapping the London money market, where the banks were having to direct funds, rather than borrowing directly from their

banks. The problems resulting were two-fold. The alternative means of obtaining short-term finance were often more cumbersome and/or expensive than those provided by the banks. Business was encouraged to bypass the financial system altogether, as with the expansion of large companies that could mobilise and distribute their own finance without the aid of intermediation. The new financial institutions were also not part of the system where the Bank of England was the lender of last resort, and so in any crisis, as in the mid-1970s, they possessed neither the liquidity nor the expertise to withstand sudden withdrawals of deposits, with many collapsing as a result. The government itself had created the conditions that led to that crisis by, in 1971, reducing the required liquidity of the banks from 28 per cent to 12.5 per cent, which led to a rapid growth in lending followed by the inevitable collapse.[45]

The British financial system was one of great complexity and sophistication, incorporating a variety of firms, institutions and markets that complemented each other in the mobilisation and use of money. Within this the Bank of England was of key importance for, by acting as a lender of last resort, it allowed the entire system to operate with a lower level of liquidity than any individual component could risk, thus releasing more funds for remunerative employment than in other financial systems. By using this key position of the Bank of England, the government was able to manipulate the entire financial system to serve its own ends, but this had the consequence of undermining the system's stability and value through the constant creation of financial firms and financial devices that were often neither as sound nor as effective as the ones they were replacing, but whose use was not restricted. There also developed a close relationship between the principal components of this financial system – principally the Bank of England, the clearing banks and the discount houses – which substituted collusion and complacency for competition and innovation. However, the members of this protected and remunerative trading environment slowly found themselves losing business to more aggressive outsiders.

The discount houses suffered the growth of parallel markets to which an increasing flow of short-term funds was directed and which were heavily used by borrowers. The sterling inter-bank market, for example, which grew rapidly from the late 1950s onwards, used specialist intermediaries to trade deposits between banks, rather than employing such funds in loans to the discount market. Between 1960 and 1972 the funds employed in the London money markets rose

from £2.3bn per annum to £38bn per annum, but the proportion taken by the discount market fell from 46 per cent to 6 per cent, while those in the inter-bank market grew from negligible proportions to 29 per cent. Similarly, the banks lost out steadily to the building societies and other financial institutions. Though deposits in the London clearing banks did rise from £6.4bn in 1951 to £45.5bn in 1979 in nominal terms, most of this was accounted for by inflation, with the increase of savings resulting from economic growth being largely directed towards the building societies. Altogether, after 1945, the London clearing banks commanded a declining share of all bank deposits located in the United Kingdom, while the banking sector itself faced growing competition from the building societies, which steadily built up a greater share.

By the early 1970s, there was a general acceptance that the policies pursued by successive governments had seriously distorted the operation of the British financial system, undermining in the process the position of the City-based markets and institutions, control over which was the principal means used to make the government's intentions effective. It was only with the legislation beginning in 1971, which introduced more competition into the system, and the gradual realisation of the banks that they would have to change if they were to hold onto their business, that the City-based components of the financial system really began to respond to the developments taking place domestically. However, inevitably, it was a difficult process to reverse the habits and attitudes that had largely prevailed over the previous thirty years. The abandonment of the interest-rate cartel and the move of the banks into the mortgage business and consumer credit all reflected the more aggressive stance taken, both to each other and to the building societies and finance houses in the 1970s and 1980s. By then, however, competition did not only come from UK-based institutions. Foreign banks and finance houses, especially American, were attracted by the opportunities neglected by the existing British institutions and so began to establish rival operations. They offered competitive interest rates and were aggressive lenders to manufacturing industry, for example, and so created for themselves a significant presence within the British financial system. In 1987 foreign banks accounted for around a quarter of the lending in sterling in the UK. Altogether, the City-based banks lost a great deal of the dominance of the domestic financial system that they had established in the late nineteenth and early twentieth centuries, both through the growth of non-City-based rivals, like the building societies

and finance houses, and the appearance of foreign competitors, particularly from the United States. Much of this loss can be blamed on the restrictive governmental controls under which they had to operate, compared with other components of the financial system, but their willingness to rest contented with the semi-monopoly position they thought they enjoyed in perpetuity certainly contributed significantly to the gaps that emerged and which were left to others to fill.[46]

It was not only domestically that the controls imposed by the government, and the comfortable but complacent environment they fostered, had damaging consequences for the London money market and its institutions. The exchange controls maintained after 1945 were a serious impediment to London's ability to play its traditional role as a provider of trade credit. In the late 1940s around 50 per cent of world trade was financed in sterling, but this proportion fell steadily reaching only 20 per cent in 1970, as the government increasingly restricted the use of sterling to the finance of Britain's own exports and imports. In particular, the action taken in 1957, to prevent the use of sterling in the finance of other than UK trade, severely damaged its use for international transactions and led to the switch to the dollar and other currencies. The government was, of course, motivated by its need to preserve foreign exchange for the servicing and repayment of its overseas debt.

However, international trade did grow rapidly from the end of the Second World War onwards and though part of this was financed internally, by the growing number of state bodies and multinational companies, there was a great need for the credit facilities that London provided. The period of inactivity during the war had led to the loss of qualified staff in the City, but London still remained the centre with the most extensive knowledge, contacts and expertise and thus the place to which the business naturally gravitated, despite increasing competition from other cities. Consequently, when the British government's exchange controls made it increasingly difficult to use sterling as the currency of international trade, the demand for a substitute was such that the London money market learnt to use other currencies. The way this money market was operating, and its composition, was also altering substantially in this period. No longer was it centred on the operations of the discount houses, their bills of exchange and their international borrowing, for these discount houses were now largely engaged in Treasury bills and short-dated government stock. Instead, it was a market increasingly dominated

by the London branches of foreign banks, and their inter-bank operations. Money brokers also appeared to act as intermediaries in this international inter-bank market.[47]

Essentially London already possessed the greatest concentration of banks in the world, and the most extensive international financial contacts, and so, as the use of the inter-bank market grew in the finance of trade, it was natural for even more banks to gravitate to London where they could more readily participate. As the Inter-Bank Research Organisation itself reported in 1973, London 'attracts business because of the range of markets and services that it offers and develops new markets and services because of the scale of business it can attract'.[48] London had the critical mass necessary to attract banks, and by so doing it became even more attractive to other banks. This was despite the exchange, credit and other restrictions imposed by the British government because potential rival centres, like New York, Paris or Zurich, were also subject to similar interventions.

As a result, the City continued to be the principal location for the finance of international trade, though this was now heavily reliant on the operations of foreign banks through their London subsidiaries. For example, forfeiting, which provided credit for importers short of foreign exchange, had been centred in Zurich, because of its origins in East-West trade, but moved to London, where there was a greater spread and depth of participants. Similarly, the financing of European commercial debt, in the form of dollar-denominated negotiable paper, was handled in London, with a total approaching $70bn outstanding at the end of 1988. Even the principal market for ECU-dominated (European Currency Unit) short-term debt was in London rather than Paris. Gradually, as banks sought to impart a greater degree of liquidity to their lending in the 1980s there was something of a switch away from the straight provision of credit on a regularly renewable basis, to a packaging of debts in a negotiable form that could be easily resold if the bank wished to improve its liquidity quickly. This process was to the benefit of the City as it possessed the inter-bank money markets where this could be more easily done.[49]

As before, the presence of these foreign banks in London was not only to handle the finance of international trade on behalf of their customers, but also to employ their short-term funds in a safe and remunerative fashion. The British overseas banks, for example, were among many who were of the opinion in 1960 that:

> We can readily find opportunities for lending in London at short-term – on anything from an overnight loan to a three months' bill – such funds as we do not want to lend commercially or invest or retain in cash.[50]

The London money market remained adept at employing highly volatile funds in highly liquid assets. Though government controls worldwide tried to restrict the movement of these funds, banks continued to direct them to London out of their need to earn interest on their otherwise idle balances. In fact, the very restrictions imposed by New York in the 1960s, in an attempt to stem the outflow of dollars, encouraged US banks to maintain substantial holdings abroad where they would be free from such controls. At first Paris was the preferred location, but restrictions there, and the greater opportunities in London, soon made the City the centre for such operations. Thus, while London ceased to be the automatic destination for idle balances from the Empire, partly through restrictions imposed by the governments of those countries, other restrictions, especially those imposed by the United States, provided an alternative source of funds, while the basic reason for London's importance – its ability to employ otherwise unemployable money – continued to be a major attraction to the world's banking systems. Between 1957 and 1969 the number of foreign banks directly represented in London almost doubled, reaching 150, while their deposits rose from £263m to £12.5bn. By then over 40 per cent of all deposits in London originated overseas. Unlike the past, however, these deposits were now largely in foreign currencies not sterling.[51]

The Eurocurrency market was in London because the restrictions and controls imposed by the British government continued to be outweighed by the benefits derived from the number and variety of the financial institutions in the City and their range and depth of expertise, and by the continuing need of the world's banking system for a centre of some kind where imbalances could be adjusted, liquidity maintained and interest earned. This need grew rapidly from the early 1970s onwards, when the management of the international economy by the world's central banks began to fall apart, leading to reliance, once again, on the operation of the market. Though operations between central banks continued to be of major importance, especially in times of crises, it was now much more necessary for commercial banks to create a mechanism whereby they could settle their own imbalances and employ all their funds profit-

ably in the process, than rely on the monetary authorities to do this for them. International banking business thus expanded rapidly, greatly to the benefit of the City of London which was central to the whole process.[52]

The number of foreign banks directly represented in London rose to 521 by 1989, or twice the number in any other centre, with many more being indirectly represented. There were over forty Arab banks, for instance, while the numerous Japanese banks used London as the base for their international lending. As the *Financial Times* remarked in 1986, about a process well underway:

> As deregulation and technological advance pull the world banking market into a single great pool of capital, bankers are having to map out new strategies which, for most of them, amount to establishing sizeable presences in the major financial centres, London, New York and Tokyo, and some secondary ones as well.[53]

Even though Tokyo eventually overtook London in 1988 in the absolute volume of lending, London continued to remain the centre for international banking because in no other location could there be found so many banks, such extensive contacts, so well-developed facilities and so many experienced personnel. Whereas New York and Tokyo were mainly channelling the savings of their own nationals into opportunities abroad, London was distributing the funds of lenders in one country to the borrowers of another. In 1979, for example, it was estimated that around three quarters of the money flowing through the UK banking system, both came from abroad and was directed abroad, and this position was accentuated in the 1980s. It was this international business that preserved London as a major money market, able to compete with New York and Tokyo, as both the United States and Japan had large domestic economies and a large share of the world's physical trade to support their operations. As early as 1975, of the international claims on the UK banking system, totalling $184.1bn, 78 per cent was accounted for by foreign banks operating in the UK, principally those from the United States with 38 per cent of the total. By 1988, the claims had risen to $1124.2bn of which 83 per cent was with foreign banks, though now 36 per cent was done by the Japanese. London continued to offer the most attractive opportunities to the world's volatile funds – available for seven days or less – by employing them in equally short-term uses,

such as trade credit or the holding of actively traded long-term securities, such as Eurobonds.[54]

The international nature of the London money market also made it an ideal location for the growth of foreign exchange operations where one type of currency was exchanged for another, but this did not develop automatically in the post-war world. Initially, the Bank of England, and other central banks, kept tight control over exchange movements and so there was little need for the spot and forward transaction, necessary to cover future commitments in foreign currencies, that had characterised the much more loosely managed system of the 1930s. Central banks had also arrangements, internal to themselves, as well as the International Monetary Fund, that allowed the settling of international imbalances without disturbing the markets. In addition, the government's exchange regulations restricted the ability of the City to participate in the foreign exchange market because currency flows outside the sterling area were strictly controlled. As a result, the international foreign exchange market largely centred in New York and Zurich, rather than London, where it had been before the war. It was only gradually in the 1950s that the restrictions on foreign exchange dealing were relaxed sufficiently for the City again to become a major centre of operations.[55]

In particular, the liberalisation of 1958, when sterling was made fully convertible, led to a rapid expansion of London's foreign exchange dealing, regaining for it the position of the premier centre. The growing instability of the world's currencies, as economies fell out of line and the central banks could not maintain the regime of fixed exchange rates, also led to a growing need for some means to cover international transactions against future changes of one currency against another. This need became even more acute after 1971 when the system of fixed exchange rates finally broke down. Between 1979 and 1989 alone, turnover in the foreign exchange markets of the world rose from $75bn to $600bn per day (each deal counted twice). London was the principal centre for this trading with a 30 per cent share, but other markets were catching up, principally New York and Tokyo. Gradually, the operations of the foreign exchange market began to replace the fixed exchange era with a regime that was both more flexible, and thus less likely to collapse under sudden pressure, and one which did not impose so great a strain on the whole economy to maintain. Increasingly, the costs of meeting the needs of importers/exporters and international lenders/borrowers for some guarantee about future exchange rates was achieved not by fixing

these rates at some arbitrary level and maintaining that by central bank intervention, but by allowing the rate to vary and allowing those unwilling to accept the risks of an unfavourable fluctuation to off-load that risk onto others, though at a cost.[56]

> As major industrial and commercial companies become more sophisticated in their use of options, swaps and forward transactions to cover their currency exposures, they have become less vocal in their call for less volatile exchange rates,

reported the *Financial Times* in May 1986.[57] However, it was only hesitantly that business, the public and the government were weaned away from a desire to restore a fixed rate regime, managed by central banks. The apparent simplicity of a fixed exchange rate regime continued to attract support from governments even though they were unwilling to follow the domestic policies that would keep economies in line, and thus reduce the need to alter continually the exchange rates that reflected their relative economic standing. Recognising the reality of economic life in the last quarter of the twentieth century, the foreign exchange market in the City continued to devise ever more ingenious products that met the needs of those exposed to currency risks and to offer these at very low costs indeed. Through the operation of the financial markets, almost every uncertainty involved in a currency transaction could be covered, at a cost, such as fluctuations in exchange rates or interest rates. The currency and interest rate swaps market, for example, which began in 1982 and was worth $2000bn per annum by 1990, allowed lenders and borrowers to mix or match, if they so wished, the currency in which the debt and the interest payments were denominated. This market was London based despite fierce competition from other financial centres. At the same time the developments by Reuters after 1971 created the technological infrastructure for a worldwide, interactive currency market based on advanced technology and communications. By 1989, they had 11,000 monitors in place through which passed around a third of the world's trading in currencies. Though the period since 1971 brought turbulence to the world's exchange rates, out of it emerged a market-based system which possessed the capability to remove exchange rates from the control of politicians, as the gold standard had done before 1914, and allowed them to adjust to underlying economic realities without provoking a financial crisis.[58]

Thus the history of the City as a credit centre is one of continuous

adaptation to new opportunities and new constraints, in the course of which a complete transformation took place. Throughout, London had to compete with rival financial centres, whether it was Paris and New York or Tokyo and Chicago, with varying degrees of success. There was also always the constant struggle against control, whether it was the Bank of England as a private monopoly before 1914 or the direct power of the state after 1945. The result was a move from where the London money market was concerned in mobilising funds for world trade and investment, via a situation where it was largely involved in the finance of the UK government, to a position where it acted as an international conduit for the supply and demand for money in all its variables – type, amount, location, time and price. What preserved the City's importance in fulfilling these functions, long after Britain's own economic importance had waned, was not the role of the government, as its measures did little to promote the international position of the London money market, but the simple fact that, having once been established, the critical mass of banking and financial concentration present in the City developed its own momentum, despite all the difficulties it passed through. The facilities existing in the City attracted financial institutions that wished to make use of them which, in turn, improved the facilities London could offer, and thus made it more attractive. This process accelerated from the 1960s onwards as the world looked for market-based solutions to the monetary instability which came with the crumbling of the post-war fixed exchange rate regime.

Nevertheless, the restrictions that the City faced after 1914, and more particularly after 1945, undermined the role and importance it played in the use and provision of credit at home and abroad. Domestically, the supervision of the Bank of England, supported by an increasing body of legislation, was largely aimed at City-based institutions until the 1980s when it began to cover the entire financial system. With a more equitable environment, the City-based banks began to be more responsive to the needs of their customers and fight back against the inroads made by newcomers, such as the building societies and finance houses, either by competing in terms of services, facilities, lending and interest-bearing accounts or by diversifying into these new areas through subsidiaries or acquisitions. The domestic factoring companies that provided an important source of credit for small business through purchasing customer debt, were mostly owned by banks at the end of the 1980s. Internationally, there was also a growing demand for factoring services as small and medium-

sized UK manufacturing companies became involved in export sales but did not possess the financial resources to provide their customers with the necessary credit, and these the City increasingly provided. Though taxation and/or regulations were often less onerous in the UK than other major financial centres, such as New York or Tokyo, they were sufficiently restrictive to encourage the rapid growth of offshore banking centres, like Switzerland or, nearer to home, the Channel Islands and the Isle of Man. These all flourished as the international banking community sought to escape charges and controls imposed by governments, including that of Britain, and small countries benefited from playing host to their activities. The Isle of Man's deposit base, for instance, rose from £0.4bn in 1978 to £4.6bn in 1988 as the result of its development as an offshore financial centre, but that was dwarfed by Switzerland, with approximately $700bn in non-resident funds by the late 1980s.[59]

Thus, the City of London gained banking business from other developed economies with over-restrictive regulatory regimes but, in turn, lost business to the increasingly numerous small offshore centres. Consequently, any move towards worldwide de-regulation could both harm and benefit the City, as long as there was a belief that the change was a permanent one, and Britain did not follow a contrary path. At the same time, the opportunities open to London, as the credit centre with the most extensive range of contacts and facilities, were never brighter than at the end of the 1980s. Not only were there the continuing complexities of international currency exchange and the need for short-term financial arrangements, but there were also the new developments with the disappearance of centrally planned economies which created the need for privately organised trade credit and monetary flows. All these called upon the facilities and expertise that were encompassed in the Credit City, and had evolved throughout all the vicissitudes of the last hundred years.

# 4 Capital City

[T]he problems of finance underlie the whole field of human activities. Merely to deal in the abstract with the technique of the existing financial system, domestic and international, without relating it to the actual economic circumstances of the moment, would serve little purpose.

Committee on Finance and Industry, *Report*, London 1931, p. 2

[T]he hazards and difficulties of investment have been greatly increased since the war by the increased effort of government to direct and regulate the economy. The successful investor must therefore foresee not only changes in trading conditions, but possible forms of political intervention. This task is made the more difficult when there are alternating governments with widely differing views on the role of private capital in the economy.

Committee on the Working of the Monetary System, *Principal Memoranda of Evidence*, vol. 2, Association of Investment Trusts, London 1960, p. 41

There are many explanations for the relative decline of the UK economy, prominent among which are the relatively low level of real investment in this country, particularly in manufacturing, and the poor effectiveness with which new investment is used. The part that the financial institutions have played in this, or could play in helping the economy to break out of the vicious circle, is a matter of contention.

Committee to Review the Functioning of Financial Institutions, *Report*, London 1980, pp. 19–20

The Credit City begat the Capital City. By the mid-nineteenth century the institutions and personnel of the City of London had already begun to blur the distinction between short- and long-term funds to a significant extent. Through ever more complex procedures and devices the City was increasingly able to employ whatever funds it was entrusted with to meet whatever demands borrowers made of it. '[T]he market for credit is a single market', reported the Committee on the Working of the Monetary System in 1959, and this was a viewpoint that the Treasury endorsed when they gave evidence in

1977 to the Committee to Review the Functioning of Financial Institutions.[1] This ability of the City to alter the time dimension of money, and so mobilise long-term finance, created a self-perpetuating cycle whereby it attracted both lenders, because it could offer conditions under which they would part with their savings, and borrowers, because they could obtain the finance they required under terms they found acceptable. There always existed a division between lenders, who wanted both a high rate of return and the ability to withdraw their savings at short notice, and borrowers, who wanted to pay a low rate of interest for funds totally under their own command. It was the role of the City of London to resolve these conflicting interests by matching supply and demand, and this was by no means a simple automatic process. Two New York investment bankers, Sandfor and Vojta of Bankers Trust, summed up its complexities in 1988 when they said:

> It takes time and effort to find a counter-party to a bargain, and a suitable counter-party with complementary financial needs may be hard to find or may be non-existent. Bargains cost money to structure and to enforce. Crafting a deal properly to reflect real-world legal, tax and accounting considerations takes considerable skill.[2]

The need to design a specific solution to meet individual requirements, and the markets and mechanisms its successful implementation required, is what underlay the growth of the City of London as a financial centre. As the needs of the British economy for capital became larger and more varied, an expansion in the number and nature of those who performed the intermediation between lenders and borrowers was needed. The activities and regions generating savings might have no direct contact with the industries and areas in which finance was required. This was especially true in a continually changing dynamic economy and so links had to be provided to facilitate the flow of funds between different groups. Increasingly London came to be the dominant centre for such operations as it was already the place to which idle funds were sent and from whence commercial credit was most easily and cheaply obtained. The integration of the British economy, from the mid-nineteenth century, beginning with the railway and telegraph, provided fast and efficient transport and communications which made it progressively easier for London to act as the central market for funds, wherever their origin

and destination. In addition, as the same process of integration took place on a world scale in the second half of the nineteenth century, the City was thrust into a similar position internationally, as funds flowed from the wealthier and established economies of Western Europe to the newly developing countries of the Americas and Australasia.

It is in the realm of the City's role as a financial centre that it has been exposed to the harshest and most consistent of criticism, both from those who do not believe that any free market system operates and those that blame the City for the poor functioning of the market. There is a widespread opinion that the City of London failed to direct finance to where it was most needed in the domestic economy, initiating a cycle of low investment, low profitability and low growth. In particular, the City is seen as ignoring the requirements of manufacturing industry, and thus emerges as one of the principal culprits in any explanation of Britain's economic decline over the last one hundred years. Typical of this viewpoint is this remark by Rubinstein in 1986:

> private investment from the banks and leading institutions of the City into Britain's heavy industries has for decades been withheld at the expense of investment overseas or in highly profitable, but economically and socially useless areas like property development, to Britain's long-term and severe economic detriment.[3]

Rubinstein is merely echoing the opinions that began to be voiced after the First World War, by the likes of Lavington in 1921, and eventually became the accepted orthodoxy of the 1980s.[4] Even those favourable to the City tend to accept that it has done little to help manufacturing industry and that that is a major source of weakness in the economy.[5]

However, before accepting this orthodoxy, it is wise to remember that the City was always a target for complaint, standing as it did between savers, who might have made unwise investments, and borrowers, denied access to the funds necessary to establish a new venture or maintain a business against adverse circumstances. The City was continually taking decisions about the allocation of financial resources in the process of which losses would be made and applications turned down, leading to dissatisfaction, but this did not mean that it performed its functions poorly. If the losses were due to fraud or a failure to perceive the most profitable investment opportunities

and promising projects and healthy businesses were denied support, then the City was clearly failing and can bear a major responsibility for Britain's economic problems. For that, however, it is necessary to examine the City's role in the functioning of the capital market, and the environment within which it operated.

The City of London was never the sole source of finance within the British economy but shared that responsibility with a wide range of other channels, whose relative importance, and relationship to each other, continually fluctuated. At its simplest the capital market was the means by which the owners and users of finance could be brought together. This was not always necessary for much investment took place at the individual level, with the single entrepreneur, partnership or firm undertaking both the saving and investment on an annual basis. There existed considerable coincidence of supply and demand in capital formation, as in many areas of agriculture, industry and trade, and this removed the requirement for intermediation in these fields. The growth of large-scale corporate enterprise, for example, provided a means by which funds could be directed from one activity to another without the use of financial intermediaries and markets, as the whole process was internal to the company. In fact, retained income remained by far the principal source of industrial finance throughout, rather than issues of securities or bank loans. Consequently, a substantial proportion of the British economy made no direct call upon the organised capital market as it was accustomed to financing its own requirements from re-invested profits, aided only by the short-term credit it obtained from the banks and other such institutions.[6]

Nevertheless, as the scale of operations in certain sectors outran the ability of single individuals or small groups to provide the finance, it became increasingly necessary to use the formal capital market at some stage. However the demand for capital was not homogeneous but varied enormously in the individual amounts required and when, and the risks involved. There was a world of difference between a large infrastructure project like a railway, which necessitated the commitment of substantial funds within a short period if it was to be usable and a small industrial or commercial operation that required a modest initial outlay, with expansion financed out of re-invested earnings. One required a well-organised capital market capable of mobilising huge sums within a short period of time while the other needed a close and often lengthy relationship between the borrower and the financial backers as problems were surmounted and the

business grew in size. Thus, even where the formal capital market was called into use, that component which was located in the City of London might be much less appropriate than that in a provincial centre, closer to the region and activity looking for finance.[7]

Housing, for example, provided the single largest demand for finance in the British economy, amounting to around a quarter of capital formation between 1873 and 1973. However, throughout the period, the City's involvement was minimal. Before 1914, around 90 per cent of housing was privately rented, with owner occupation and local authority housing being of limited importance. As an investment, house property required constant management in order to ensure that responsible tenants were found, rents were collected and repairs done. This was most easily achieved if the owners themselves were able to exercise personal supervision, and so housing was provided by innumerable local owners. Housing was also easily divisible with each house being either rented or sold as completed, and so helping to finance the next. These private owners, in turn, borrowed the finance required to supplement their own funds from a local pool of savings, mainly organised by the legal profession. There thus developed a structure through which the capital required for housing was obtained on a local basis from interested investors in response to both demands for accommodation and supplies of funds. On the whole this worked fairly well, though, of course, only those who could afford the rents could obtain housing and, occasionally, demand outran supply as in the years before the First World War, or supply outran demand, as in the housing boom of the 1890s.

However, this pattern of housing provision, and its finance, changed with the First World War and the passing of the Rent and Mortgage Restriction Act of 1915. With the introduction of rent control, in order to dampen down wage demands in the face of wartime inflation, and its maintenance from then on, the return which an investor could obtain by providing accommodation for rent was now rigidly controlled. The result was a gradual withdrawal of private investors from the housing market and their replacement by either owners purchasing their own homes on mortgage or local authority provided accommodation. By 1938, the privately rented sector had fallen to 65 per cent of all homes as compared with 25 per cent owner occupied and 10 per cent publicly provided. The demise of the private sector was hastened even further after 1945, when the rise in prices eroded the value of the rents owners could charge, leading to a net disposal of 4.4 million privately rented houses

between 1951 and 1987. Their place was taken by owner occupation and public housing to such an extent that by 1989 only 7 per cent of the housing stock was privately rented, as compared with 66 per cent owner occupation and 25 per cent local authority. Even in the provision of finance for this housing the City was largely bypassed since it was not the banks but the building societies that dominated. Lending for house purchase rose from £19bn in 1973 to £230bn in 1989, and over 80 per cent of that came from building societies, few of which had ever been London based let alone located in the City. The City's involvement with housing finance was thus marginal, confined to the loans made by banks, insurance companies and other City institutions, and the borrowing done by the local authorities through the City. It was only in the realm of industrial and commercial property, where property companies were important, that the City had a major role to play, for the property companies were dependent upon their ability to raise finance by public issues of securities and extensive bank borrowing. Between 1973 and 1989, for example, bank lending to UK property companies rose from £2.3bn to £32bn, with more than 40 per cent coming from overseas banks.

Consequently, suggestions made that Britain devoted, since 1945, either too large or too small a proportion of its savings to housing, as compared with countries like Germany, France, Japan and the United States, cannot be ascribed to the City of London as its role in the process was minimal throughout. Instead, in the absence of privately rented accommodation, individuals either devoted their own savings to house purchase, and were encouraged to do so by the tax benefits they received both as borrowers and savers, or local authorities provided housing as a social service for their own inhabitants. Therefore one major area of capital provision in the British economy largely bypassed the City of London. Housing was increasingly provided according to tax-induced personal preferences and the perceived needs of society rather than the impersonal forces of a capital market directed from the City of London. Despite that trend in the late 1980s towards the securitisation of mortgages, which would have brought them more into the province of the City's market, only 6 per cent of UK mortgages were in this form by 1988. This method of providing the bulk of UK housing via variable rate mortgages to individual borrowers had major repercussions for the economy as a whole. Any rise in interest rates would make an immediate and substantial impact on the roughly fifteen million home owners through higher mortgage charges, leading to inflationary

pressure through demands for higher wages and salaries. Conversely, any fall in interest rates would lead to lower mortgage payments and thus higher disposable income, and this would fuel inflation through a rise in consumer spending. Unlike the era of the privately rented sector there was now no moderating cushion, in the shape of the small property-owning class, who could adjust the investment in housing according to prevailing interest rates.[8]

In complete contrast to the position of housing, the City of London was intimately involved in the finance of government. Institutions like the Bank of England, which acted as the central bank even before nationalisation in 1946, and the London Stock Exchange, where the National Debt was traded, were very much dependent upon the business generated by the government. Until the mid-nineteenth century, for example, the London Stock Exchange was essentially a market in government stocks. However, despite rising expenditure and the occasional war, between 1850 and 1913, the government financed itself without recourse to long-term borrowing, mainly through a gradual rise in income tax and a reduction in interest payments. The National Debt actually fell from £794m in 1850 to £680m in 1913, by which time it comprised only 10 per cent of the nominal value of the securities quoted on the London Stock Exchange, as compared with 70 per cent at mid-century. In this period the government made relatively modest demands on the City, leaving the City free to pursue other interests. This changed dramatically with the First World War, the needs of which led the National Debt to rise more than ten-fold, reaching £7.5bn by 1919. Most of this was raised in the City and even that proportion that was raised abroad (approximately 18 per cent) was done through City financial institutions and firms. By 1920, UK government debt amounted to 35 per cent of quoted securities, and this proportion continued to grow between the wars as the government was forced to borrow to pay for reconstruction, unemployment and to meet interest charges. In 1938, the National Debt stood at £8.1bn and this increased to £23.8bn in 1946 as a consequence of the financial needs of the Second World War. With the experience of the First World War as a guide, the government did raise more finance by way of increased taxation and directly tapped the savings of the nation through the national banking system. Nevertheless, the result of two world wars was to increase the National Debt thirty-fold by adding £23bn to its pre-1914 level, so that by 1946 it again dominated the securities quoted by the London Stock Exchange, comprising 60 per cent of their nominal value.[9]

Unlike the years after the mid-nineteenth century, the second half of the twentieth was not to see a reduction in the National Debt, at least in nominal terms. The government that emerged from the war was committed to an extensive programme of social provision and state ownership, all of which called for extensive borrowing. As a consequence, by 1950, another £2bn had been added to the debt, which continued to grow even after the defeat of the Labour Government and its replacement by the Conservatives. Though less inclined to borrow, they proved incapable of restraining public expenditure or, at least, financing it out of revenue. The debt thus reached £28bn by 1960 and, after two more Labour governments, in which borrowing was again deliberately expanded, it grew to £33bn in 1970 and £95bn in 1980. Its rise seemed inexorable, with the political nature of the government determining only its pace, until the late 1980s when, with the debt standing at roughly £200bn in 1989, central government revenue was not just in balance but in surplus, so allowing a start to be made on repayment. By then the net public sector indebtedness was £158.5bn, reflecting the fact that part of the National Debt was held by the government itself. However it was not just central government that became an extensive borrower, for local authorities also had increasing recourse to the capital market in order to finance improvements for their own communities. Consequently, some forty years after the end of the Second World War, in 1984, total UK government debt still comprised 46 per cent of quoted securities. Only the inflation that has taken place since 1945, which progressively eroded the value of the fixed interest securities issued by the government, reduced the importance of these debts in the economy, and then at the expense of the investors who had held them. In 1984, the market value of government debt was equivalent to only 12 per cent of quoted securities, or a quarter of its nominal value. Despite this decline in real terms, the need to finance government borrowing since 1914, and particularly since 1945, was a dominant force in the London capital market.[10]

It was exactly this type of financial operation that the City excelled in – the mobilising of large sums of money from numerous national, or international, investors to lend to a particular borrower under specific conditions, and the creation of an active after-market in the resulting debt so as to make lending attractive not only to the few who could spare large sums for long periods but also to the many with small amounts available for short periods. Consequently, the government's borrowing requirements gave a domestic importance to the

City which it had not possessed when borrowers were much more diffused and localised, for then they could be more easily serviced by intermediaries closer at hand. The government was a very competitive borrower as it could offer as security the entire taxable capacity of the nation. This made government securities very attractive to investors and this attraction was further increased by giving them special privileges, denied to those of other domestic borrowers, and restricting access to comparable foreign securities by the use of exchange controls from 1914 to 1979, with the exception of 1925–31. It was only with the gradual build-up of inflation from the 1950s onwards that fixed interest debt became increasingly unattractive, leading investors, particularly the institutions, to switch to equities and property that would rise in value along with prices. As a result, whereas in 1913 only 1 per cent of the assets of UK insurance companies was invested in British government debt, this had risen to 32 per cent by 1920, largely due to the First World War, and then to 40 per cent in 1946, largely due to the Second, after a fall between the wars to 16 per cent in 1938. It again fell back after 1945, being down to 14 per cent by 1968, for example, by which time securities, mortgages and property dominated their asset holdings.

However, it is inconceivable that the government could not obtain the finance it required from the City of London, especially during both world wars and given both its attractions to investors, though they were fading with inflation, and the controls it possessed and used to limit access to the capital market for other borrowers. What the government intended to use the funds for was not the concern of the City, only the government's ability to service its debts. The City provided a mechanism whereby it was made possible for governments to raise funds to fight wars, or purchase private assets, or provide social services, but it was the government that made the decisions on how to allocate the financial resources it raised, not the City. Thus, the costs and benefits that flowed from the way in which the government used that portion of the nation's savings entrusted to it, must be attributed to the wisdom or folly of the decisions made by successive governments, not the market from which they obtained the funds. The City cannot be either blamed or praised for what the government did with the money it raised, only assessed on how effectively it did this, and at no stage was there any suggestion that the government was unable to finance itself through borrowing in the City, at the cheapest possible rates.[11]

Before 1914, when the government's demands on the capital

market were limited, the City turned increasingly to the finance of infrastructure development, especially the railways. The quoted paid-up capital of UK railways, for example, rose from £211m in 1853 to £1217m in 1913. Many infrastructure developments depended upon the formal capital market owing to the need to commit large amounts of finance from the outset. It was not possible to build a railway line in small sections as it was only when the entire length, or even network, was completed that it could generate sufficient traffic to make it profitable. Similarly half a tunnel or a telecommunications system with few connections were equally valueless. In the case of infrastructure investment the whole was much greater than the sum of the parts. The method chosen by the Victorians to provide themselves with these facilities was the joint-stock company, which raised its capital from numerous individual shareholders but was managed as a collective enterprise. Companies of this kind provided the country with railways, tramways, telegraph, telephone, gas, water and electricity. Though some of this was done on a local basis, especially at the outset when capital requirements were still modest, as the companies grew larger they turned increasingly to the City for finance.

However, the freedom of these companies to operate, especially in the newer areas, was increasingly constrained by legislation and government control. From the 1870s onwards there was a gradual move towards municipalisation, which saw numerous established companies supplying gas and water and running tramways taken over and operated by the local authorities while the supply of electricity was often restricted to council-owned utilities from the outset. On the national level the state took control of the telegraph system, vesting it with the Post Office. When the telephone was introduced, it was regarded as coming within the Post Office's monopoly of communications, and though it licensed companies to provide telephone services, it restricted their availability, especially on inter-city routes where it competed with the telegraph service. Eventually, in 1912, the companies were nationalised and the provision of telecommunications became a state service run by the Post Office. The result was that many of the new developments of the late nineteenth century, such as electricity and the telephone, were controlled by the same authorities that owned the facilities that they were competing against, notably gas and the telegraph, which slowed down their introduction in Britain as compared to other countries in western Europe or North America.

Many of these conflicts of interest were resolved after the Second World War with the wholesale nationalisation programme in which gas, electricity, water and the railways were taken into state ownership. With municipalisation and then nationalisation, the finance of infrastructure development largely bypassed the London capital market, being determined as part of government policy and the persuasive power of the controlling boards. It was no longer in the power of the City to allocate finance both between individual borrowers, like gas, electricity, telecommunications, railways and water, and these sectors as opposed to other areas of the economy. These nationalised industries were also of major importance, being responsible for around one fifth of fixed capital formation in the economy between 1950 and 1980. By 1977, the nationalised industries had obtained some £17.5bn in external funding – excluding the substantial self-generated finance – and of this 72 per cent came from the government, 23 per cent from overseas borrowing and only 5 per cent from the public issue of securities.[12] The Association of Investment Trusts, for example, in the late 1950s, complained that:

> the nationalised industries have not been obliged to compete in the market for their capital and have thus not been subject to the control imposed by the limited supply of private savings.[13]

These industries had their borrowing controlled by the government which eased or restricted access depending upon general policy requirements. The industries' own needs were of secondary consideration in this, but when they were allowed to borrow they could do so directly from the government or through public loans – at home or abroad – backed by the government guarantee, which gave them privileged access to finance. Thus, again, there is a major area of investment in the economy which at one time did make extensive use of the City in order to obtain the funds required but increasingly distanced itself from having to compete in the London capital market for funds. Since 1945, the City has only been involved in one major domestic infrastructure project, namely the Channel Tunnel. All other similar areas of the economy, such as the entire road network, were the responsibility of local and central government. Investment was determined not by the market and its assessment of the relative merits of competing projects – both public and private – but by the often short-term considerations of political expediency.[14]

However, in any assessment of the role of the City, and the power of its capital market, to allocate funds, the areas over which it had limited control are forgotten, even though they collectively represented the majority of domestic investment. Instead, the entire allocation of financial resources within the British economy over the last century tends to be credited to the City by its critics. For the period before 1914, they concentrate upon Britain's high level of overseas investment, which was largely directed and organised from the City of London, with the implicit or explicit assumption that these funds could and would have been better employed domestically. Certainly Britain's foreign assets rose rapidly in the second half of the nineteenth century. In 1856, these stood at £0.3bn, in current prices, and had reached £4.2bn by 1914. If allowance is made for the fact that prices were generally falling in this period the increase is even more dramatic, as overseas assets, measured at constant (1938) prices, grew from £0.5bn to £7.3bn between 1856 and 1913. This was not just an absolute rise but also a relative one for these foreign holdings represented 34 per cent of total UK assets in 1913 as compared with 9 per cent in 1856. Little of this foreign investment took the form either of lending by the British government or overseas expansion by established companies though a few, like the thread manufacturers J. & P. Coats, did open factories abroad. Instead, it was done in two ways. Specific British companies were set up, usually in the City of London, to own and manage foreign operations, whether it was Argentinian railways, South African gold mines or Malayan rubber plantations. These companies financed themselves by issuing shares and debentures in London and this was handled by the City's merchant banks, stockbrokers and other financial institutions. Popular as this method was, however, the most common way was for foreign governments, or established foreign corporations like the North American railroads, to raise loans in London by way of stocks and bonds which were also handled by City finance houses. Supplementing that was the purchase by UK investors of securities issued abroad, and that was done mainly via the brokers and jobbers of the London Stock Exchange.

Between 1865 and 1914, securities totalling £4.1bn were issued in London on behalf of foreign governments or companies operating abroad. Of these almost 70 per cent went to finance infrastructure development, either directly or via overseas government, especially in the areas of recent European settlement which were being rapidly

developed at this time. One third went to North America alone while almost another third went to South America and Australasia.[15] As an American, W.C. Van Antwerp, observed in 1913:

> As Great Britain is a country where there is never any difficulty about raising capital for the creation or extension of any business, which offers a reasonable possibility of large profits, it is natural that new countries where capital is scarce and credit scarcer should turn to London.[16]

In the period before the First World War, the London capital market emerged as by far the most important in the world for international borrowing. Though other centres had their specialities, such as Paris for Mediterranean countries or Brussels for tramways, no other city could match London's scale and variety.[17]

Many have suggested, especially since 1914, that the City was unduly favourable towards overseas issues, channelling funds into them that would have been more remuneratively employed at home. In particular, the foreign origins of many of the merchant banks handling the issues gave grounds for believing that their orientation was entirely abroad. As Jarvie stated in 1933: 'These Anglo-foreign private banks have rarely any interest in the financing of British industries. They are out all the time for foreign loans.'[18]

There is no doubt that the London merchant banks did have strong overseas connections which greatly facilitated the flow of capital abroad. However, most originated not in the countries to which the finance was directed but in continental Europe, especially Germany, and they came to London to develop the international links that were largely absent at home. A bank like J.S. Morgan (later Morgan, Grenfell), for example, that originated in the United States, used its London operations not simply to channel British savings into US securities, but from which to manage its international operations, including US investment in Argentina and Canada or even in the London underground system. Even merchant banks with domestic origins, like Fleming's from Dundee, came to London to further their international business, not to tap the City for capital on behalf of their jute manufacturing clients.

Therefore it was not the presence of foreign finance houses in London that made the City so heavily involved with overseas investment, but the fact that international investment flowed through London which attracted foreign finance houses to it. Of course, the

existence of so many specialists in foreign investment in London, and their extensive contacts, helped to make the City such a dominant force in international investment, which in turn attracted more finance houses from abroad. Essentially, what the City was very good at was the raising of large amounts of capital for the likes of governments and railways wherever they were located. For example, between 1860 and 1904, Baring's and Rothschild's issued between them 250 loans worth £1.9 bn, or with an average size of £7.7m. Established firms like these were specialist issuers of large loans and when an industrial issue came into that category they would handle that as well, such as Barings' issue of £6m in securities for Guinness in 1888. Beneath them there existed numerous other merchant banks that specialised in smaller issues. J.S. Morgan concentrated upon loans for the principal US railroad companies and, later, industrial enterprises, where issues of between £0.1m and £0.2m were common, with few being over £0.5m. Smaller still were firms like Dunn, Fischer & Co., or the Canadian Agency, with interests in Latin American tramways and Canadian industries respectively. They were on the active look out for any kind of securities to issue until they too became established and could hope to handle the larger loans where the profits were greater because of the scale of the business.[19]

When the range of firms and the issues they handled are, therefore, examined it is difficult to accept that there was any particular bias for overseas issues in the City that would distort the absolute flow of funds. However, that still leaves the question of whether such a large proportion of the nation's wealth should have been placed abroad, particularly into the countries and activities to which it was directed by the City. In terms of direction and composition, although the City could discriminate between competing claims, it could not lend to those who did not attempt to borrow. Consequently, most of the overseas investment flowed to 'new' countries as these had the greatest demand for capital relative to the accumulated savings of the population, and within these countries the principal need was to create the essential infrastructure that would allow development to take place, especially transportation in the form of railways. Thus, the main demand made on the City was to supply the finance for railway construction. There was a growing diversity as the international economy became more integrated and new opportunities appeared. Agriculture and mining absorbed 12 per cent of British overseas investment, and manufacturing 4 per cent, between 1865 and 1914, but it was difficult for the investor at a distance to

participate in these type of activities without the facility of a transnational company that could combine capital with management. That was only just beginning before 1914.[20]

Foreign investment was certainly productive for less and less went to cover administrative expenses or fund wars, and more and more made a direct contribution to economic growth, including that borrowed by governments. In particular, it helped to open up new areas for development by assisting in the provision of improved transport. This led to a rapid expansion in the world's production of foodstuffs and raw materials, bringing down prices and raising real incomes in the consuming countries, like Britain. The overseas investment also stimulated UK exports as it put purchasing power into the hands of foreign consumers whether they wished to build railways, buy cotton textiles or ship manufactures and commodities. To a significant degree, the overseas issues made by the City translated directly into foreign purchases of British goods, by providing importers with the credit they required. In the era after 1914, when overseas issues were restricted, the banks for example had to provide much more long-term credit for their industrial customers in order to finance exports.

This overseas lending was also being financed increasingly by the returns from successful investment in the past, with the UK receiving, net, approximately £200m per annum in 1913 by way of interest, dividends and repayments, and this comprised 22 per cent of the country's entire foreign earnings. At the same time not all the foreign issues made in London were taken by British investors. The very growth of London as an international financial centre meant that it was an ideal place to raise capital because it was the centre of a distribution network that extended worldwide.

Through their connections, the merchant banks, for example, were able to handle the largest of issues because they possessed clients in numerous countries who were always ready to take up the securities that they were issuing. Hence the reason why the European-based banks established a presence in London was because they wanted direct access to the largest new issue market in the world – they were employing funds rather than trying to raise them.[21]

Thus, it is clear that by 1913 the funds being channelled abroad by the City were not necessarily siphoning away domestic savings, while they also contributed to the British economy through stimulating external demand for British goods and services and providing cheaper and more abundant sources of primary products. However, Britain's position of being the dominant creditor nation, with a high

degree of commitment to overseas investment, was radically altered by the First World War and subsequent events and policies. During the war Britain sold off assets worth £0.6bn and also accumulated foreign debts, as it borrowed to finance the war. At constant (1938) prices, Britain's overseas assets fell £2.4bn between 1913 and 1924, by which time they stood at £4.9bn or 24 per cent of all UK assets as compared with 34 per cent in 1913. Although the export of capital resumed in the 1920s, as borrowers returned to London, there was now increased international competition, especially from New York, while the UK investor was, collectively, not as wealthy. Whereas in 1913 issues on behalf of overseas borrowers comprised 82 per cent of all those made, this proportion dropped to 45 per cent in 1924–8. With the world economic crisis of 1929, and the imposition of strict exchange controls in 1931, access to the London capital market for foreign borrowers was severely restricted. The result was that between 1934 and 1938 overseas issues provided only 18 per cent of the total, or the complete reverse of the pre-war position. In real terms, the UK was actually disinvesting abroad, as loans repaid were not being matched by new ones. By 1937, at constant (1938) prices, the stock of foreign assets had fallen to £4.1bn or 18 per cent of total assets.[22]

This process was finally completed by the Second World War when, again, overseas holdings worth £1.1bn were sold and debts accumulated abroad in order to purchase essential war material. Britain emerged from that war a net debtor, and it was only gradually, from the early 1950s onwards, that foreign credits were accumulated. However, even as late as 1973, overseas assets only totalled £1.5bn (at 1938 prices) or a mere 3 per cent of total UK assets. Between 1914 and 1945, Britain ran down the net stock of foreign assets that it had largely accumulated over the period 1850 to 1914 in the interests of waging two successful wars. The maintenance of exchange controls and a rigid policing of the capital market in the era 1945–79 ensured that there would be no rapid or large-scale revival of the export of capital. In fact, persistent balance of payments problems in the 1960s and 1970s, and the need to finance them, ensured that Britain remained a marginal creditor nation.[23]

Much of the foreign investment that was permitted at this time was directed to the countries of the sterling area, as a result of government monetary policy. It was also done largely through the international expansion of British companies, like BP and ICI, financed mainly out of re-invested profits rather than direct appeals to the

market for funds for specific projects. Again, since 1945, the City was losing control over another component of the capital market for it was now the management of the multinational companies that determined the area, sector and amount of overseas investment. It was only in the 1980s, with the ending of exchange controls in 1979 and the balance of payments surpluses arising from the oil revenues, that something of a revival in traditional overseas investment took place. Between 1979 and 1987 the UK's net external assets increased from approximately £12.5bn to around £100bn and much of this was directed and managed by City-based financial institutions. However, the £4.2bn (current prices) in foreign assets of 1913 would translate into £700bn, in 1987 prices, leaving the UK far short, in real terms, of the position it had reached before the First World War. Despite their rapid growth, net overseas assets remained marginal to the UK economy in the post-1945 era, reaching only 5 per cent of national wealth by the mid-1980s, as compared with over a third in housing, almost 30 per cent in offices and factories and 15 per cent in plant and machinery. In 1989, net UK overseas assets were valued at £110bn but, at the same time, the owner-occupied housing stock was capitalised at £970bn, or nine times greater.[24] Consequently, if it is difficult to show that the foreign investment that flowed through the City before 1914 was harmful to the economy, it must be impossible to do so for the period afterwards when it was at a fairly low level. Since the Second World War it has only been from 1979 that the City gained any effective control over the process of overseas investment. Basically, there have been too many radical alterations over the last hundred years in Britain's position as a net creditor, and in the City's power to influence the nature and extent of overseas investment, to suggest that the London capital market's placing of funds abroad was a major cause of Britain's long-term economic decline.[25]

Nevertheless, there remains the long-standing complaint that the City neglected the finance of British industry, whether it was for overseas investment before 1914 and after 1979, or something else in between. In the period before 1914 the finance of manufacturing industry certainly made little call on the London capital market. Manufacturing was an easily divisible process in which the initial scale of operations was at such a low level that it was accessible for any individual with only modest savings, supported by business and family connections. Bank credit could be easily tapped to finance stocks of material and finished goods. If the process or product was a success, profits generated the finance for future expansion whether in

the same line or allied fields. These profits were also a signal to outside investors that the industry was prospering, making it relatively easy to obtain further funds from a wider investing public as a tangible business rather than a business dream was now in existence. The motor vehicle industry, for example, which became very capital intensive, passed through all these stages resulting in such successful firms as Austin, Morris and Daimler. Profitable growth industries never found themselves deprived of finance, from either re-invested profits, bank loans, or public issues of securities, even in the most depressed years between the wars.

Though the capital requirements of businesses were continuously on the increase, putting increased pressure on individual savings, so was individual wealth before 1914. It remained a fairly simple matter for an entrepreneur with a successful record and with personal or business contacts to obtain the necessary finance for any promising new venture. The Committee on Finance and Industry were told in the late 1920s that £50,000 could be raised with little difficulty and that was more than sufficient to establish all but the most ambitious manufacturing enterprise. Generally for every activity there existed an interested and informed group who could be called upon to supply the necessary finance if they were convinced of the merits of either the proposal or the proposer. This allowed for the movement of capital into new industries but in the same locality, as from bicycles to motor cars in Coventry, or into the same industry but in a different locality. It was important to possess this element of familiarity as only intimate knowledge could reduce the risks to a level which made the investment a matter of calculation rather than a gamble and thus attractive to the average investor most of the time.[26]

Despite the existence of these methods by which industry was financed before 1914, an increasing number of manufacturing companies were publicly floated in the City. By 1907, there were already some 570 industrial and commercial concerns quoted on the London Stock Exchange and they were worth around £500m. However it was rarely the need to raise capital that led to the adoption of the joint-stock form but other requirements, for almost all were the conversion of established private businesses into public enterprises. The need to facilitate the division between ownership and management on the retirement of the founder of a business dynasty or the merging of individual firms so as to re-organise production were among the principal forces behind conversion. In the process, little by way of new capital was raised for the enterprise for it was a change

of ownership that was being effected not a raising of finance, though the transformation into a joint-stock company certainly facilitated the issue of new securities to f[illegible] further expansion. These conversions were also very responsible [illegible] the desire of investors to purchase the securities being issued r[illegible] than the needs of the industry for capital, for the process of ca[illegible] formation was continuous through re-invested profits and bank loans. The institutions and firms of the City were also eager to participate in the conversion of private enterprises into joint-stock companies, with company promoters, stockbrokers and merchant banks all competing for the business. Even established merchant banks like Baring's and Morgan's could be tempted. Consequently, before 1914, there existed a diversified capital market in which London's role was to offer a home for the largest companies when they wanted to convert to the public joint-stock form for whatever reason. The rest of the capital market operated very successfully at the local and informal level, with no apparent shortage of capital.[27]

Superficially, nothing appeared to have changed as a result of the First World War. The City gave an enthusiastic response to the rash of industrial and commercial flotations that were made in the early post-war boom and the one that followed it in the late 1920s. There was certainly no reluctance on behalf of the City to participate in industrial finance. The number of industrial and commercial firms quoted on the London Stock Exchange reached 719 in 1924 and then grew to 1712 in 1939, by which time they had a capital value of £2.5bn. One observer, writing in 1931 on the finance of industry, maintained that:

> In no other country are there organisations which surpass in efficiency the experience of the London Stock Exchange, the London issuing houses, investment houses, finance companies and under-writing agencies, and in no other country is there a more varied and enterprising band of company promoters than is to be found within the boundaries of the City of London.[28]

However, this very enthusiasm was condemned by contemporaries, and later by historians, for included in the company promotions, especially in the 1920s, were many completely new enterprises proposing to produce such items as films, gramophones, radios and synthetic fibres. The problem was most of these turned out to be short-lived, either because they possessed poor business judgement

or were simple frauds to attract gullible investors. Of the 183 issues made in 1929, for instance, 74 were conversions of established firms, and they raised £29m, while 109 were for new ventures and they pulled in £27m. By the end of May 1931, while the conversions had lost 18 per cent of their value, the value of the new companies had depreciated by 83 per cent. The City's involvement with the finance of untried manufacturing enterprises had not proved a success while its traditional business of conversions had held up well against the general economic collapse. Nevertheless, this hardly suggests a deep divide between the City and industry, but more the City's poor judgement of completely novel undertakings as compared to its ability to sell proven companies to investors at a realistic price.[29]

The real problems of industry did not lie primarily with the City, for the First World War had led to a fundamental alteration in the way business was financed in Britain. During the war, the government had issued vast amounts of stock, creating in the process a vastly inflated investing public who held these securities. Comyns Carr reported to the Company Law Amendment Committee of 1918 that:

> We have seen during the War a remarkably widespread diffusion of money, and a wonderful growth in the habit of investment, among classes of the population to whom both are a novelty. It is computed that no less than 13,000,000 people [sic] are directly interested in various forms of Government war securities. After the war it may be expected that a large number of people who never were investors before will be willing to entrust their savings to commercial companies, but will not be very well equipped to select those which are worthy of their confidence. Simultaneously there will be a large crop of new schemes appealing for public support, mostly bona fide, but offering unique opportunity to the fraudulent and over sanguine. In my opinion it would be a disaster if by such means the money of the new class of investors were to be lost, and they were ultimately to be frightened away.[30]

Never was a more accurate prediction of events made, but his plea for greater checks on new companies and new issues was ignored. The result was the rash of new issues that took place in the 1920s, among which were a number of projects that before 1914 would have been tested by a small group of closely involved investors before those that proved successful were opened up to the general investing

public. Nevertheless, the losses that did result, estimated at a maximum of £5m in any one year, were tiny when placed against the large sums raised annually in the London capital market. However, the publicity surrounding them was such not only to discourage investors but also City firms and institutions from handling issues by entirely new companies, and this was given legislative backing by the Company Act of 1929. Consequently, one effect of the war was to expand the investing public too rapidly, without their becoming aware of the pitfalls, and forcing reactions which actually made it more difficult for new companies to raise capital from the 1930s onwards by way of new issues in the London capital market.[31]

This restriction was of importance because the war, and its aftermath, made it difficult for both established companies and new ventures to raise capital in the traditional ways. For the established companies, re-invested profits had been the principal source of funding but in the inter-war years, once the immediate post-war boom was over, many experienced a long period of low profitability and even large losses. Major export industries like coal, shipbuilding, mechanical engineering, cotton and woollen textiles, found it difficult to recover markets lost during the war, especially with the overvalued pound during the 1920s and the collapse of overseas lending in the 1930s. They faced severe over-capacity and, once they had used up their reserves, they could no longer finance their operations let alone invest in new equipment. This lack of profitability also meant that they were unattractive to outside investors, as they offered little prospect that a remunerative return could be obtained. Their plight and its cause was all too plain to those who investigated their position. The Committee on Industry and Trade reported in 1929 that:

> It has been shown that the root cause of this incapacity (to re-equip) is not any defects on the part of the British banks or other financial institutions, which are undoubtedly able and willing to supply industry with all necessary facilities on reasonable terms of security. Nor does it arise from any indisposition of the public to subscribe new capital for industrial concerns provided that there is a prospect of obtaining a reasonable return. This is abundantly shown by the ease with which such industries as are earning good profits are able to secure all the capital they need. The tap root of the mischief is the continued unprofitableness of so many industrial

concerns, which makes them unable to give security to the banks or to offer an attractive investment to the public.[32]

In the 1920s there was still the belief that the export industries' problems were of a temporary nature and would disappear once the international economy returned to its pre-war scale and pattern. Thus City firms did become involved in trying to re-organise and re-finance some of the major firms while the banks allowed temporary loans to be extended almost indefinitely, and even made new loans to business customers of long standing. With hindsight, it is clear that the banks over-lent to the distressed cotton textile and heavy industries in the 1920s. By the end of 1929, the Midland Bank had around £2m locked-up in loans to firms in Lancashire cotton manufacturing and the South Wales coal and steel industry. With the actual worsening of economic conditions for the export industries after 1929, there was the realisation that they were not likely to revive as their markets appeared to have shrunk permanently.[33] Reluctantly many businessmen were forced to agree with the rather harsh judgement of W.N. Goschen, the Chairman of the National Provincial Bank, when he stated as early as 1930, that: 'I think when the industry has reached such a point that it has exhausted all its capital and credit that it is entitled to have there is only one thing – to disappear.'[34]

As the economic crisis deepened there emerged real fears that the entire financial sector would be de-stabilised as a result of the export industries' inability to service their debts. In continental Europe major banks had already collapsed from their over-commitment to particular industrial sectors, or been forced to retrench considerably. The consequence was that the Bank of England itself was forced to become involved in industrial finance and re-organisation for the first time, in order to achieve an orderly run-down of the troubled industries before a total collapse would bring down a bank or finance house, with major repercussions for the rest of the economy. In co-operation with other financial institutions and firms in the City, it set up such bodies as the Securities Management Trust (1929), the Bankers Industrial Development Company (1930) and the Special Areas Reconstruction Association (1936) to co-ordinate its attempts to help such industries as shipbuilding and cotton textiles.[35] Thus, in the inter-war years, it was not a case of the City and its institutions ignoring the needs of industry, for never had they been so involved.

Rather it was forced into the decision that the prospects of particular industries were such that they could not be supported indefinitely without damaging the interests of depositors and investors, whose savings they handled, and creating long-term harmful effects for the economy as a whole, as funds were diverted to unprofitable activities and the stability of the whole financial system undermined in the process. The City had to take the overview and look to the long-term, even though this meant the decline of once great industries and regions.[36]

However, it was not just the problems of the depressed industries which led to criticism of the City from business and other interests between the wars. There also emerged the complaint that the City was failing to finance the establishment of new manufacturing firms, because their financial requirements were too small for it to bother with. Even Sir Robert Kindersley, a director of the City merchant bank, Lazard Brothers, accepted that this view might be valid. Certainly, once firms proved themselves successful, like motor vehicle manufacturing, they had no difficulty in raising funds in the City, but the problem was how did they reach that stage. Before 1914 this would have been done through the informal webs that proliferated in British business but after the war this was more difficult because of the lower level of profitability. Between 1924 and 1937, the gross profit rate averaged around one third the pre-war level, at constant prices.[37] The consequences for the finance of new enterprise were spelled out in the late 1920s by E.L. Payton, representing 3000 small firms nationwide, when he maintained that 'most of your friends have got their own commercial difficulties and have not their money free'.[38]

Accentuating the problem of low profitability was the rapid rise in personal taxation due to the war and the post-war need of the government to service its debts. Whereas in 1913, a bachelor earning £10,000 per annum was left with a post-tax income of £9242, this had shrunk to £5672 in 1922 and only recovered to £6103 in 1938. Although much of this taxation did return to the wealthy by way of interest payments to holders of the National Debt, the very nature of savings and investment had been transformed in the process, as Sir Josiah Stamp so accurately pointed out at the time:

> You cannot expect these private businesses to be financed as they were by people who knew them once the money has left them by high taxation and gets into the hands of rentiers who do not know

> them, and if it is bid for by home enterprise it goes into the very large concerns. No rentier getting his war loan return and looking round for further investment is going to put the money into the business of John Jones or Tom Smith whose securities are not marketable, he will put them into the securities of some large combine. You have altered the whole direction of savings by that very fact.[39]

No longer was there an abundance of wealthy people with strong business connections who were able and willing to finance all manner of new enterprises in novel areas. Though they still continued to exist, they had now to be much more selective about where they placed their funds, and thus much more cautious.

Generally, there was a growing institutionalisation of savings between the wars as the new investing classes sought security and management, especially after the new issue failures of the 1920s. Consequently, building societies, unit trusts, insurance companies and other such institutions received a growing volume of the nation's savings in this period. Life assurance funds, for example, rose from £506m in 1919 to £1458m in 1938, while an estimate for 1933 suggested that institutional holdings of securities already totalled £1.7bn. This was to the benefit of the City in many cases as these passive investors sought the facilities that it could provide in placing their savings in safe but remunerative investments. It also encouraged the growth of large companies that could offer the type of securities that these institutions required for they needed investments which could be easily realised when investors required repayment. The stocks and shares issued by large companies possessed an active market, allowing purchases and sales to be made easily, while those of small companies were usually difficult to sell, and then only at a substantial discount.[40]

Thus, the high tax regime of the inter-war years ushered in a new environment for investment, and though the City did respond with alacrity where it already possessed the facilities, as in handling new issues, it was slow to respond in other cases. Unit trusts, for example, did not appear in Britain until the early 1930s with Municipal and General. Similarly, it was not until the late 1920s that the City really began to be involved in mobilising savings from the many to finance new enterprise. By then, however, a number of merchant banks and stockbrokers were already involved in the financing of new or smaller businesses, such as Morgan Grenfell in electrical manufacturing. This

even led to the formation of a number of specialist City firms in the 1930s, such as Charterhouse Industrial Development Company (1934) and Leadenhall Securities (1935). Kinross, who was associated with the Gresham Trust and the Cheviot Trust, handled between 1934 and 1938 over 100 issues for small UK industrial and commercial firms, some as low as for £25,000, helping to finance such firms as Pye Radio in consumer electricals and J. Hepworth, in ready-made clothing. For those issues requiring a quotation on the London Stock Exchange there was increasing use made of placings or introductions where the expenses of a public offering were avoided by distributing the securities among a small group of investors organised by a City firm.[41]

Certainly by the 1930s, the City was responding to the new needs for external finance of British business by organising ways that they could tap the savings of the general population rather than those of a small circle. This response had been a tardy one because there was little tradition of City involvement in finance at that level. However, once entrepreneurs approached the City looking for finance and banks, brokers and others in the City realised their needs and developed ways to meet them, then a satisfactory arrangement was gradually worked out. The result was that as the City became more proficient in the finance of British industry in the 1930s the need to merge so as to create companies of sufficient size that would appeal to the institutional investor declined. The share of the largest 100 firms in manufacturing output, which had risen from 17 per cent in 1919 to 26 per cent in 1930 actually fell back to 23 per cent in 1939.[42] Nevertheless, the facilities provided by the City were not a complete substitute for leaving funds in the hands of those likely to invest them productively, in risky projects requiring considerable initiative and constant involvement. Passive investors were, generally, likely to be wary of projects they knew nothing about, put forward by people they did not know. The result was a widespread feeling of trepidation that the market-orientated economy of the past would survive into the future, as Grant questioned in 1937 at the end of his review of the capital market:

> Is there anyone who will confidently assert that in fifty years from now private enterprise will still be the dominant force in the economic life of this country, even though Conservative Governments remain in force throughout the period?[43]

As with the First World War, the Second, and its aftermath, was to alter yet again the environment within which the City operated. From the outset of the war, the government aimed to finance much of its expenditure from taxation. The post-tax income of £6103 out of £10,000 thus shrunk to only £3138 in 1945, and until the 1980s a high tax regime was maintained especially on larger incomes. The top rate of taxation stood at 98 per cent in both 1945–6 and 1975–6, having fallen to 90 per cent in 1963–4. In 1978 an income of £50,000 produced only £15,124 after tax. It was only after 1979 that these top rates came down significantly, reaching 40 per cent in 1987–8. Thus, for almost the entire post-war era, there was a trend towards the redistribution of income away from the wealthiest through the taxation system. As a result the post-tax income of the top 10 per cent fell from 34 per cent in 1938 to 27 per cent in 1949, reaching only 22 per cent in 1976/7. It was wage and salary earners who absorbed a growing share of national income as opposed to those who received profits, rent or were self-employed. Inevitably this reduced even further the income and wealth of those groups in society most likely to invest directly in business, accentuating the need for intermediation if industry was to obtain the finance it needed. Consequently, the inter-war trends towards the institutionalisation of investment and the encouragement of big business were not only continued after 1945 but were greatly stimulated.[44]

The government was creating the environment within which the London capital market could operate for much, if not all, the post-war period. The Association of Chambers of Commerce complained, in the late 1950s, that:

> Penal rates of taxation have distorted business activity, inhibited capital development and have seriously affected the viability of the medium and small firm, which is so dependent on private risk capital.[45]

This was not just in the general realm of taxation but involved direct controls over the operation of the capital market itself. The Capital Issues Committee, for example, directed finance in accordance with perceived national interest and this operated from the war until 1959. Even when it was abolished other controls and restrictions remained or were introduced. Never before had the government such power over the capital market, and that power was exercised. Therefore, it

is impossible to accept as valid the assessment that it was the 'blind and unaccountable forces of competition and the market' that dictated the City's relationship with industry in the post-war period.[46] Similarly, the use to which industry put the capital it did raise in the City, through bank borrowing and new issues, was determined by the management of the increasingly large and diversified companies involved, not by the market allocating funds to specific sectors or activities.[47]

The taxation of company profits, for example, gave added advantages to large companies beyond the appeal of their securities to passive investors like the institutions, because of their greater marketability over those of smaller companies. Big corporations could move funds internally, from one branch to another, without paying tax, while separate firms would be taxed on each move. As self-generated funds were the principal source of finance, this was a major consideration. Consequently, whereas the proportion of net output produced by the 100 largest manufacturing plants in the UK remained roughly constant at 11 per cent over the entire 1930–68 period, the share provided by the 100 largest industrial firms rose from 23 per cent to 41 per cent. It was not the necessity of increasing the relative size of the production unit that lay behind the desire to merge and create giant firms but the opportunities simultaneously to internalise financial flows and appeal to institutional investors. The post-war growth of the diversified company was a reflection of these changed circumstances. Its securities appealed to the institutional investor because they possessed an active market, being numerous, and were relatively stable, as the company possessed a varied source of earnings. At the same time the firm could channel profits made in one sector of its business to another or use its funds to acquire another enterprise, all without incurring any taxation charges. Takeover by such a company was also attractive to the smaller business as a way of realising accumulated profits at a lower level of taxation. In 1975, for instance, while earned income of over £20,000 per annum incurred a tax rate of 83 per cent, and investment income one of 98 per cent, capital gains were only taxed at 30 per cent. Thus, in 1970, 60 per cent of the top 100 British manufacturing companies were diversified enterprises covering a wide variety of different activities. In contrast, in 1950, only 25 per cent of the top 100 manufacturing concerns were of that kind. These 100 manufacturing companies accounted for 41 per cent of industrial output in 1978 as contrasted with the 22 per cent of 1948.[48]

Possibly the moves in the 1980s towards the dismemberment of large corporations and management buy-outs reflects a position where the tax position and government controls have become of less importance. When the functioning of the financial markets is heavily distorted through taxation and restrictions, large companies become very attractive through their ability to undertake the tax-efficient allocation of financial resources and avoid externally imposed credit and capital controls, though at the cost of expensive management structures to direct the process. Conversely, when the tax burden is reduced and restrictions lessened, the cost of the management is no longer outweighed by the ability to distribute funds internally, and so there is an incentive to split the company into its separate components, either by external aggression or internal decision. Certainly corporate buy-outs rose from 52 worth £50m in 1979 to 229 worth £1.2bn in 1985.[49]

Prais noted in 1976 that: 'if we are looking for reasons for Britain's slower industrial progress, the idea that it is because enterprises are smaller here than elsewhere is not supported by the facts'. This was after he had discovered that large firms controlled a greater proportion of industrial output in the UK than in other major countries. As this increasing concentration has not been accompanied by a growing share of output coming from larger plants, which would suggest proportionate gains through economies of scale in the production process, the very growth of these large companies may actually have contributed to Britain's slower rate of economic growth. The investment decisions of the management of these companies were not determined by the discipline of the market-place, where they would have to compete with all other borrowers, but by the availability of funds within the group and the general corporate strategy adopted. As this did not necessarily aim to maximise the rate of return, these large and diversified enterprises may have contributed to a less than efficient allocation of resources within the British economy since 1945. Therefore, any reversal of this process of concentration, as in the 1980s, could actually contribute to a change in Britain's poor economic performance.[50]

In the early years after the Second World War, British industry had little need for external finance as it had accumulated large reserves, as well as tax credits, that could be run down to fund reconstruction and expansion. Tax on company profits also discouraged large dividend payments and so left corporate income in the hands of the management to be used for re-investment. However, from the early

1950s onwards, British industry suffered from a generally low level of profitability, not due to any lack of investment but because of the general state of the economy and the uncompetitiveness of UK manufacturing. In particular, there was a collapse of corporate profits in the 1970s, with a recovery in the 1980s. Altogether, for UK industrial and commercial companies, whereas trading profits financed 72 per cent of their investment in 1952–5, this had fallen to 64 per cent in 1961–5 and 45 per cent in 1971–6. Although income from domestic assets like property and securities and from subsidiaries operating abroad did rise strongly in the 1970s, helping to finance 35 per cent of investment in 1971–6 as compared with 22 per cent in 1966–70, there was an increasing reliance placed upon external sources of funds. In 1952–5, external funds financed only 6 per cent of investment but 20 per cent in 1971–6. Thus, until the 1980s, the gradual inability of industry to finance its own expansion, which accelerated rapidly in the 1970s, led it to make increasing calls upon the City for finance, whether it was in the form of bank loans or new issues of securities.[51]

These demands met a ready response in the City, especially as manufacturing firms could offer, through the issue of ordinary shares, an equity stake in the prospects of the business that would allow returns to grow over time, and thus, at least, keep pace with inflation. Corporate capital issues, for instance, rose from £90.1m per annum in the 1945–50 era, to £1369.7m per annum in 1975–6, and this was increasingly in the form of ordinary shares, or loan stock convertible into equities, other than when the tax regime gave a particular advantage to fixed-interest debt finance. The established merchant banks, for example, which had once been concerned almost exclusively with overseas lending, now concentrated heavily on domestic new issues, especially of industrial equities. In addition, they had competition from a host of newcomers in the City of London, which were also orientated towards industrial finance. By 1980, the finance houses had financed equipment worth £14bn for leasing to industry, as compared with £0.3bn in 1973.[52]

Although mistakes were undoubtedly made, and connections helped to place finance where it was not deserved on objective grounds, on the whole the considerable change that took place in the composition of the financial sector in the City of London in the post-war years ensured that there was a ready response to the needs of industry, whether from the existing firms or newcomers, like the

First National Finance Corporation set up by Percy Matthews from the East End ot London. The 1959 investigation into the monetary system accepted that: 'the new issue market is an effective and important mechanism for the raising of long-term capital by public companies'.[53] Generally, no evidence can be found that manufacturing industry suffered any shortage of finance throughout the post-war era, apart from the times when the government itself imposed a credit squeeze. Even those critics of the City, such as Harris, have been forced to admit this, reluctantly, as has the CBI, representing the interests of business, and thus the users of the City financial facilities.[54] After an investigation into City-industry connections, the CBI was forced to admit that:

> The task force had found no evidence to link attitudes of the City directly to the long run decline of the nation's manufacturing sector nor to its resurgence. Rather, it found that many commonly-held perceptions were simply not supported by the available facts.[55]

The real problems were ascribed to the policies of the government and the state of the economy. However, no amount of evidence will dispel the notion of a causal connection between the City and the decline of British industry.

Beginning with the Labour Government of 1945 there started the policy of state intervention to bridge the inadequacies in the City which prevented industry obtaining the finance it required for expansion, especially the funds necessary to establish small but dynamic enterprises that would eventually make a major contribution to economic growth. Immediately after the end of the war, two new organisations were established with the aim of facilitating the finance of industry by bypassing the normal mechanisms of the City. These were the Industrial and Commercial Finance Corporation (ICFC) and the Finance Corporation for Industry (FCI), which were to meet the financial needs of companies under and over £200,000 respectively. However, Kinross, who was General Manager of ICFC, and then Deputy Chairman, indicated the dilemma these organisations were in, when he wrote in his memoirs:

> ICFC had been specifically created to help the small and medium-sized business. To carry out this mandate we had to accept a considerable degree of risk. We had not been set up just to engage

> in safe business. Yet unless we were able to do this at a reasonable overall profit, ICFC itself would not endure.[56]

This was the classic bankers' difficulty. FCI followed a more risky strategy than ICFC and had to be rescued in 1958 by the Bank of England, after which it had to adopt a far more cautious policy. ICFC grew steadily and carefully, eventually merging with FCI to become a successful merchant bank. The problem was that the City had already begun to cater for the needs of potentially attractive small businesses in the 1930s, and was ready to do so again after 1945. All the ICFC did was add another channel, and a successful competitor, to the process, but whether it actually added a new dimension to the London capital market is dubious. The City banks themselves had £30bn outstanding to small firms by 1988 and accounted for 90 per cent of all lending to that sector.

Nevertheless, subsequent Labour governments in the 1960s and 1970s continued to believe that the financial mechanisms of the City were inadequate, setting up as a result such bodies as the Industrial Reorganisation Corporation, the National Enterprise Board and Equity Capital for Industry, as well as others. Again, there is no evidence to suggest that they made more than a marginal contribution to industrial finance, and many of their actions and investments turned out disastrously.[57]

Instead, in the City itself, there began to be established specific venture capital funds to provide the finance required for new businesses, in response to demand, especially in the 1980s. By 1988, there were around 130 such funds in Britain with £4bn in available finance, and of this 52 per cent was located in the City itself and another 34 per cent in the rest of London, often just outside the immediate boundaries of the City. Thus London provided 86 per cent of such funds, leaving only 14 per cent for the rest of the country. These funds were four times greater than their equivalent in West Germany, being more than the entire sum available in continental Europe. The difficulty was that Britain faced not a lack of supply but a shortage of demand from individuals with realistic and well-worked out projects. City investors and bankers, for example, appeared willing to back almost any entrepreneur who came up with a new retailing concept in the mid-1980s, despite the risks involved. However, the inception of a new enterprise depended much less on available finance but on investors with knowledge, experience and contacts to judge its merits and to support it during the difficult early stages. This was most easily

done by the entrepreneur himself backed by those from the locality or the industry rather than any institution that had to consider its own shareholders or depositors when taking risks. The institutions were ideal once a track record had been established but they were not suited to initiating and creating most types of new business. Basically, no post-war government was really willing to accept the socially undesirable fact that to get finance to those with the desire and ability to develop new businesses it was easiest and most efficient to leave it with them in the first place. It was never a simple matter for new enterprises to raise money, especially with an untried management in a novel field, for such firms did have a higher failure rate than established businesses.[58] It was thus important to leave as much incentive as possible for those who were willing to take the risk, both for themselves and those who backed them. However, as early as December 1956, the editor of the *Financial Times* warned that: 'If we impose penal taxation on business profits then we shall continue to destroy the foundations on which a return to wealth could be built.'[59]

Although the number of individual investors did grow substantially in the post-war era, not fall as was feared in the late 1940s, they controlled progressively less and less of the securities issued by industrial concerns. The 1.5m of 1953 had become 2.5m by 1966, and 3m by 1979, before expanding rapidly to 11m by 1990 under the Conservative Government's generous privatisation issues, or 25 per cent of the adult population. However, between 1963 and 1989, for instance, the proportion of UK shares owned by individuals dropped steadily from 59 per cent to 18 per cent, while the share of financial institutions and pension funds rose from 28 per cent to 63 per cent. Those with savings chose to place most of it with building societies or it was invested for them through pension schemes, insurance companies or unit and investment trusts. In 1960, there were 51 unit trusts controlling funds of £201m for 0.7m clients, while in 1986 there were 964 trusts and these had invested £32.1bn on behalf of 3.4m people. Similarly, life assurance funds grew from £2bn in 1946 to £27.5bn in 1977, while by 1988 pension funds had assets of £250bn, and this was largely managed by City institutions, banks and finance houses. In contrast, most of the individually owned shares were held by only 200,000 wealthy people, including the 20,000 or so who had become millionaires by 1988. It was the wealthy who, traditionally, owned shares and as taxation eroded their position so it undermined that group in society which was willing to take a direct stake in business.

As Britain became a more affluent country, in which more and

more people could afford to make significant savings, it was inevitable that the institutional arrangements for their investment would grow, and thus the importance of individual holders would decline. The very proliferation of different types of investment at home and abroad, for example, required a committed and professional expertise which no individual could match in constructing a safe but remunerative portfolio. These trends were evident both before 1914 and 1939. However, the post-war tax system, by giving tax privileges to regular savings made through institutional arrangements, gave a significant boost to institutions as compared to individuals, and thus made them even more powerful in the allocation of funds. In turn, this increased the influence of the City as it was there that most of these institutions were located or from whence their funds were managed. Consequently, on the one hand the government and its taxation policy was depriving the City's capital market of its power to allocate financial resources by placing it in the hands of the state or corporate managements while, on the other, it was directing institutional funds towards the City as the only place from which they could be effectively managed. In the process, the efficiency and flexibility of the whole process by which finance was provided for business was undermined, to the detriment of the economy as a whole.[60]

When examining the London capital market over the long term, one is left impressed by its ability to respond to demands, and to devise solutions for the most complex of problems. One is also left aware of the limitations of its power considering how much investment continuously bypassed it or was absorbed by government and big business, over which it had little control on how the funds were used. At times its response was slow and inadequate, as in the 1920s, but these were only temporary and often marginal difficulties. Far more serious was the environment within which it had to operate because that became increasingly conditioned by government policy, especially after 1945. Those who criticise the City for providing an inadequate supply of capital for the British economy tend to lack any belief that the market can allocate funds efficiently, even though there is little evidence to suggest that what the City was allowed to do was not successful.

'The more the state can influence the course of investment the easier will be the task of ensuring the balanced growth of the economy', was the viewpoint of the TUC in the late 1950s. The Labour Party consistently demanded an alternative to the City in the management of

investment, whether in the form of a National Investment Board as in the 1930s, or a National Investment Bank in the 1980s, but the institutions it did create when in power were not successful. The process of mobilising and utilising finance for an almost endless variety of purposes in a modern market economy is an exceedingly complex task requiring the services of many and diverse financial institutions and firms operating at all levels, as well as the personal initiative of individuals. It cannot be reduced to an automatic mechanical process conducted by the board of a national agency.[61] When that task becomes an international one the process becomes even more difficult, as the *Financial Times* reported in 1989 regarding foreign investment in Africa: 'only an intimate and detailed knowledge of complex local conditions and regulations can allow a competent evaluation of a project's viability'.[62]

Even many of those who accept the merits of a market-based system for distributing finance suggest that how it was done in the City was not the best way to achieve the same results. In particular, they are enamoured with the role played by banks in continental Europe, especially Germany. The largest continental European banks, often called Universal banks, acted as intermediaries between the public and business, providing not only finance but also management assistance. However, it is not clear that the intermediation of the banks, rather than the issue of securities to the public, is obviously superior. There was always the risk that existing customers would be favoured with loans, to the detriment of recent clients, making it just as difficult for new businesses to raise funds from banks as via the market, or for finance to move easily from one sector to another. In addition there was the problem faced by banks when a crisis resulted in withdrawals by depositors but loans were tied up in the unrealisable assets of private businesses. The criticism of the British banking system in the 1920s, and the praise of its German equivalent, ceased in the 1930s, when the economic crisis of 1929–31 exposed the vulnerability of the Universal banks, leading to the collapse of a number of them. However, since 1945, with the rapid growth of the German economy, attention has again turned to the merits of the Universal bank. This has resulted in the simple belief that as the system of banking in Germany was different from Britain and the German growth rate was more rapid than the British then a causal connection existed. However, there is no evidence to suggest that the Universal banks benefited from economies of scale or were better at making long-term investment choices, while it was clear that one area of weakness could undermine their whole performance, and that they

were not particularly profitable. Post-war controls on the operation of the market did lead UK banks to undertake more long-term lending. This created liquidity problems when defaults occurred, as in the property collapse of the mid-1970s or the more long-lasting international debt crisis. Conversely, the issue of marketable securities allowed banks to employ their funds to the same end but with more security and flexibility as the resulting debt could be sold to another, at either a gain or a loss. Consequently, though there are differences between the British and German methods of finance, it is not obvious that one was particularly superior to the other, and certainly not to an extent that would suggest that it represented an important reason why the British economy has not performed as well as that of Germany. In fact, in the 1980s, with much bank lending becoming non-performing, there was a tendency to try and securitise the debt. This could then be traded, freeing banks of the destabilising threat of a complete default.[63]

Integral to the view that sees a financial system composed of a series of specialist intermediaries linked through a securities market, rather than a few Universal banks each providing the whole range of financial services, was the role played by the London Stock Exchange. Though the members of the London Stock Exchange were involved in such activities as new issues and company promotion, this business was dominated by the merchant banks. The prime functions of stockbrokers and jobbers was to provide a market for the securities, not their creation. This secondary market was of vital importance as few investors were both sufficiently wealthy and confident enough of the future to alienate permanently their savings in long-term investment, irrespective of the return offered. Over time institutions like insurance companies, investment trusts and banks did become adept at forecasting the demands on their assets, so releasing funds for long-term investment. However, the demands for such funds also grew rapidly as economic activity became more capital intensive and the needs of government expanded in the twentieth century. The importance of the Stock Exchange was that, by providing a market for securities, it became easier to persuade investors to purchase new securities and thus facilitate the finance of long-term projects. The possibility – or, even better, the certainty – that securities could easily be converted into money and money into securities meant that access was gained to the much larger pool of short-term savings. Those requiring finance could obtain it for the

time required while those providing it could realise their investment at will, not by withdrawal but by sale to another investor. The contribution made by the Stock Exchange was, thus, to separate the needs of the borrower and the lender, provide each with the finance or investment they wanted, and so increase the supply of funds available by mobilising total savings for productive use. The Stock Exchange was the institutional link between the Credit City and the Capital City.[64]

As the market provided by the London Stock Exchange improved and came to embrace different types of securities, so did the employment of short-term funds in the holding of long-term investments. For example, banks increasingly employed their funds either in holding stocks and shares, or lending on their security.

> We cannot lend our money direct for capital purposes, but we can lend our money on a marketable share. The effect of lending money on a marketable share may be that we are finding money for capital purposes that we would not find in the shape of a capital advance,

noted Hyde, the Managing Director of the Midland Bank in 1929.[65] The relationship between the London Stock Exchange and the rest of an increasingly specialised and sophisticated financial system, not only allowed banks to lend long-term but encouraged them to do so, safe in the knowledge that the underlying asset, in the form of a share or debenture, could be sold at will. The Scottish pension and unit trust funds, for example, looked to the City for the buying and selling of securities, as it was there that they could find a market of sufficient liquidity to allow the rapid employment or realisation of funds. German bankers envied their British counterparts because of the flexibility the holding of, or lending upon, readily marketable securities gave them.[66]

Not all securities offered suitable collateral for loans for it was necessary that they should possess an active market and be widely held so that they could be easily bought and sold without dramatic price fluctuations or serious delays. For much of the nineteenth century only the National Debt met these criteria but, slowly, a variety of other securities came to do so, including the issues of the bigger domestic railway and industrial companies and those of major foreign governments or large corporations operating abroad in such fields as transport, mining and manufacturing. This move into a range

of home and foreign securities was greatly aided before 1914 by the decline in the size of the UK National Debt in relation to quoted securities. Thus the benefits gained by the existence of an active market in issued securities gradually pervaded important areas of economic activity, helping to mobilise finance for both British and world economic development.

Within this process, the London Stock Exchange emerged, before the First World War, as the central element of an integrated world securities market. With international communications transformed with the coming of the telegraph, and later the telephone, and the need to mobilise funds on a world scale for the finance of infrastructure developments, there appeared the possibility of creating global trading in securities. Information and orders could be quickly transmitted between exchanges and there existed a substantial pool of commonly held securities, ownership of which could easily be changed between the nationals of different countries, especially in the absence of exchange controls. By 1913, securities with a paid-up value of $2bn were common to both the London and New York Stock Exchanges, and it took less than a minute to communicate between the two. The members of the London Stock Exchange were among the first to exploit the potential of this new world market, reflecting the growth of Britain's foreign investment. Consequently, London possessed the necessary contact, experience and communication facilities that encouraged its use both by governments and corporations wishing to tap the pool of international finance and the investor looking for opportunities outside his own country. In turn, this further improved the London securities market not only because of the range of securities on offer and the depth of investor interest, but also through the steady improvement in facilities and expertise that they required. By 1910, around one third of all securities issued in the world were quoted on the London Stock Exchange, and foreign securities comprised around 60 per cent of all the securities listed in London, indicating both London's importance to the world securities market and this market's importance to London. Certainly, investors from all over the world, but especially Europe, made extensive use of the London Stock Exchange in their dealings, and its membership rose substantially as a result, from 1406 to 5567 between 1870 and 1905.

This dominant position in the global market before 1914 did not fall automatically to the London Stock Exchange for it faced strong

rivalry from Paris and Amsterdam throughout, and later from Frankfurt, Berlin and New York. The transformation of communications and the internationalisation of investment meant that national stock exchanges were now competing with each other for business. London's willingness to expand membership in line with demand, including the acceptance of foreign nationals, and impose very few controls, including the freedom to negotiate commission charges, meant that it was both an accessible and cheap place in which to trade securities. In particular, the foreign nationals who became members acted as major channels in bringing in business from other countries, especially Germany where legislation introduced in the 1890s restricted the operations of the stock exchange and drove part of the market abroad. However, London's competitive advantages were undermined by limitations on the increase in membership in 1904 and the introduction of fixed commission charges in 1912, but these had hardly begun to make much of an impact before the First World War.[67]

Consequently, in the period between 1850 and 1914, the London Stock Exchange was transformed into a securities market of international importance, establishing strong links with both exchanges and investors worldwide, and contributing greatly to the City's attractiveness as a centre where loans were raised through the issue of securities. This trend was not only interrupted by the First World War but, to an extent, reversed. The quadrupling of the British government's debt during the war restored its importance as the most attractive home for investors' funds, especially in comparison to many overseas issues which suffered from defaults and currency instability both during the war and subsequently. By 1920, foreign securities had fallen to 43 per cent of the paid-up value of those quoted on the London Stock Exchange and continued to fall in the inter-war years, reaching 36 per cent in 1933 and 30 per cent in 1938. Although there was a revival of the London Stock Exchange's international role in the 1920s, when dealings in both US securities and those of international companies again became popular, this collapsed with the Wall Street Crash of 1929 and the introduction of exchange controls in 1931. Instead, the members of the London Stock Exchange resorted more and more to handling domestic business, especially central and local government stock and the issues of British companies. In 1920, UK government stocks comprised 35 per cent of the paid-up value of the securities quoted on the Stock

Exchange, with manufacturing and commercial companies providing a further 7 per cent, while in 1938 the government's share had risen to 43 per cent and that of industry to 11 per cent.[68]

The London Stock Exchange was also losing its competitive edge internationally between the wars. The restrictions imposed before 1914, which were under strong attack at the time, were confirmed by the war and increased. The Stock Exchange emerged from the war as a generally more restrictive institution, giving priority to the protection of its existing business rather than expansion and with a tendency to outlaw practices that suggested speculation. Dealings for the account in UK government stock and the use of three-month options were both prohibited, for example, and these had made an important contribution to the London Stock Exchange's ability to employ short-term funds safely and remuneratively in long-term investments. Similarly, the high commission charges of the London brokers and the restrictions on access to jobbers by non-members, which the ending of dual capacity (1909) meant, encouraged outside brokers and dealers to bypass the Stock Exchange. The discount houses, for example, became increasingly active as dealers in UK government securities while the provincial stock exchanges set up their own market-making mechanisms instead of directing their buying and selling orders to London jobbers as this could now only be done via a broker and the payment of commission charges. Thus, through a combination of exchange controls and the growth of the National Debt, and restrictive practices enforced by the London Stock Exchange itself, the City saw its position in both the national and international securities market eroded between the wars. This was reflected in the decline of membership of the London Stock Exchange, which fell to 3924 in 1938. In particular, the number of jobbers fell from approximately 2500 before the war to around 1500 as the London Stock Exchange's role as an international intermediary in transactions in securities fell away.[69]

This decline was greatly accelerated by the Second World War. Again this saw a great expansion of UK government debt and deliberate discrimination against foreign securities, which was continued into the post-war world. In 1946, the share of foreign securities of those quoted on the Stock Exchange had already fallen to about 20 per cent, and this continued in the post-war years, reaching 16 per cent by 1953 and 12 per cent by 1968. Stock Exchange firms like Heseltine, Powell & Co., Panmure Gordon & Co. and de Zoete & Gorton, which had specialised in international securities, such as

US railroad bonds or Chinese government securities, now found that they had to rely on orders from UK investors for sales and purchases of domestic securities. The sale of UK-held foreign securities during the war, and the restrictions imposed on overseas investment afterwards, limited the volume of international business emanating from British investors, while the maintenance of strict exchange controls until 1958 prevented non-British investors gaining easy access to the London securities market. At the same time, heavy taxation prevented member firms from building up the capital reserves essential if they were not only to buy and sell securities on commission but also to make markets through holding and supplying particular stocks on demand. Hence the continued fall in the number of jobbers after 1948.[70]

Nevertheless, important as these controls and restrictions were in preventing the London Stock Exchange from recovering its position in the international securities market after 1945, they were further compounded by the Exchange's own restrictive practices. These were given governmental authority through the support of the Bank of England and legislation, as the London Stock Exchange was increasingly recognised as the regulatory body for the British securities market. Consequently, practices that appeared to outsiders as very speculative, such as trading for the account or option dealing, were either restored only gradually or not at all, in case they gave public offence and result in the imposition of even stricter controls. As Wincott observed in 1946:

> I am afraid that we must face the fact, however, that speculation, particularly professional speculation, is essential if the Stock Exchange is to operate at its maximum efficiency; if pressure of public opinion prevents the return of pre-war speculative facilities, public opinion should recognise that its attitude will make the investment machine more expensive and less efficient.[71]

Despite this warning it was only slowly, and often reluctantly, that the London Stock Exchange restored the practices that were essential for the operation of an active market in securities, preferring to concentrate on forming rules that would create an orderly market and limit competition. It was not until 1958, for instance, that the use of options was again permitted, and even then barriers were placed limiting their use. There was little incentive to adopt a more progressive attitude since the London Stock Exchange was given a

virtual monopoly over security trading within Britain, while exchange controls restricted foreign competition. The Prevention of Fraud Act of 1939, for example, had outlawed stockbrokers who did not belong to a stock exchange while agreement with provincial stock exchanges on sharing commission and restrictions on their direct access to London prices blunted the competition they had shown between the wars. Consequently, the London Stock Exchange was able to survive, and even thrive, though its charges were considered high, entry was restricted and regulations prevented jobbers obtaining from non-members the capital required to fulfil their functions properly as market makers. Membership fell slowly, reaching 3278 in 1968, as compared with 3950 in 1947, before recovering to 4495 by 1985, but most of these were brokers dealing with a straight commission business, while the jobbers, essential for active market making, continued to decline to very small numbers. The only real competition came from the discount houses as a result of the position they had established for themselves as dealers in government stock, but that was the one exception that was allowed by the supervisory authorities. As in the mid-nineteenth century, the only active market in which short-term funds could now be employed was again UK government stock.[72]

However, outside the London Stock Exchange, but in the City, there grew up a parallel market in international securities. This circumvented the exchange controls imposed until 1979, especially after the currency liberalisation of 1958, and ignored the restrictive practices of the Stock Exchange, by the simple expedient of not joining as it did not deal directly with the public.

> The result of the rigidity in the domestic market has been the growth of a parallel international market based in the City of London but dominated by foreign firms dealing in international capital instruments, particularly debt, in which British participants have tended to lose market share in recent years owing to their lack of domestic product,

reflected J.H. Forsyth, of Morgan Grenfell, in 1987.[73]

Initially this market was largely confined to fixed interest securities – Eurobonds – which vied with syndicated loans as a source of international finance. By 1989, there was $830bn outstanding in the Eurobond market, and turnover had reached $1200bn per annum. The active market in which the debts could be sold, even at a loss,

was of great advantage to financial institutions threatened by a collapse of liquidity when debtors defaulted, if only temporarily. Dominating this trading in international bonds was the City of London, to which were attracted securities houses from throughout the world. In 1989, there were 911 firms of international bond dealers in the world and of these 209 (or 23 percent) operated in London, more than in any other centre. Of the 114 most active firms, 80 (or 70 per cent) were to be found in London. Consequently, though the City of London regained its position in the 1960s as the principal international market for fixed-interest securities, this market was now located outside the Stock Exchange, whereas before 1914, and even before 1939, it had been largely dominated by members of the London Stock Exchange, though often in an unregulated after-hours market.[74]

Essentially the restrictions imposed by the London Stock Exchange were sufficient to limit the involvement of its own membership in this rapidly developing market but were outweighed by the historic attractions of the City as a centre for international securities trading. As London possessed the short-term money market it offered a natural home to the bond market, where such funds could be employed. The City also had the facilities, expertise and the international links that the operation of a successful global securities market required, once such barriers as exchange controls were lessened or removed. In addition, the regulatory regime in Britain, though providing few attractions, did not repel the market, as did the restrictions imposed in such centres as New York or Tokyo, where financial institutions' freedom to operate were limited, or Frankfurt, where the government attempted to tax the volume of turnover. As Jean Rousseau, of the New York brokerage firm Merrill Lynch, put it in 1987:

> London has achieved its predominance not because of any active or positive steps by British governments in the past, but because of short sighted and negative measures by governments elsewhere in Europe.[75]

The fundamental and historic relationship between money and securities lay behind the City's success in the Eurobond market and this surmounted the restrictive practices and the regulatory environment present in London, as in other financial centres. However, this balance was a continually shifting one, and the degree of competition

between securities markets became increasingly intense in the 1980s as barriers were removed and finance became more international. In particular, the City's relative decline as an international banking centre, and the growth of a stricter regulatory regime, were all factors undermining London's position in the international securities market by the late 1980s.[76]

However, the basic factors underlying the growth of global securities remained strong for, increasingly, multinational companies saw benefits to themselves in tapping international sources of finance through equity issues as by this method they could gain access to larger sources of funds, at a cheaper price, than were available in their country of origin. No longer was expansion abroad controlled by the limits of their own domestic capital market, or by the willingness of banks to lend for they could now attract foreign investors through the issue of internationally held securities. As part of this process, trading gradually gravitated to the most active markets, where it was easier to buy and sell securities whatever the volume, without greatly disturbing the price. In most cases this was the national market as it was there that the majority of the shareholders lived and the greatest volume of business was done. Heavy trading on the German stock exchanges in 1988–9, for example, drove turnover, collectively, to just above the UK level even though the capitalisation of the market was less than a third of that of London.[77]

Turnover on the New York Stock Exchange, for example, was some ten times greater in the late 1980s than that of the London Stock Exchange and that of Tokyo was about eight times larger. Consequently, for US and Japanese securities, their national exchanges dominated, apart from those hours when they were closed and London was still open. However, in the more fragmented markets of Europe, with many small countries home to large multinationals, such as Phillips of the Netherlands and Electrolux of Sweden, London's greater turnover and expertise attracted business in these securities. By 1986, it was estimated that cross-border trading in foreign equities was running at approximately $750bn per annum, of which around 20 per cent was conducted in London, the single most important centre for such activity. London was also much more orientated towards international transactions, for they comprised around 40 per cent of London's turnover as compared with only 5 per cent in New York. Of the major markets London was one of the few that was sufficiently large to generate the necessary expertise and facilities, such as inter-dealer brokers and electronic market making, but small

enough so that domestic business did not dominate international activity. In 1986, for example, whereas 10 per cent of the US markets' turnover in equities was on behalf of foreign investors, and 9 per cent in the case of Japan, in Britain it was 36 per cent. Middle Eastern investors, for instance, looked to London as their principal centre for equity trading. This was matched by the international orientation of UK investors who, in 1989, owned 28 per cent of all cross-border equity holdings. Consequently, though in the 1980s the London securities market was dwarfed by its New York and Tokyo equivalents, because of the huge volume of the turnover generated by their trading in domestic securities for domestic investors, and was eventually overtaken by Germany, in international securities London had established a dominant position both in bonds, with the Eurobond market, and in equities, both on and off the Stock Exchange. By 1989, turnover in London in foreign equities was running at £40bn per annum. Domestically this was around one third of the level of UK equities, and the proportion was growing rapidly. Internationally, it was 1.5 times greater than the turnover of foreign equities in New York and 10 times greater than in Tokyo, representing as it did nearly half of measured global equity trading. Issues of German (27 per cent), French (18 per cent), Dutch (16 per cent), Swedish (9 per cent), Japanese (9 per cent), Norwegian (8 per cent) and Swiss (6 per cent) companies dominated this £40bn turnover in London.[78]

Consequently, from the 1960s onwards, first with bonds and then with equities, the City emerged once again as the central marketplace of the global securities market though now its position rested much less on the activity and investments of UK investors and much more upon the services it could provide, especially, to European issuers and holders of securities, who both sought to find a larger market to operate in than their own, and that naturally attracted them to London, which was substantially bigger than any other in Europe, especially with the fragmentation of the German stock exchanges. As Sir Martin Jacob, Chairman of Barclay de Zoete Wedd (BZW) noted in April 1989: 'Liquid markets are important because investors will pay more for securities which they can readily sell and, thus, the cost of capital is reduced.'[79]

Thus, as an integrated securities market developed in Europe, London was able to capitalise on its established advantages of size, experience and facilities by attracting companies to list their securities there and investors to use it for their sales and purchases.

However, through the 1960s and 1970s, all these developments

were taking place outside the Stock Exchange. As the *Financial Times* noted in August 1983:

> Rooted in their profitable niche in the British securities market, stock exchange member firms have failed to exploit major new opportunities on their very doorstep, such as the Eurobond market, let alone make any significant impact on major markets overseas.[80]

By then the London Stock Exchange was also losing its grip on the domestic market. The ending of exchange controls in 1979 had removed the barriers that had insulated it from foreign competition, so that it lost not only most of its remaining trading in foreign securities, but also began to experience a drain of business in major British companies, especially to New York, where fixed commissions had been abandoned in 1975, making the market much more competitive. By December 1985, the turnover of British shares on US stock markets, repackaged in the form of American Depository Receipts (ADRs) was equivalent to about 7 per cent of the total turnover of the 100 stocks that constituted the FTSE index.[81]

Domestically, there was also a growing threat to the Stock Exchange's monopoly by the successful establishment by Flemings, a merchant bank and non-member, of a market in electrical securities. By 1985, Flemings had taken between 15 and 20 per cent of the total market in the stocks in which they traded. In the past, all such moves had been prevented by actions of the Stock Exchange, backed by the Bank of England. By the mid-1980s, it was clear that, if the London Stock Exchange did not change, it was going to be largely bypassed in the changes taking place within the securities market. This was increasingly recognised by those in the Stock Exchange itself, especially by the Chairman, Nicholas Goodison. The result was the removal, after some prodding by the government, of the restrictions which had prevented the Stock Exchange from responding to the new opportunities. Fixed commission charges were abandoned, members were allowed to operate as both brokers and jobbers, and membership was widened to include any type of financial institution, not merely those operating solely in buying and selling securities. This all culminated in the 'Big Bang' of 27 October 1986.

As a result of the Big Bang the Stock Exchange became much more internationally orientated and its members free to decide their own charges, such as offering discounts on volume business, to

amalgamate with other financial institutions, including merchant banks, to form integrated banking and brokerage houses, and both to buy and sell securities on commission and make markets. From this emerged, for example, firms like BZW, covering merchant banking, broking and jobbing with 2800 staff in 1988 and a 7 per cent share of equity market trading. These firms were large enough to bypass the common facilities provided by the Stock Exchange and set up their own inter-market operations independent of it.

Generally, as a result of the changes, there was a substantial fall in the charges made for large deals and a rapid growth of international business in London, interrupted, as always, by ups and downs in the market. Foreign firms took advantage of the liberalisation to become members of the now renamed International Stock Exchange, which had been a privilege previously denied them. By 1990, out of the 408 member firms, 154 were foreign owned, of which 51 were from the United States, 20 from Japan, 18 French and 12 Swiss. It was firms such as these that were making the City such an important centre for global securities trading because they possessed the contacts, capital and experienced staff. In fact, the downturn in trading after the collapse of October 1987 forced both British and foreign-owned members to use their highly paid employees and expensive technology to develop further the market in cross-border equity trading.[82]

On the domestic front, even before the Big Bang, the Stock Exchange had already begun to try to stimulate business by providing a market for smaller companies which were normally denied a stock market quotation. This led to the establishment in 1980 of the unlisted securities market (USM) for those companies with less of a proven track record – three years as opposed to five. Although there was always the lack of marketability of small issues, with many securities being closely held, this market proved a success, with a number of companies gravitating to the main market once they had become more established. In contrast, the Third Market, set up in 1987 to cater for even smaller and more speculative concerns, attracted little interest, indicating that a public issue, and its subsequent trading, was not the best way to finance a new enterprise which needed careful management and informed investment before bringing it to the market when capital gains could be realised.[83]

Thus, in the course of the twentieth century, the London securities market came full circle. It was at the very centre of the emerging global securities market before 1914, but became increasingly inward looking between the wars. After 1945, it re-established its inter-

national position only from the early 1960s onwards, first in bonds and later in equities. However, the City's position in these international markets in the late 1980s was much weaker than in the early 1900s, as it was no longer the dominant securities market of the world. Before 1914, UK investors had by far the largest share of the world's holding of securities and the London Stock Exchange was the largest and most active in the world. In contrast by the 1980s the Americans and Japanese dominated. London's share of world domestic equity turnover was a mere 5 per cent in 1988, for instance.

Instead, the London securities market's success rested upon its links with other City markets, particularly that for short-term funds, and its employment of the latest technology and skilled personnel to compete with other exchanges worldwide for the business in internationally traded bonds and equities. Under these circumstances its position was very vulnerable to changing circumstances, which could undermine its competitive position. A restrictive and expensive regulatory environment, the high costs of premises and staff in London, or a failure to meet customer requirements in terms of charges, methods of conducting business, quality of service and facilities provided could all prove detrimental to the City in comparison with some other centre. This vulnerability was also greatly increased because the improvement in communications technology allowed both instantaneous and continuous contact between all major financial centres, so facilitating the transaction of deals in the most competitive markets worldwide to an even greater extent than before 1914, when such business had previously been unrestricted. London, for example, gained business from Germany, Sweden and Japan in the 1980s, owing to their attempts either to tax the turnover in securities or impose regulations that hampered the efficient operation of the market. Conversely, the withdrawal of such taxes and the repeal of the legislation could repatriate much of that trading back to the country of origin.[84]

Nevertheless, the potential for increased activity in the City for securities trading – though not necessarily on the Stock Exchange – was enormous by the end of the 1980s, especially in international bonds and equities. Financial institutions were becoming enamoured of the flexibility which the use of marketable securities imparted to lending, as were investors in general, while borrowers, whether governments or companies, recognised that such issues offered access to a cheaper form of finance. Securities markets, for example, were of growing importance in developing countries as they turned away

from fixed interest/fixed term loans, and the servicing problems they created, to equities whose fortunes fluctuated in line with economic success or failure. By 1989, the 30 leading emerging markets had a capitalisation of $620bn. Altogether, the world securities market was worth $20 trillion in 1989 but, of this, only $1.6 billion (8 per cent) was held internationally, offering vast scope for a rise in cross-border investment in an increasingly integrated world economy. At the same time, the importance of securities markets varied enormously between countries. Even in Europe, whereas equities were equivalent to 87 per cent of Gross Domestic Product in Britain in 1989, in France it was only 24 per cent and in West Germany 21 per cent, suggesting a rapid rise in issues of securities until the British level was reached.[85] All this implied that the prospects were bright for that element of the City involved in the securities market. As the *Financial Times* put it in 1988:

> In a world where cross-border financial activity is bound to increase, the internationalism and sophistication of London-based – though not necessarily British – firms should give them a competitive advantage.[86]

Over the last hundred years, the Capital City has had to change considerably in order to retain a position for itself as a mobiliser and trader in long-term debt. Prime among the influences against which it has had to contend has been the role played by the government, both as a borrower of funds and as a framer of legislation. During two world wars and, more generally, from the 1930s onwards, the government has created the domestic and international environment within which the City operated. This could deliver benefits, such as the institutionalisation of savings and the temporary lack of competition but, in the longer term, it undermined the role of the Capital City since it bypassed it as the central market allocating financial resources. Increasingly, it was government itself, at central and local level, and large-scale corporate enterprise that controlled the direction of investment, leaving the City with only a residual role. Even that residual role was subject to particular distortions, as with the flow of funds into housing. The City was not even in control of its own destiny after 1945, let alone that of the economy as a whole. That privilege rested with the state and the multinational corporations and building societies which its policies had fostered. Areas of success in the City, such as the Eurobond market and international equity trading, flourished much less because of the liberal regime which the government fos-

tered, through the Bank of England, or the active policies followed by institutions like the Stock Exchange, but because of the world economy's need for a financial centre which could act as a bridge between short- and long-term funds and as a conduit for international lending. London's historic position as the credit capital of the world, with its links, facilities, expertise and attitudes, made it the prime candidate for such a role and the restrictions imposed in other countries, like the United States and Japan, rendered them unattractive.

# 5 Client City

[T]he aid of accountants is always required when others lack competency in the arrangement and adjustment of their affairs.

William Cooper, 15 September 1855 (reprinted in *A History of Cooper Brothers & Co., 1854–1954*, London 1954, pp. 2–3)

Simply providing the means for the underwriting and acceptance of risks is not, however, sufficient on its own to create an international insurance market, and alongside this facility a sophisticated array of ancillary services is required.

J.A.S. Neave, *London as an International Insurance and Reinsurance Centre*, London 1977, p. 6

For a country like Britain, which has inevitably to import on such a great scale, it is far more economical to strive to earn an income from abroad by providing invisible 'services', which entail the application of skill and knowledge that we have, assisted by some clerical manpower, than to seek to earn our livelihood exclusively by devoting large quantities of manpower and materials to physical exports.

Roy Harrod, 'The Financial Position of Great Britain and the Balance of Payments', in Institute of Bankers, *Current Financial Problems and the City of London*, London 1949, p. 7

The United Kingdom has lost share in the value of world exports of services at a rate similar to that at which it has lost share in the value of world export of manufactures.

Bank of England, *Quarterly Bulletin*, vol. 25, 1985, p. 410

In the end there was the Client City. What the City of London supplied was services and this became more true as time passed, for it produced and manufactured less and less. The last major industry in the City was printing and publishing and this provided, essentially, information rather than a manufactured product, though it could take a tangible form, as with a newspaper. Much of that industry was to desert the City, with even the *Financial Times* moving out in 1989, leaving its building to be occupied by a Japanese bank. However,

within the services which the City provided there was a major division between those that were market based and those that were client orientated. Those in the City who traded in commodities, whether tea or textiles, acted as intermediaries between buyers and sellers. Similarly in the provision of credit, by type or time, and the mobilising of capital from whatever source to whatever use, those in the City provided an organised forum in which they were agents. In contrast, there also developed in the City services which involved the sale of knowledge, experience and training for its own sake rather than as a means to facilitate transactions between different parties. Consequently, there evolved two fundamental branches within the services provided by the City of London. One involved the creation of markets, which became more numerous, sophisticated and far-reaching over time. The other provided the advice and facilities that increasingly complex economic and social structures required. These two branches interacted closely, each stimulating developments in the other, while their relative importance changed over time, but together they contributed the range and depth of services that ensured that the City of London remained an international commercial and financial centre of major importance. The markets themselves came to rely completely upon these client-orientated services for the back-up they increasingly found necessary.[1]

London's initial role as a commercial centre led it, inevitably, into shipping as without that the movement of goods, especially internationally, would have been impossible. Many merchants were also shipowners as a result, though the two occupations did become increasingly distinct as the demands of each grew. Shipping and its capacity, and later air freight, themselves became commodities to be traded like any other in the City, in terms of type, time and cost. However, that still left a need for those who would manage the ships that were being bought, sold or chartered, and in this the City of London emerged as a major centre.

The management of a fleet of vessels is a highly complex undertaking',[2] reported *The Times* in 1928, involving not only the outfitting and manning of the ship but also securing the cargoes, planning the journey and dealing with any eventualities. This was especially so in the case of the British fleet, for it comprised around half the world total before 1914, though declining slightly, and still over a quarter between the wars. Of this fleet around a third carried cargoes which never touched Britain at all. British shipowners were providing a shipping service for clients from all over the world, not just in

Britain. For this purpose ready access to a worldwide communications system, and proximity to those requiring shipping services, were essential and thus the management of both shipping lines and individual ships gravitated to the City, since it possessed both these attributes. Ellerman, for example, centred the control of his extensive shipping interests in the city of London, though he himself came from Hull, while the ship-management firm of Turnbull Scott, of Whitby origins, also located there. Although much of Britain's shipping capacity was owned in ports like Liverpool and Glasgow, the bulk of its organisation was carried out in London. As shipping became increasingly organised into joint-stock companies and these became larger, with extensive and more diversified operations, there was a tendency to centralise their direction in a City head office. This was especially true after The First World War, when amalgamations resulted in the creation of a number of very big shipping companies operating worldwide in an exceedingly competitive environment.[3]

However, with the growing nationalism in ship ownership after the Second World War, with countries confining their carrying trade to national shipping lines, and the rising costs of operating British flagged vessels, particularly in terms of the level, flexibility and remuneration of the crew, the British fleet sank to a very small proportion of the world total, in the post-war years, though growing absolutely before 1975. By 1985 only 23 per cent by weight and 36 per cent by value of Britain's own imports and exports were carried in British ships, and the cross trades had been largely abandoned to Greek and Hong Kong ship owners. The British fleet was then only 2 per cent of the world total. This decline in Britain's own fleet seriously undermined London's position as an international maritime centre, with ship management gradually dying in the City from the 1950s onwards. Even among those firms that still remained, like Turnbull Scott, the rising costs of conducting business in the City forced them to leave, relocating in Farnborough in 1970, while others, like Houlders, moved into travel agency for the principal airlines. Increasingly the City only retained its position in shipping through the market it maintained on the Baltic Exchange in the sale and purchase of ships and the chartering of their capacity, rather than as a centre from which the world's shipping could be controlled and directed. That was now centred in other ports, like Hong Kong and Singapore, and it was also to these cities that the freight market was gradually drifting. Consequently, as Britain's own commercial and shipping supremacy declined after 1950, so did the maritime services

that the City of London had provided for clients worldwide.[4]

Closely linked to commerce and shipping was insurance. A considerable risk was involved in the movement of cargo and even more in the hazards to which the vessels carrying it were exposed. Numerous ships did sink without trace at sea, or were wrecked along the world's coastlines, resulting in substantial losses for the owners of both the vessels and their contents. It was thus important to try to ward against such losses if international trade was to become a regular part of business, rather than a speculative venture to be indulged in by the few. Such risks could be tolerated by spreading gains and losses among many, as in the system of joint ownership of cargoes or ships. The ownership of ships, for example, was traditionally divided up into 64 parts. However this involved an element of chance as the return was dependent on the success, or otherwise, of each of the ship's voyages. An alternative was the use of insurance, by which others undertook to bear the risk of loss for a fixed charge, or premium, reflecting their estimation of the likelihood of a loss, and their ability to spread the risks over many individual ships and cargoes. Consequently, the City's role as a major trading centre led it into marine insurance with many ship agents and brokers being responsible for organising appropriate cover for their vessels and cargoes.[5]

From this developed in the City the specialist profession of underwriter. This was a person who used his experience and knowledge of ships, cargoes, routes, destinations and general conditions to assess the degree of risk involved in any individual case, and then quote a premium to be charged for insuring against it. Their operations eventually led to the formation of Lloyd's as the body representing these independent underwriters and providing, collectively, the services they required but could not afford individually, such as an experienced clerical staff to issue the policies and handle the claims. Essentially, the London underwriters actively competed for business on price – the premium quoted – but shared the staff and facilities that ensured the quality and reliability of the service they were offering. However, by the middle of the nineteenth century, Lloyd's underwriters were facing increasing competition in the field of marine insurance. Legislation in 1824 had removed the monopoly they had enjoyed over marine insurance, with the exception of the limited business done by two chartered enterprises. The result was a rash of joint-stock companies formed to transact marine insurance, among the most important being the City-based Alliance and the Indemnity.

Moreover, at the same time provincial underwriters and companies increasingly met the needs of local merchants and shipowners, especially in Liverpool and Glasgow. Consequently, not only was London's marine insurance business now split between Lloyd's and the companies, but it was also shared with competitors from elsewhere in Britain, undermining the dominance the City once had. The very existence of the independent London underwriter, and Lloyd's itself, was threatened by these developments.[6]

Nonetheless, the members of Lloyd's did eventually respond not only by competing with the companies for the insurance of British shipping, but also by developing additional business through expansion in other directions. Though Britain's ships did dominate world trade in the 1850–1914 period, the volume and value of world shipping was itself growing rapidly after the mid-century, especially with the shift to steam, and much of the expansion belonged to the nationals of other countries, such as the Germans and Scandinavians. This non-British shipping also required to be insured and was attracted to London through the competitive premiums offered by Lloyd's underwriters. Lloyd's facilitated this move into the international market by admitting to membership many from abroad who then acted as channels through which foreign marine insurance was brought to London. Reflecting this growing international orientation was the fact that Lloyd's began paying out abroad on policies in 1886. Such was the success of Lloyd's underwriters in capturing foreign business that the UK marine insurance companies themselves soon followed suit. Around two thirds of world marine insurance was thus handled in Britain, mainly in the City, by the early twentieth century, and this was shared equally between Lloyd's and the companies.[7]

The search for new business did not just lead Lloyd's underwriters abroad, for they also developed other forms of insurance during the second half of the nineteenth century. In the 1901 smallpox epidemic, for example, a number of Lloyd's underwriters immediately offered policies insuring against catching the disease. More widespread and long-lasting were the policies offering insurance against burglary, loss of goods in transit, accidents and natural disasters such as earthquakes and hurricanes. Other forms of transport also required to be covered against risks, with both aviation and motor insurance being introduced before the First World War. Many of these new departures were pioneered by Cuthbert Heath, whose underwriting syndicate generated an income of £100,000 per annum by 1907 as compared with £2300 in 1887 owing to the popularity and profitability

of the risks he was willing to insure against. Such was the success of these novel forms of insurance that new or existing insurance companies offered to provide similar policies for their customers. Although insurance was a business that rewarded caution, as a reputation for security and stability attracted clients, in a changing world there was also a need for those who would respond to new risks by offering to insure against them. The independent Lloyd's underwriter could be much more flexible and rapid in that response than an established insurance company with its existing business and regular customers to think of, though many in Lloyd's itself were also resistant to change.

Within Lloyd's there existed a wide spectrum of individuals ranging from the most conservative to the most radical, and though the ruling body did exercise some control, it lacked the power or authority to restrict change before 1914. Lloyd's acted as the proving ground and the companies provided the means of retailing the successful policies to the public at large.[8]

Another area of insurance that Lloyd's became involved with in this period was reinsurance, mainly against the risk of fire damage. In fire insurance the company issuing the policy always faced the possibility that, no matter how careful it was in extending cover and building up reserves, a major conflagration could bankrupt it. However, with reinsurance part of the risk could be passed on to another insurance company in return for a share of the premium. However, this meant allowing a rival company to participate in the business, which most insurance concerns were not keen to do. Consequently, there developed the growing use of Lloyd's underwriters for reinsurance purposes by insurance companies, firstly from within Britain but then increasingly worldwide. Such was the success of the Lloyd's underwriters in reinsurance that, unlike continental Europe and North America, few specialist companies offering this service were successful. Thus, Lloyd's increasingly complemented the service offered by the insurance companies by providing a means for covering undue risks, hence contributing to the industry's stability and security, and thus the willingness of people to take out insurance.[9]

Despite these new departures, Lloyd's remained dominated by marine insurance before the First World War, with around 80 per cent of its premium income coming from that source in 1913. By then Lloyd's had established itself as a major force in international insurance through the role it played in three particular areas, namely marine, special or novel risks, and reinsurance. As a result its

membership grew strongly, rising from 257 in 1853 to 621 in 1913. By then the composition of Lloyd's had taken on its modern form.[10] An ex-chairman of Lloyd's, I.H. Davison, described in 1987 its organisation as follows:

> The principal participants in the Lloyd's insurance market are the brokers who bring the business, the active underwriters who price it and write it, the underwriting agents who manage the underwriters and get together the Names to back the syndicates, and finally, the Names themselves who, pledging their assets without limit, provide the capacity for Lloyd's to compete as successfully as it does in the world insurance market.[11]

All these elements had developed before the First World War.

Originally the underwriter, for example, acted for himself, backing his skill and experience with his own capital. However, as the scale of the risks to be covered grew in the late nineteenth century, especially with the move into new areas like cover for natural disasters, there developed the underwriting syndicate which contained one active underwriter and a number of others – Names – who, in return for a share of the premiums, pledged their wealth as security for the insurance granted. In turn, people willing to become Names had to be found and organised and this led to the underwriting agent, who undertook that task, also for a share of the premium. The outcome of this was to remove constraints on Lloyd's capacity to offer insurance, which had been limited to the assets of the active underwriters. This allowed Lloyd's to expand rapidly in the face of demand by attracting in more and wealthier people who neither had the time nor inclination to become underwriters themselves but were keen to make their wealth more productive, obtaining a return not only by way of investments, such as in land or securities, but also by pledging these investments as cover for the insurance of risks, and thus receiving further payment.[12]

Simultaneously with the rising capacity of Lloyd's was the growth of specialised Lloyd's brokers, as it was often these brokers who found the people willing to become underwriters from among their friends and clients. Initially these brokers were engaged in other businesses, such as shipping and commerce, and insurance grew up as an ancillary service they could offer to their customers. In particular the large number of British mercantile firms operating in other countries acted as agents for British insurance, receiving a useful

supplement to their income through the commissions they obtained. Bowring, for example, were established shipowners and shippers with a Liverpool/Newfoundland operation before adding marine insurance to their activities in 1866, and joining Lloyd's in 1876. They then branched out into other forms of insurance, with insurance broking becoming an important element in their business by 1914.

As the scale and complexity of risks grew, and insurance became a worldwide business, Lloyd's brokers responded by specialising in particular types of insurance which they sold internationally. As a result insurance broking fell into the hands of a small number of large firms, who relied not only on the capacity, flexibility and competitiveness of Lloyd's underwriters to provide them with the appropriate policies, but also made extensive use of the London-based insurance companies in the process. There thus developed a complex relationship in which Lloyd's underwriters relied on Lloyd's brokers to bring them risks requiring insurance, but the brokers also brought business to the companies who, in turn, also established their own extensive branch and agency networks that generated even more business. This all led to a very competitive environment in which British insurance was sold, aggressively, worldwide by both brokers and companies.[13]

Lloyd's, and the companies with which it competed, represented only one branch of insurance. Life insurance, with only minor and particular exceptions, was not done at Lloyd's, while its involvement with fire insurance only developed after the mid-1860s, and came via the reinsurance of risks already accepted by companies. However, like these other areas of insurance, London initially dominated the fire and life business, though in this case not in the form of independent underwriters but through joint-stock companies or mutual societies.

It was only to be expected that this would happen as London was home to the greatest number of people, and the wealthiest, and among them there would be a number who were interested in insuring their lives, and could afford to do so, in order to provide for their dependants. At the same time, London was also by far the largest city in Britain and thus possessed the greatest concentration of property requiring cover against the risks of destruction by fire. Hence, among the oldest and largest British insurance companies were such City-based concerns as the Sun or the Royal Exchange, both joint-stock companies formed in 1710 and 1720 respectively, and specialising in fire insurance, and the Equitable, a mutual society established in 1762, and concentrating on life insurance.[14]

However, in the course of the nineteenth century the dominance of British fire and life insurance by London was challenged by the increasing formation of provincial insurance companies and societies. Edinburgh and Norwich, for example, emerged as major centres for non-marine insurance, but almost every major city came to possess its own insurance companies, often combining both fire and life business. The Norwich Union, a mutual society, began as a fire insurance company in 1797 and moved into the life business in 1808, while both Scottish Widows and Standard Life were established as mutual societies in Edinburgh in 1815 and 1825 respectively, to conduct life insurance. One measure of London's decline was that by the 1860s, London companies only covered 56 per cent of the fire risks insured in Britain, compared with two thirds in the 1830s and some 90 per cent at the beginning of the century. Of course the total volume of business had expanded rapidly, with the value of property insured in the UK reaching £1.5bn in 1869 as compared with £0.2bn in 1800.[15]

This competition between London and provincial insurance became increasingly intense as all the companies extended their operations to cover the whole of Britain. Such was the level of competition within British insurance that many of the newer companies were forced to expand abroad as they could not generate sufficient premiums domestically to maintain the momentum of their business. This was despite the fact that the value of both fire and life insurance in the UK continued to grow substantially. This foreign expansion was soon followed by the London companies, who had been experimenting with foreign business in the first half of the nineteenth century. The Royal Exchange Assurance already obtained 4 per cent of its fire insurance premiums from abroad by the 1850s but this grew rapidly after 1880, reaching 69 per cent in 1914. Again, the very competitive environment of British insurance in the domestic market stimulated a rapid expansion overseas not only from the newer companies trying to establish themselves, but also from the older concerns whose share of the business was now threatened.[16]

This competition was not just reflected in a worldwide search for business, but in the growing diversity of risk for which these insurance companies catered. Railway travelling, for example, led to the creation of a railway accident insurance in the 1840s, while the popularity of bicycling in the 1890s also stimulated specific policies to cover the risks it entailed. Government legislation allocating responsibility for industrial injury (1880), boiler explosions (1882) and

employee compensation (1897) also led to the need to insure against their occurrence. Prosperity also brought a new clientele for insurance. The Prudential appeared in London in 1848 to provide life insurance for workers who could only afford to pay the premiums weekly. As each of these developments took place, companies were quickly formed to cater for it. Some of these subsequently collapsed, having misjudged the demand or the costs, or as a result of fraud, while a few grew into major enterprises, such as General Accident, established in Perth in 1885. Most, however, were absorbed by existing concerns once the business had been proved and its prospects had become clear, leading to the creation of the composite insurance companies offering to insure against a range of risks.

Within insurance there was constant entry and exit of insurance companies as novel areas of business stimulated the formation of new companies which then disappeared, expanded or amalgamated. Even attempts to put up premiums to levels considered unacceptable by customers could result in the formation of new insurance companies by dissatisfied customers. The great Tooley Street fire, in which a considerable area of warehouse property on the Thames was destroyed, led to a substantial rise in the rates charged for fire risks. A group of London merchants and shippers formed Commercial Union in 1861 as a consequence. Generally, it was these new companies, many of an ephemeral nature, which provided much of the innovation within British insurance, fostering its expansion at home and abroad.[17]

However, that expansion also rested upon the stability and security that British insurance offered to its customers, for any insurance required an act of faith that the company would pay out if and when necessary. The very success of the British fire insurance companies abroad, for example, especially in the United States, was based on the belief of clients there that they could and would meet their obligations while US companies might not, as demonstrated in the conflagrations that regularly took place in major US cities in the second half of the century, like Chicago in 1871 and Boston in 1872. In addition, as well as the stability and security that size possessed – and was seen to do so – there were also other benefits of scale among insurance companies. Consequently, by conducting a large and varied insurance business, the bigger companies could support a more extensive branch and agency network which, in turn, attracted more customers. A larger and more varied business also reduced the

need for outside reinsurance, which drained income, as more could be covered internally through a mix of risks.[18]

One of the simplest ways to achieve both growth and diversification was by take-over or merger, as this both created larger units and facilitated expansion either by type or geographic area. As the London-based companies were often the largest and longest established, and the City was an ideal place from which to manage an increasingly extensive business, there was a gradual tendency in the late nineteenth century for insurance again to become London dominated. Alliance Assurance, for example, was a large City-based company, and it acquired 28 other insurance companies between 1847 and 1923, including its sister company Alliance Marine. The result was that its premium income rose from £1m to £23m in the process, and its funds from £1.5m to £27m.[19] Altogether, the period 1851 to 1915 witnessed amalgamations in insurance totalling 576 separate companies and though there were continually new creations, both in London and elsewhere, the bigger companies gradually established a dominant position for themselves in the major fields of fire, life and accident.[20]

Nevertheless, not all the largest companies were London based for a number of the most successful enterprises were located elsewhere in Britain, and they retained their head offices, outside the City even though they themselves absorbed numerous other insurance companies both in Britain and abroad. The Liverpool & London & Globe Insurance, for example, had its head office in Liverpool until after the First World War, despite having an additional board in London from 1847 onwards. Similarly, the London & Lancashire Insurance Company, which was formed in 1861 with offices in both London and Liverpool, made Liverpool its headquarters from 1867 to 1919.[21] However, there was a slow drift of control in insurance to the City. The management of the mutual Protecting and Indemnity Insurance Clubs, for instance, was also gradually transferred to London. These clubs insured the shipowners against the claims of the crew for compensation or damage caused to port facilities, and they appeared in all the major ports. However, as the business became more complex and international, firms such as T.R. Miller, which had managed the Newcastle Protecting & Indemnity Club, moved to London in the 1890s, from where affairs were then conducted.[22]

Of increasing importance to insurance was also the City's role as the premier financial centre for the employment of funds both short

and long term. The successful investment of an insurance company's income and reserves became a major factor in the competitive environment of the late nineteenth century, as it allowed insurance companies to charge lower premiums and thus gain more business, as well as take over less profitable rivals. In the mid-nineteenth century insurance companies tended to confine the investment of their funds to a combination of mortgages on land, which were high yielding but illiquid, and government stock, which was liquid but low yielding. The combination of the two produced both a reasonable income and the ability to meet sudden demands through selling government stock. At the same time, the investment portfolio did not require active and constant management. A provincial base also gave ready access to landowners requiring mortgages.

However, investment became a much more complex process as it moved away from the simplicity of government stock and mortgages. The size of the National Debt did not grow between 1850 and 1914, and its yield tended to fall before 1900, while the security of land mortgages was undermined by the agricultural depression from the 1870s onwards. At the same time, insurance funds grew rapidly, with those of life insurance companies rising from approximately £50m in 1856 to £382m in 1913. This forced the insurance companies to pursue other avenues of investment if they were to maintain income, achieve capital growth and remain competitive. The rapid growth of endowment life insurance after 1890 emphasised the need to invest the premiums successfully, rather than simply calculate expected mortality and the sum to be paid out yearly on the death of customers. Increasingly life insurance was being regarded as a form of saving rather than just a way of warding against misfortune though that remained the case in other forms of insurance.

The result was that insurance companies diversified into a wide range of domestic and foreign securities as well as overseas mortgages, which all required both considerable skill and experience in investment management. For this close contact with the London capital and securities markets was an advantage, while access to the London money market offered immediate employment for those premiums not yet permanently invested. Over time the staff of British insurance companies became increasingly adept at calculating the expected demand on their funds, as endowment policies matured, or death and disaster occurred, and so could reduce to a minimum the amount not employed to maximum advantage. In 1870, UK life insurance companies had placed 47 per cent of their total assets in

mortgages and 34 per cent in securities, mainly those issued by home and foreign governments. By 1913, securities comprised 56 per cent of total assets, with those issued by the UK government being only 1 per cent, and mortgages had fallen to 21 per cent, with part of it placed abroad such as in the United States, Canada and Australia. Altogether, by 1913, around 40 per cent of the assets of UK life insurance companies were invested abroad.

This growing need to manage investments actively, and the increasing concentration on domestic and overseas securities, encouraged insurance companies to locate in the City of London where they had immediate access to all the relevant financial markets and institutions, as well as being at the centre of information flows and communications. However, though this was of increasing importance, it had not become essential by the First World War to locate in the City. Insurance companies, by their very nature, had to take both a broad and long-term view of investment and, as long as they had ready access to the relevant markets and their personnel, this could still be done at a distance. This was especially true for life insurance companies. Thus the imperative to centre operations in the City was much less for insurance than for other financial institutions like banks, which were more closely involved in the continually changing money markets. Even London-based insurance companies, such as the Prudential, were quite content to locate in Holborn rather than the City. Consequently, by the First World War the City did not dominate British insurance to the same extent as it did banking or securities trading. Other insurance centres existed in Britain, from which extensive and diversified operations were controlled and directed worldwide. The operation might or might not include an office in London which dealt with investments since, though investment was important to insurance companies, serving the needs of their clients was equally so.[23]

Therefore, by the First World War, considerable change had taken place in British insurance. Lloyd's had evolved into a specialist market not only for marine insurance but also novel, or unusual, risks and reinsurance, supported by a network of brokers who fed it business from throughout the world. These brokers also helped to supply the insurance companies with business, though these also maintained their own extensive branch and agency networks at home and abroad. They acted as their principal salesforce for an increasingly diversified business, not only competing with Lloyd's in marine insurance, but also conducting a wide-ranging fire, life and accident

business that provided policies for an ever-widening range of risks and clients. To back it all up both Lloyd's and, especially, the insurance companies made increasing use of the City's financial markets and expertise in order to invest the premiums they were receiving. An illustration of the worldwide success of British insurance was the fact that by the early twentieth century around 60 per cent of the premium income of the leading fire insurance companies came from abroad, with some 40 per cent coming from the United States alone. Not only was overseas business important to British insurance, but British insurance was a major force in the world, especially in marine and special risks, where Lloyd's dominated, and fire insurance, where the companies were predominant though aided by reinsurance at Lloyd's. By 1900, British fire insurance companies provided almost a quarter of the fire insurance cover in the United States and over two thirds of that in Canada. In life insurance, foreign government legislation, often restricting protection to national companies, severely hampered the international advance of British insurance, but even there international business was important. These restrictions were much less severe in fire, marine and accident before 1914, though they did exist.[24]

Unlike many other areas of the City of London, the First World War actually benefited insurance for it greatly increased the risk of loss, and such risks needed to be insured against. Though the UK government did provide marine insurance so as to keep the supply of goods flowing, this did not even provide for all British requirements, while leaving international risks uncovered. The result was a boom in activity for both Lloyd's and the companies in marine insurance, especially as the ability of the German companies to compete was seriously curtailed by the war. The Royal Exchange Assurance Company's marine business grew from £0.4m in 1914 to £1.3m in 1918 as a result, while many established insurance companies entered the marine field at this time. Other benefits also flowed from the war as the Germans had been providing increasing competition in reinsurance, where they possessed a number of specialist companies. However, they were prevented by the war from providing reinsurance cover not only to British fire insurance companies, but also internationally, such as in the United States, and both Lloyd's and the companies picked up much of the business they lost. The premium income of UK fire insurance companies, for instance, rose from £29m in 1914 to £42m in 1918. In fact, the First World War gave a substantial boost to Lloyd's as an international reinsurance centre.

Inevitably, however, some business was lost, especially that conducted in continental Europe and Russia, but that was minor in comparison to the gains made, in marine and fire, and the continued growth in life insurance. If adjusted for wartime inflation, however, these increases would be much less.

The greatest change that the First World War brought was the transformation of the investment position of the insurance companies. In 1913, these companies had placed only 1 per cent of their funds in UK government stock, while by 1920 this had risen to 32 per cent, as they channelled their premium income to the government and sold off overseas assets, all to help finance the war. Naturally, this switch of investments for patriotic reasons would undermine their competitive edge in a market such as the United States.[25]

Though the war did remove, temporarily, German competition, the inter-war years were difficult ones for both Lloyd's and the British insurance companies. In marine insurance, the depressed state of British trade in the 1920s reduced the volume of ships and freight requiring insurance, and this was further compounded in the 1930s with a worldwide trade depression. At the same time, the growth of large shipping companies, especially as a result of amalgamations in the early 1920s, allowed Lloyd's and the insurance companies to be partly bypassed as these shipping combines could now carry some of their own risk, spreading it over their entire fleet. More generally, there were growing restrictions on the conduct of insurance in foreign countries as governments increasingly sought to provide either a state service or to confine it to domestic companies. As early as 1915, the State of Ontario, for example, took over the provision of employers' liability while the Japanese restricted access to their market generally. In addition, currency instability and exchange controls further restricted the movement of premiums, investments and the money to pay claims. Nevertheless, during the inter-war years, British insurance remained committed to the international market and continued to be a dominant force within it. The Protecting and Indemnity Clubs, for example, began to serve non-UK fleets, managed as they were increasingly from London where opportunities in the international market were more easily perceived. The Royal Exchange Assurance earned 70 per cent of its fire insurance premiums from abroad in 1913, 74 per cent in 1920 and 75 per cent in 1938. There had been some reversal in the course of the 1930s, especially with depressed conditions in the United States, but the company remained heavily dependent on foreign business.

Both Lloyd's and the insurance companies also continued to develop new lines of business. Motor insurance became of major significance, especially after the Road Traffic Act of 1930 which made Third Party cover compulsory in Britain. Similarly, Lloyd's dominated international cover for aviation risk. New policies were also introduced like comprehensive house insurance in 1922 and kidnap insurance in 1932. However, there was a growing sign of caution in Lloyd's for, after a series of scandals in the early 1920s, they barred themselves from credit insurance. By insuring the credit extended to customers, the debt could be more easily marketed as payment was guaranteed in the event of default, and so the cost of credit was lowered. Credit was of growing importance with the appearance of more and more goods whose sale needed to be financed by instalment payments, like motor vehicles, but Lloyd's barred itself in 1923 from this new field when it was discovered that it had been defrauded by having insured fictitious or over-priced goods whose purchasers had then defaulted, leaving the underwriters to pay out on the claims. The government even stepped into this area forming the Exports Credit Guarantee Department in 1927, which formalised temporary arrangements made at the end of the First World War and then continued by the Board of Trade since 1921. These guaranteed the credit being obtained by UK exporters. By 1936–7 the Export Credit Guarantee Department covered 6.5 per cent of UK exports.[26]

The difficulties faced by British insurance between 1914 and 1939 also gave an added importance to a City of London head office. As a result of a continuing spate of mergers, especially between 1900 and 1925, the provision of insurance became more concentrated in the hands of a number of very large composite companies. The need to be even more competitive in the inter-war years led them to rationalise their structures, frequently resulting in the transfer of the head office to the City. In addition, the need to invest successfully became even more necessary and complex, with a greater dependency upon securities – initially government stock and later equities as the yields on government stock fell. By 1937, ordinary shares comprised almost 10 per cent of insurance company investments. This tied them more and more to the London Stock Exchange and the new issue houses, where they could obtain both advice and the securities. The London & Lancashire and the Friends Provident both moved their head offices to London in 1919, from Liverpool and Bradford respectively, while the North British & Mercantile and the Liverpool & London & Globe followed suit in 1926 and 1929 respectively, leaving

Edinburgh and Liverpool as a result. Similarly, insurance brokers, like Bowring, finding difficulties in both shipping and trade, increasingly concentrated on insurance since that at least was still profitable, and so switched the centre of their operations from Liverpool to London in the 1930s.[27]

Consequently, though the inter-war years were difficult times for British insurance, especially with the growing restrictions on, and complications of, international business, it did experience overall growth, and continued both to hold onto most of its overseas markets and to develop new areas like motor and aviation at home and abroad. Its one missed opportunity was credit insurance, which Lloyd's did experiment with, but then abandoned when it became aware of the ease with which fraud could be perpetrated on its underwriting members. Illustrating the growth of insurance was the fact that life insurance funds rose from £506m in 1919 to £1458m in 1938, while the membership of Lloyd's, which had stood at 631 in 1913, tripled to reach 1882 in 1938. Compared with the increasing difficulties faced by other areas of the City, such as trade and finance, insurance appeared to offer secure and growing opportunities, leading merchant banking firms like Anthony Gibbs & Sons, to enter insurance broking in 1921 and underwriting in 1937. In fact, the very difficulties and complications encountered by British insurance in the inter-war years encouraged it to improve its organisation to aid competitiveness. This process made a City location more attractive since it was a better centre from which to handle a worldwide business and where access to specialists in investment and foreign exchange could be more quickly and readily obtained.[28]

The Second World War, like the First, actually stimulated certain areas of insurance because of the new risks it created. However, unlike the First, the British government from the outset began to cover more of these risks itself, and more comprehensively, so limiting the opportunities. The aerial bombing of London also affected insurance's ability to conduct an orderly and regular business, as did the extent and severity of controls imposed on international connections, such as exchange restrictions and censorship of information.

Nevertheless, both Lloyd's and the insurance companies continued to carry out something of a normal business during the war, though various difficulties had to be overcome. Special provision, for example, had to be made to meet the problems of remitting foreign exchange in order to pay claims. In 1939 Lloyd's set up an American trust fund which created a pool or reserves in North America, with

government permission. Altogether, over the war years, while much insurance business was lost, especially in occupied Europe, there was a general expansion of activity, even if mainly in the United States where the premiums received for underwriting fire, accident and marine risks grew from $245m in 1939 to $441m in 1946. To counter this was the decline in UK motor vehicle insurance caused by restrictions on the use of motor vehicles. Motor insurance premiums fell from £36.6m in 1939 to £33.8m in 1945 as a consequence. In contrast, over the same period, life insurance premiums rose from £159m to £197m. Marine insurance business also boomed again though now there was greater competition from the government's War Risks Insurance Office, which insured ships not only on voyages to and from the UK but also on the cross-trades. Of course, the wartime period was one of rising prices and these gains represented, at best, stability in real terms. The one major impact of the war was again to direct insurance company investment towards UK government securities, which doubled from 21 per cent in 1937 to 40 per cent in 1946, largely at the expense of mortgages and other fixed interest securities, especially those located abroad. However, the poor return on these government securities, especially in the post-war years with inflation, hindered insurance company competitiveness abroad. Nevertheless, in contrast to other areas of the City, the war brought some gains to insurance and did not completely disrupt or suspend its operations.[29]

The war was followed by a more restrictive environment, both at home and abroad, which limited access both to particular countries and to types of insurance. Domestically, the development of the welfare state reduced the necessity, for some time at least, for private insurance to provide for education or against sickness. The Prudential provided health benefits from 1911 until 1946, by which time it was insuring one third of the UK population. Similarly, the nationalisation of major industries, like coal and railways, meant that they were sufficiently large to meet their own insurance requirements by covering risks internally rather than using the facilities of an independent company. The same was also happening in private industry with the growth of captive insurance companies as subsidiaries of large corporations and for whom they provided insurance. This forced insurance companies to design products to cover ever more varied types of risks to person and property. Despite this erosion of certain areas of business, there remained considerable scope for both established forms of insurance, like fire and motor, as well as the need to cover new risks, such as holiday travel. Premiums paid for motor insurance,

for example, grew from £34m in 1945 to £633m in 1969.[30]

Moreover insurance was marketed much more as a savings medium, benefiting from tax relief on the premiums paid until the 1980s. The appearance of both Abbey Life and Hambro Life reflected this change in emphasis as they offered policies whose value was based on a portfolio of securities – unit linked – and this was particularly attractive at a time of rising inflation, which undermined the value of fixed interest securities and pension payments. Developments of this kind continually created opportunities for new entrants into insurance, like both Abbey and Hambro, founded by Mark Weinberg, a South African. Abbey Life eventually linked up with Lloyds Bank to market insurance. Even in an established business like motor vehicle insurance, prone to cartels between companies and underwriters in order to fix the tariff to be charged, it was impossible to prevent competition by restricting entry. Vehicle & General, for example, was set up to undercut the existing companies, which it did before becoming bankrupt in 1970. Those companies in the motor insurance tariff cartel saw their share of the market fall from two thirds in the mid-1950s to one third in 1968, and the agreement collapsed as a consequence.

Though the trend towards larger insurance companies was continued after 1945, the insurance market remained very competitive, with new entrants always able to establish themselves and challenge for business, especially if faced by a cartel arrangement that attempted to keep premiums up. In 1968, the 12 largest insurance companies controlled 87 per cent of the fire and accident insurance carried out by all British insurance companies, and the top three did over 50 per cent, compared with 75 per cent in 1928, and 37 per cent for the top three. However, this did not represent any real slackening of competition in the domestic market. There was always the threat from Lloyd's underwriters and from the growing number of foreign insurance companies that established themselves in Britain as part of their worldwide operations. In fact, it was often the need to reach a size that would sustain international operations that created the mergers within British insurance, rather than any aim to monopolise the domestic market.[31]

The growing restrictions on the international market created both barriers and opportunities for British insurance in the post-1945 era. In marine insurance there was a pronounced move towards confining insurance to national insurance companies, or self insurance for state-owned shipping lines, and this pattern was repeated for almost

all kinds of insurance, especially as countries became independent. This could take the form of restricting insurance to nationals of the country. The National Mutual lost its business in Mauritius in 1968 when that happened. In other countries the business of British insurance companies was expropriated, as in Burma, Ceylon and Tanzania. More commonly there was a growing insistence by governments that insurance companies maintained reserves in each of the countries in which they operated. This constrained their ability to pool assets centrally, then employ them on a worldwide basis to achieve a balance of return and liquidity so that not only could any sudden emergencies be met but a reasonable profit be generated from the funds. This was the competitive advantage possessed by the large international insurance companies, as it was increasingly the income from the investment of the premiums that ensured that they could both offer low rates and pay attractive dividends to their shareholders, despite their large staffs and expensive offices and facilities. If that freedom was undermined so was their ability to compete with small companies.[32]

However, these growing restrictions were not universal, for the United States market continued to remain open to British insurance and it was, by far, the largest insurance market in the world, accounting for over half of all property and casualty premiums in 1985, for instance. Although the UK life insurance companies relied on Britain for approximately 90 per cent of their business, those in fire, accident, marine and liability were heavily overseas orientated with around 60–70 per cent of their premium income coming from abroad in the post-war era. The same was true for Lloyd's, with roughly 75 per cent of its income coming from overseas. In all cases, it was the United States, Canada and Australia that dominated. UK underwriting premiums earned in the United States alone almost doubled between 1946 and 1963 from $441m to $908m. Major British companies continued to earn a large proportion of their income from the United States. In 1986, North America provided Commercial Union with 27 per cent of its non-life premium income while the proportion for General Accident was 40 per cent and Royal Insurance 46 per cent.[33]

Similarly Lloyd's brokers were heavily dependent upon the US market, with the largest firms receiving around half their income from that source. A major firm like Bowring did 40 per cent of its business there by the late 1970s, for example. Increasingly, it was a small number of these brokerage firms operating worldwide that handled most of the business flowing to Lloyd's. In 1978 the three

largest Lloyd's brokers provided 40 per cent of the business coming into Lloyd's. A firm like Willis, Faber & Dumas had by then 3600 employees, including 1000 outside the UK. In 1986 the largest firm of UK insurance brokers, the Sedgwick Group, had revenues of $1.1bn, far outclassing its European rivals with the top French concern managing only $91m, the German $82m and the Dutch $69m. However, the biggest US firm had revenues of $1.8bn. The Protecting & Indemnity Clubs, which many insurance brokers like Bowring managed, also operated fully internationally in the post-war world, with some 80 per cent of the shipping risks they insured belonging to non-UK ships by the mid 1960s.[34] By then the business had become a most complex one, as Ledwith noted in 1974:

> The internationalising of shipping has complicated the work of a P and I man far more. He must know what liabilities a shipowner has to his crew in Hong Kong or Chile, or to stevedores in Australia or USA. He must know the customs regulations of Brazil, the Turkish law on limitation of liability, and how blame for a collision is dealt with in Venezuela. The rates for foreign exchange of currency concern him deeply, so do questions of investment, for the sums he handles are so much greater than in the past.[35]

In 1989, the largest London-based Club, the UK Protecting & Indemnity managed by Thomas Miller & Co., provided liability cover for one quarter of the world's shipping fleet and dealt with claims of $230m.

The growing international restrictions on insurance, conversely, brought business to London. As more insurance was preserved for local companies, these companies found it necessary to take out reinsurance in order to cover themselves if any major catastrophe occurred, for they were often too small and too dependent on one country or even one type of risk to cover losses over their entire business, as the international companies could do. There were some 10,000 insurance companies worldwide by 1985, with all but a few confined to domestic operations. Consequently, the world reinsurance market expanded strongly after 1945, bringing an increase of business to both Lloyd's underwriters and British insurance companies. Lloyd's brokers, for example, with their extensive worldwide operations shared the business they brought to London between Lloyd's and the companies, with 20 per cent to the former and 80 per cent to the latter, while the companies themselves also conducted a large direct busi-

ness overseas through their own branch and agency networks. Consequently, though Lloyd's provided less than 1 per cent of the insurance cover in the world, it occupied a dominant place in that insurance business which was conducted beyond national boundaries by way of reinsurance. Lloyd's premium income, for example, which stood at £22m in 1928 and £126m in 1948, had reached £2162m in 1978.

In 1963, US insurance companies reinsured abroad business worth $309m, and of this 78 per cent was done in London. This continued to be the case in the mid-1980s, bringing both rewards in terms of substantial premiums and heavy losses in particular areas. Generally, by the 1980s, Lloyd's was heavily dependent upon reinsurance for around 70 per cent of its income whereas in the immediate post-war years, the direct insurance of risks was predominant. Income from marine insurance at Lloyd's, for example, dropped from 49 per cent of the total in 1948 to 35 per cent in 1978 and that was done increasingly via reinsurance.[36]

However, successful as both Lloyd's and the insurance companies were in maintaining a growing income from abroad in the post-1945 era, this masked a relative decline in the international importance of British insurance. In the United States, for example, the value of business done by Lloyd's and the British insurance companies rose from $0.4bn to $1.3bn between 1946 and 1966, or more than threefold, but their share of the market fell from 14 per cent to 9 per cent. In particular, the proportion taken by the companies was halved, from 11 per cent to 5 per cent, with a number of them abandoning the market altogether since they could not compete with increasingly larger North American rivals. Norwich Union abandoned the US market in 1963, as did the Royal Exchange in 1964. It was only the largest British companies, like Commercial Union and General Accident that could match their US counterparts and survive in what was, at times, a very difficult market with litigation, rate cutting and legislation.[37] UK insurance companies were also weak in continental Europe. This meant, for instance, that despite life insurance being cheaper in Britain than in other European countries, the companies lacked the distribution network which would have made it available to potential customers there. What happened to the companies was also true for Lloyd's, as Cockerell accepted in 1984:

> During the past thirty years Lloyd's has expanded at an unprecedented rate, but world insurance has expanded even more, so

that Lloyd's share of total premiums for general insurance has fallen.[38]

Over the 1948–78 period, though Lloyd's total premium income grew by £2bn, or over seventeen-fold, its share of the areas it insured was falling and this continued in the 1980s. Problems of liability insurance in the United States, for example, led UK underwriters to withdraw from the market when faced with mounting losses. Altogether, by 1985, when world insurance premiums totalled $500bn, only $60bn was reinsurance and though Lloyd's and the UK insurance companies each held a 10 per cent share of that market they met strong competition from the specialist German and United States reinsurance companies.

The maintenance of UK exchange controls also helped to undermine London's position as an international centre for insurance as it encouraged the move to tax havens like Bermuda. In international insurance there was a need to be able to move funds around the globe without cost or hindrance, as premiums were received from one location and claims paid out in another. By 1988–9, there were 1300 insurance companies located in Bermuda and they received a premium income of $11bn per annum, though liberalisation and tax reductions in major financial centres was reducing the island's attractions. By circumventing the exchange controls in this way Lloyd's brokers were able to operate successfully in international markets. It did, of course, increase the opportunities for fraud as the business was driven to less-regulated offshore countries.[39]

Relative decline internationally was matched domestically by the relocation of many insurance company head offices away from the City. This was in the face of the fact that successful investment was becoming vital for the survival of both Lloyd's and the insurance companies in the post-war world, as the environment within which they operated became ever more competitive. Underwriting profits on US business, for example, which stood at £16m in 1939, actually turned into losses in the post-war years, being £32m in 1963. It was only the revenue earned from the investment of the premiums, which grew from £18m in 1939 to £58m in 1963, that sustained the business. At the same time, insurance companies diversified away from the government stock they had held at the end of the Second World War, which fell from 40 per cent in 1946 to 14 per cent in 1968, and this required greater access to the City's money and capital markets

where both advice and securities could be more readily obtained.[40] The Refuge Life Assurance Company of Manchester located its investment office in London in 1953 for precisely these reasons, as their historian, writing in 1958, indicated

> Despite the excellence to-day of specialised telephonic communication, there is no doubt that it is a real advantage for any investment concern to have permanent representation in London, the centre of the financial world. With the enormous funds in the charge of the company, it was felt that the investment should be in the hands of specialists, who should be operating at the heart of affairs, and it was therefore resolved on June 25th, 1953, to take an office in the City of London, and to transfer there one or two investment secretaries together with two of the company's actuaries to assist him in the work. The move has proved entirely successful, the board now being in a position to receive immediate and informed advice upon which they may act with speed and confidence. There is no doubt that a great part of the increase in the net yields on both the ordinary and industrial life assurance funds has been due to the carrying out of this – from the standpoint of the pre-war years – revolutionary idea.[41]

Nevertheless, from the late 1950s onwards there was a steady stream of insurance companies transferring their head offices away from the City, and even London and the South East. Friends' Provident began a move to Dorking in 1958 that left only an investment office in the City by 1975. There was a general exodus of companies to Bristol, including Clerical Medical, London Life, Sun Life and Phoenix, with the result that some 10,000 people were employed in insurance there by 1987. Clerical Medical only retained their board meetings, and the property and legal departments, in London after their move. The Institute of London Underwriters also moved most of its operations to Folkestone. Those companies that did retain a London head office often set up satellite offices elsewhere to provide the clerical and other back-up, with Sun Alliance having a staff of 600 in Sussex. Even Lloyd's transferred much of its support staff to Chatham in 1979. The explanation for these moves was to be found in the rising cost of a City location, both in terms of rent and salaries, as opposed to a location elsewhere in Britain. Insurance companies had to balance the extra expenses of a City head office against the advantages of such a location and increasingly, for many,

the benefits were not found to be worth the cost. The long-term investment perspective of the life insurance companies meant that it was not vital for the head office staff to have immediate access to the City's money and capital markets. The Scottish life companies, for example, did not appear to have suffered from non-City locations, taking as they did around 40 per cent of the UK market for life insurance in 1988. Similarly, Manchester provided the home for such major companies as Refuge Assurance and Co-operative Insurance, and had done so since the mid-nineteenth century. Consequently, as long as those insurance companies without a City, or London, head office retained strong direct or indirect representation in the City in areas like investment, they could dispense with a large physical presence.

However, in the case of Lloyd's and those companies heavily involved in marine, fire and accident insurance, a City location was more important since their perspective was shorter term. Accumulated premiums did not have to be repaid on death or maturity but only when a disaster occurred. This required both more liquid assets and sudden disposals, which a continuous and intimate connection with the City facilitated. Lloyd's underwriters, for instance, employed their funds in short-dated government stock as premiums were received but not yet paid out to Names. Yet, even in these areas of insurance the City was facing both competition and a loss of control. Lloyd's, for example, tried to resist the take-over of its member brokers by the major US firms which attempted to gain direct access to its underwriters rather than go through British brokers and pay commission. This opposition proved impossible to sustain as these US firms were indirectly responsible for so much of the business that flowed to Lloyd's from the United States, by way of reinsurance. There was always the prospect that they would switch wholesale to a rival reinsurance market. The result was that major UK brokers like Bowring, Leslie & Godwin, Wigham Poland and Alexander Howden, were acquired by US-based firms, respectively Marsh & Maclennan, Frank B. Hall, Fred S. James and Alexander & Alexander. Though their London operations usually retained autonomy, the final direction now lay outside the City, and even Britain, as they formed part of an international insurance broking operation. At the same time, while Lloyd's brokers maintained offices near to Lloyd's, they conducted most of their dealings with customers from bases outside London, with Croydon emerging as an important centre. Poland's even moved its main office out of the City

in 1965, while Sedgwicks moved to Norwich in the 1980s. The largest UK retail broking operation, Swinton, which was founded in Salford in 1964, directed its operations from Manchester, keeping in touch with around one million clients from there. Consequently, the City's role as an insurance centre increasingly rested on the activities of Lloyd's brokers and underwriters, and the use made of its financial expertise and markets for investment purposes, rather than as a place from which clients from throughout Britain and the world were served. That activity had never become entirely concentrated in the City and since 1945 the reverse took place with a dispersion of head offices to other locations, particularly the South West of England.[42]

Like other areas of the City, insurance was not immune from the restrictions imposed by both government legislation, covering such areas as investment and the free movement of money, and the general economic conditions of the British economy. As a result of such constraints, it lost business internationally to centres with less restrictive tax and exchange regimes and to companies with more profitable investment policies. However, the need to escape exchange controls, in order to operate internationally, did lead the government to grant exceptions to Lloyd's. This loophole was then exploited as a way of generally avoiding such controls, fostering the expansion of Lloyd's in the process. Not only could losses at Lloyd's be set against tax but it was also permissible to make payments abroad to meet reinsurance premiums, in the normal course of business, and so, by setting up fictitious reinsurance operations in tax havens, sterling could be moved out of the country, avoiding all controls. When these were discovered, as in the Alexander Howden case after being acquired by Alexander & Alexander of the United States, it discouraged new members from becoming Names, and thus limited Lloyd's capacity to cover risks, creating opportunities for rival institutions and companies, like Munich Reinsurance or Swiss Reinsurance. The fall in tax rates also undermined the advantages of being a member of Lloyd's. In addition, fraud led to the outcry for increased regulation which, if taken beyond the level necessary to restore confidence, could destroy the flexibility of Lloyd's to respond to new risks and ways of insuring against them. Whereas Cuthbert Heath eventually surmounted all opposition to take Lloyd's into new areas, a successful maverick like Ian Posgate was eventually prevented from carrying on business, but then he operated within a much more regulated environment. The institution had to be seen to be taking action to protect its Names, as in the potential conflict of

interest over brokers both bringing in business and controlling underwriting syndicates, rather than concentrating upon improving its efficiency so that underwriters and brokers received the back-up support they needed if they were to remain competitive, especially the facilitating of links between members.[43]

> The network aims to revolutionise the flow of the money and information within an extremely fragmented market, made up of 240 Lloyd's underwriting agents, nearly 400 Lloyd's syndicates, 240 Lloyd's brokers, and 230 London-based marine, aviation, and non-marine insurance companies,

reported the *Financial Times* in December 1987 on the potential of computerised, electronic links for Lloyd's, but progress on speeding up the flows of information, money and paper remained slow, disadvantaging Lloyd's members in the process.[44]

Lloyd's also continued largely to ignore credit insurance. In Britain this was dominated by the government-owned Export Credit Guarantee Department (ECGD) which met the needs of UK exporters, and the insurance company-owned Trade Indemnity, which dominated the domestic credit insurance market. By 1989, the ECGD was insuring exports worth £15bn per annum, or 20 per cent of UK exports, illustrating the scale of the business that was bypassing Lloyd's. At the same time, the ECGD was prevented by statute from providing short-term credit insurance for other than British exporters and so the international business also bypassed Britain.[45]

Nevertheless, despite problems and omissions, Lloyd's was a post-war success. It responded well to the challenges it faced. The willingness to accommodate the large US brokerage firms brought an increase in business while the extension of the privilege of becoming a Name (a member of an underwriting syndicate) to non-UK citizens, who comprised 15 per cent of the total by 1984, expanded the capacity of Lloyd's to accept that new business. Altogether, the total membership rose from 2422 in 1948 to 5828 in 1965 and 33,527 in 1988, by which time the revenue of Lloyd's had reached $10bn per annum.

Within the City, firms were attracted to the possibilities of insurance after 1945 with Bowring making it their main business, while Anthony Gibbs increased their commitment to life and pensions management. Other firms faced with difficulties in their own business, moved into insurance broking, as did the commodity trader

Lewis and Peat in 1962. The success of Lloyd's was also matched by the insurance companies, faced as they were with a growing demand for the services they provided. Despite the welfare state, insurance became one of the main vehicles for saving with the funds controlled by UK life insurance rising from £2bn in 1946 to £27.5bn in 1977. This was helped considerably by a favourable tax environment and the need to compensate for inflation by utilising the insurance companies' investment expertise in equities and property.[46] Throughout, insurance in all its forms remained a competitive field with neither Lloyd's, nor the brokers, nor the companies being left for long in control of profitable niches at home or abroad.

Consequently, though the mercantile activities that had spawned insurance ceased to be of major importance in the City, insurance itself had emerged as a client-based service of great importance. It did so, on the whole, by being responsive to their clients through designing both policies and ways of providing them, which met customer needs at low cost. As countries became closed to outside insurers, through nationalist legislation, Lloyd's and the companies switched to providing reinsurance. While the state provision of basic welfare removed one avenue of business, the life companies transformed themselves into savings institutions for a more affluent public in a more complex investment environment. This was all helped both by new entrants into insurance, including City firms whose existing activities were facing extinction, and a radical restructuring involving the movement of much of the non-investment business to cheaper locations in Britain, or the use of tax havens around the world. However, all this was not sufficient to maintain for British insurance the position it once held before 1914, or even before 1939, as it could not completely detach itself from Britain's own failure to take advantage of a rapidly expanding world economy.

Insurance itself spawned a whole series of ancillary services as it became an increasingly complex and international business, and a number of these became of importance in their own right, offering an independent facility not only to clients in the City but also worldwide. Marine insurance, for example, required an accurate knowledge of the condition of the ships to be insured if the underwriters were to gauge the risk they were accepting, and thus set an appropriate premium. This led to Lloyd's Register of Shipping which classified ships so as to provide an easy tool of reference. Initially these were only British ships, but from the 1850s onwards it came to include foreign vessels, and this was of increasing importance after 1886. By

1914, Lloyd's Register had a staff of 360 surveyors supported by 100 clerks and of these surveyors, 43 per cent were now stationed abroad. By the mid-1960s, there was no major port in the world without a Lloyd's surveyor, and they classified around one third of the world's shipping, even though Britain's own fleet had shrunk to small proportions. Lloyd's Register had, by then, become an independent service selling its expertise worldwide, and not just meeting the needs of the City. Lloyd's Register had even moved into the inspection and classification of aircraft in 1929, but this role was taken over by governments in the 1930s.[47]

Once a shipping loss had taken place, there was also a need for an expert to assess the degree of damage, if the vessel had not simply sunk. Moreover, it was necessary for this to be done independently if the interests of both the owner and the underwriter were to be preserved, and this led to the development of the profession of loss or average adjusters, who undertook to investigate, evaluate, negotiate and agree the amount to be paid under the claim. Demand for the expertise of the loss adjuster grew internationally, as the provision of marine insurance from London became widespread. By 1895, one firm of City loss adjusters, Robins & Co., were earning 20 per cent of their gross income from the investigation of foreign losses, in such places as the West Indies, Greece and Turkey. As the business became ever more international and complex, especially in the twentieth century, firms grew so as to encompass more diverse and specialist talents. As a result there was a gradual movement of firms to London from the provincial ports since the City's international insurance connections provided ready access to the world market. Liverpool firms of adjusters, such as Dale & Rundell, F.C. Danson and Clancey & Brown, moved to London before 1914, while the Cardiff firm of Francis & Arnold transferred in 1934. After 1945, the attractions of a London base were even greater as improved transport, especially air travel, made it possible to send experts to wherever they were required rather than rely upon local advice. In turn, these firms then relocated outside the City as rents began to rise from the 1950s onwards.

Of course, it was not only marine losses that required such experts. All types of insurance risk had to be assessed to determine the extent of damage, whether it was covered for fire, earthquake, hurricane or collision. Thus the City developed into a major provider of such professional and independent judgement, called upon by clients from wherever insurance cover was extended. Altogether it was estimated

that Lloyd's alone required, in the 1980s, the services of approximately 70,000 other people in order to operate successfully. Its own staff had risen from 46 in 1870 to 860 in 1932, and then to 2000 by 1987, reflecting the rising requirements in insurance for staff both to handle the daily routine of the business and to provide specialist knowledge when losses occurred.[48]

Thus, we have a sequence leading all the way from commerce through shipping and insurance to such specialists as surveyors and loss adjusters, each in turn contributing to the depth and range of expertise available in the City, initially for use within the City itself, but then increasingly as a service in its own right, meeting the needs of clients no matter where they were based. Yet, it was not just commerce that stimulated the appearance of such experts, for the City's development as a credit and capital centre also created its own client-based professionals, such as the accountants.

As the financial structure of businesses became more complex, especially with the growth of large joint-stock companies like railways, the need for financial experts skilled in handling the companies' affairs arose. Whereas clerks and book-keepers could be left with maintaining the accounts reflecting everyday business, events such as bankruptcy, merger or public flotation all required specialist advice and expertise. Hence there emerged, not just in the City but generally, accountants whose business it was to provide that type of expertise. In particular, it was necessary to protect the interests of the shareholder in a public company from fraudulent management, and so increasingly public companies instituted audits from independent firms for this purpose. Deloitte's, for example, began in London in 1845 to audit the accounts of the spate of new joint-stock companies being formed, particularly the railways, and this type of business grew. Eventually audits became compulsory in 1900.

Furthermore, the collapse of public companies was a regular occurrence in the nineteenth century and so it was necessary to have specialists who could liquidate the enterprise and sell off the assets, as the management had shown itself incompetent, and might even have been fraudulent. The Bankruptcy Act of 1869, for example, produced much work for accountants since they had to be appointed to superintend liquidation, but this position was removed in 1883 with the appointment of an official receiver.[49]

As the volume of London business grew so did such City-based firms as Deloitte's and Cooper Brothers, while individual accountants from other parts of Britain, especially Scotland, were attracted

to London. George Touche came from Edinburgh in 1883 with a specialism in investment trust management, reflecting his knowledge of that area of finance from its early development in Scotland. Eventually he set up his own office in London in 1899. Similarly William Peat came from Aberdeen, John and Alexander Young from Elgin and William Plender from Newcastle, and all established their own City firms in the late nineteenth century. As early as 1880, there were some 500 accountants and 50 auditors in the City, and they provided their services for a growing clientele not only outside London but also abroad.[50]

For most of the second half of the nineteenth century, insolvency provided the main work for these City-based accountants. Whinney, Smith & Whinney, for example, who did much work for banks and financial institutions, derived 86 per cent of their fee income from that source in 1860, and this rose to 94 per cent in 1870, before falling back to 72 per cent in 1880 and 46 per cent in 1890. Only gradually did auditing rise to prominence, vying with insolvency for primacy after the 1890s, and helped by its being made compulsory. In 1900, Whinney, Smith & Whinney derived 53 per cent of its income from audits and 20 per cent from insolvency, whereas in 1910 it was 53 per cent from insolvency and 35 per cent from audits. Obviously, insolvency work was much more variable, being dependent upon the level of bankruptcy. However, apart from these, other activities provided little business for accountancy firms before 1914. Even George Touche earned more from audits than from his speciality of investment trust management.[51] The business of the accountants also became increasingly international as they followed British companies overseas. George Touche set up offices in the United States (1900), Canada (1909) and Argentina (1914) as these were the areas to which the investment trusts, with which he was involved, were directing their investments. Similarly Deloitte's expanded worldwide before 1914, setting up in the United States, Canada, Mexico, Argentina and Russia in order to service their City clients who operated in these countries. The reverse was also true with the New York firm of Marwick, Mitchell & Co., opening a London office in 1904, leading to a link with W.B. Peat & Co. in 1911. The international nature of British investment before the First World War encouraged City-based accountancy firms to open offices in countries all around the world in order to service their clients wherever they operated. One measure of the growth of the City-based accountants was the fact that the fee income of Whinney, Smith & Whinney, rose from £8873 in

1860 to £28,317 in 1910.[52]

The war itself produced little fundamental change, more a suspension of normal business, as many accountants either enlisted in the forces or were engaged by the government in handling complex financial work. Whinney, Smith & Whinney's income in 1920 was derived from much the same sources as in 1910, suggesting no long-term change as a result of the war. However, the enhanced role of the state and the growth of larger London-based companies, as happened in railways, for example, did bring more business to the City accountancy firms, being conveniently situated for the head offices of these firms. The result was that provincial firms opened London offices in order to share the business being created by central government and large corporations. Mann, Judd & Co. and Brown, Fleming & Murray were two Glasgow firms that both opened London offices in 1919, faced with the prospect of losing clients, like Anglo-Persian Oil, which were locating in the capital. Once in the City, these provincial firms discovered that the business of their London branch expanded more rapidly than that of the head office, as the growing complexity of accountancy work directed clients to London, where a wider range of services was usually available within the one practice. Thomson McLintock, for example, generated a fee income of £28,000 in Glasgow and £13,000 in London in 1919, whereas in 1933, though the Glasgow amount had increased to £37,000 that for London now stood at £159,000. The result was to switch the emphasis of the firm and make it a City-orientated one. For Mann, Judd & Co., the London branch was already bigger than the Glasgow parent in 1936, leading to a division of the two in 1937.

The City accountancy firms also expanded domestically in the inter-war years, with Cooper Brothers opening a Liverpool office in 1920, while Whinney, Smith & Whinney established offices in Leeds in 1920 and Manchester in 1928. Expansion overseas also continued unabated in these years, with continental Europe becoming a major focus for activity. As more and more British industrial and commercial companies were converted into the public joint-stock form they required large and independent accountancy firms to conduct their audits, and as these companies operated not only throughout Britain but also abroad, it was convenient to use an accountancy firm that had a wide spread of representation. The result was that, by 1939, the City accountancy firms were already well established around the world so as to be well placed to serve their clients. At the same time, audit work was now dominant, comprising 73 per cent of Whinney,

Smith & Whinney's fee income in 1939. There was a slowly growing diversity though, with the complexities of tax providing 6 per cent of income and special tasks, like dealing with flotations and mergers, providing another 6 per cent.[53]

As with the First, the Second World War was largely an interlude for accountancy firms though their staff were fully occupied in other ways, and continental business was lost. The post-war years did see a greatly enhanced role for City accountancy firms as a result of government legislation and taxation. The creation of the nationalised industries took business away from the provincial accountancy firms, which had often audited the accounts of the constituent companies in such areas as coal, and gave it to the large City practices which possessed the numbers of skilled staff and the widespread offices. The merger movement in industry had the same result, especially with the need to interpret the implications of the Company Acts. Moreover, the great increase and complexity of the tax system made expertise in this area of major importance and this was something the City firms possessed. Touche's tax department, for example, had been set up in the 1930s and it grew from one partner and three staff in 1951 to 40 partners and 250 staff in 1980. Instead of accountancy firms serving particular localities, such were the complexities that medium-sized practices only survived by specialising in particular activities, such as Spicer and Oppenheim in financial services, Stow Hayward in entertainment, Neville Russel in Lloyd's members and Grant Thornton in private companies. For all, a London base was a necessity as so much was now directed from there, either by the government or company head offices.[54]

In many cases, only the very largest accountancy firms could provide the type of service that a company the size of BP, for instance, needed and demanded, both in terms of the range of skills and the geographic spread. When Touche Ross merged with Mann, Judd & Co. in 1979 they created a firm with 141 partners and 2300 staff in the process, with representatives all over Britain. Thus, especially after 1967, when the legal maximum of 20 to a partnership was removed, there was a spate of mergers, creating ever-larger UK accountancy practices. Whinney, Murray, emerged from a merger of Whinney, Smith & Whinney with Brown, Fleming & Murray in 1965, and itself absorbed six other accountancy practices between 1971 and 1977, including ones in such towns as Huddersfield, Hull, Inverness and Southampton. Consequently, whereas in 1948 the 20 largest accountancy firms conducted 33 per cent of all listed audits, in 1979

they handled 69 per cent. Over the same period, the number of Stock Exchange quoted companies tied to the top 20 accountancy firms rose from 26 per cent to 56 per cent. Though these top accountancy firms, most of which were London, and even City, based, increasingly dominated UK accountancy, there remained considerable scope for individual accountants, or small practices, catering for both business and personal customers on a local level. Such was the growing complexity of financial affairs, much of it stemming from legislation and tax, that it created a rapidly expanding need for expert financial advice beyond the scope of most individuals or small businessmen. As a result, there was a growing division between the City accountancy firms, competing for the business of corporate clients, and the local accountant meeting the needs of individuals. There were 9000 firms of accountants in Britain in 1989, most of which were small, catering for a local clientele.[55]

This expansion of City-based accountancy firms was not confined to Britain but involved the creation of worldwide networks and links, based on the branches and alliances formed before 1939. Again, this was in response to the needs of their clients whose operations were increasingly international, both through the expansion of existing joint-stock companies and the conversion of established industrial and commercial firms into such enterprises. Whinney, Smith & Whinney thus not only re-opened their European offices in Paris, Antwerp and Hamburg after 1945 but established others in the 1950s and 1960s in the Hague, Zurich, Milan and Frankfurt. In particular, the City firms were well placed to benefit from the overseas expansion of US companies as they already had strong ties with US accountancy practices, who passed on their clients' European business. Whinney, Smith & Whinney, for instance, gained much business from its links with Ernst & Ernst of the United States. The one area of contraction of British accounting firms was Latin America where offices were sold or merged with US firms.

These links with US firms eventually led to the creation of truly international partnerships, firstly informally and then formally. Deloitte's had had a link with Haskins & Sells of the USA since 1905, but this was not formalised until 1952 and even then it was not until 1978 that Deloitte, Haskins & Sells was formed. Similar such mergers were Coopers & Lybrand (1957) and Touche Ross & Co. (1969). The link between Whinney, Smith & Whinney and Ernst & Ernst (of the United States) was accomplished in 1959 although it was not until 1979 that the name Ernst & Whinney was adopted for all the constituent

firms of the partnership. There thus emerged a group of Anglo-American accountancy practices that dominated international accountancy business. By 1980 Touche Ross had 1800 partners and 17,700 staff in 360 offices in 82 countries. Similarly, Peat Marwick had 282 offices in 65 countries and Ernst & Whinney 304 offices in 71 countries. In turn Ernst & Whinney merged with another leading accountancy firm, Arthur Young, in 1989 to form Ernst & Young, becoming briefly the largest accountancy operation in the world as a consequence, with 5569 partners, 44,555 staff and a revenue of $4bn per annum. Within these operations the United States was the most important single component, providing 42 per cent of the income of the 12 leading international accountancy firms in 1987, compared with 14 per cent from the UK. A presence in the United States was therefore essential if the City firms were to retain a world importance and this they achieved by such mergers. However, they remained much weaker in Europe, where closed national audits kept UK firms out.[56]

Although auditing remained the core activity of the City accountancy firms, forming around 60 per cent of their fee income in the post-war years, there was a growing diversity of work, related either to mergers and acquisitions, flotations or taxation, especially with corporation tax. The *Financial Times* noted in 1987 that accountancy firms 'provide much of the backroom expertise that goes into preparing a bid or defence'.[57] The likes of Peat Marwick became experts on investigations into City firms, while Touche Ross were among the first into management consultancy, beginning in 1952. Accountancy firms were slowly emerging as general financial advisers, offering corporate customers more than a simple audit to satisfy the fears of shareholders. By 1988, Ernst & Whinney earned only 56 per cent of its fee income from auditing, as compared with 22 per cent from tax, 16 per cent from management consultancy and 6 per cent from insolvency. This was fairly typical of the pattern for all the major City accountancy firms. These firms had also developed as international experts on tax, not just giving advice to British clients, with Ernst & Whinney having some 300 people in its tax department in London. Consequently, accountancy emerged as a major growth area in the City after 1945, forming successful international alliances and expanding into the new areas of business that governments created with their corporate legislation and tax regimes. The rewards were clear, with Ernst & Whinney's fee income growing from £90,000 in 1945 to £345,000 in 1960 and reaching £148m in 1988. This was success on a grand scale, and it was all based on providing the client with financial

advice in an increasingly complicated world.[58]

The City's legal firms arose in much the same way as the accountants but developed at a much slower pace and on a much smaller scale. The development of joint-stock companies, particularly the railways which required an Act of Parliament, created a need for lawyers skilled in meeting their legal requirements whether it was formation, litigation or dissolution. Both Linklaters and Paines appeared in the mid-1840s, at the time of the railway mania, with the former being established by the sons of a London provision merchant and the latter by a Yarmouth solicitor. Freshfields was already well established by then as solicitors to the Bank of England, and was slow in accepting the business of these new joint-stock companies, so leaving ample scope for firms like Linklaters and Paines. There were opportunities for all as the volume of corporate legal business in the City continued to expand. By 1893, Linklaters were already employing 44 clerks and generating profits of £3500 per annum, which rose to £16,000 per annum in 1914. It was not just solicitors who were in demand, for there were also opportunities for barristers with a knowledge of law on the one hand and finance and commerce on the other. One of the most successful was Rufus Isaacs, whose family were City merchants and who himself had been a stockbroker, before qualifying as a barrister in the 1880s. However, unlike the accountants, the lawyers did not follow their clients overseas. Instead they expected all legal business to be brought to London for adjudication. Gregory Rowcliffe & Co., for example, who specialised in acting for provincial solicitors, extended their operations so that they acted in London for solicitors from throughout the Empire, including Australia, New Zealand, Canada, Malaya and India.[59]

Although the government's control of the economy during the First World War called on the services of City lawyers, this was frequently in a personal capacity. In fact, the war left a serious shortage of solicitors as so many had been killed and so few trained, leading to mergers between practices, as with Linklaters and Paines. The growing complexities of legal affairs did expand the business of City solicitors between the wars, as they became involved not only in flotations and mergers but also in government-inspired rationalisation schemes and quota arrangements as well as private cartels. All required a legal framework. As a result Linklaters & Paines had grown to 11 partners and 80 staff by 1937, but they were an exception, for most City legal practices remained small with the business of private clients rather than corporate customers being predominant.

Even a firm like Freshfields dealt more with wealthy individuals rather than with business until the 1950s.

Again, the Second World War disrupted legal activity and drained away talent, and it was some time after the war before the deficiency could be remedied. Nationalisation, mergers and a general growth of legislation, however, produced a steady stream of business for City-based solicitors since they possessed the few trained personnel who could advise on the difficult legal problems which arose, as with the value of private assets taken into state ownership both in Britain and abroad, such as in India. At the same time, lawyers were increasingly required to advise on the complications that arose out of mergers and acquisitions, especially when they were contested. Linklaters & Paines expanded as a result from 17 partners and 100 staff in 1956, to 79 partners and 700 staff in 1985, but it was not until the 1970s that they, like other City solicitors, saw the need to establish offices abroad.

Increasingly, in the post-1945 era, English law was becoming the common currency of international business, offering considerable opportunities for English lawyers. However, they did not have this field to themselves for the Americans, with a similar legal background, could offer effective competition and it was they that pioneered global legal practices with offices in New York, London, Paris, Tokyo, etc. They also moved into the City of London itself with over sixty firms of American lawyers represented there by 1990 and more planned. City solicitors were slow to respond to both the potential and challenge. They only slowly abandoned the private client business in order to concentrate upon the type of advice that large corporate customers, especially those operating internationally, wanted and were willing to pay for. Nevertheless, by the 1980s, some City legal firms, like Clifford Chance, Linklaters & Paines, Lovell, White, Durrant or Slaughter & May, competed with their American equivalents in giving this advice to the major corporations of the world. The largest firm of City solicitors, Clifford Chance, had 180 partners and 1649 staff in over fourteen countries producing a fee income of approximately £100m per annum in 1989.[60] Generally, London legal judgements were the most sought after and respected, as Justice Hobhouse explained in March 1990:

> The legal services available in the UK and particularly in the City, represented a body of expertise which had helped to make London a dominant forum of choice for arbitration and litigation.

Particularly in subjects relating to insurance, banking, commodity contracts and shipping, only the City possessed the experts, institutions and accumulated experience required to judge disputes.[61]

Although accountancy and law were the most prominent of the client-based services generated by the City's credit and capital markets, there was a variety of others, many of which also took on a life of their own, separate from the markets they had been established to serve.

The City's role in the nineteenth century as the most important centre for the financing of such projects as railway lines or mining operations around the world, created a need for engineering and surveying expertise of all kinds, as well as architects and other professionals. Once established, they too began to provide their services independent of the City of London, especially after the Second World War. A firm like Knight Frank & Rutley, chartered surveyors had, by 1986, 46 offices and 1400 personnel worldwide, and earned £110m from the fees, commissions and other payments it received from its valuation of property and the handling of sales. Similarly, it was estimated for 1986 that UK firms of engineering consultants had 13 per cent of the world market. However, they could not remain unaffected by the City's declining importance as a centre for project finance, and so they gradually lost share, firstly to US firms, who came to dominate the business, and then to the Germans and Japanese.[62]

The City's success also rested heavily on speedy access to, and use of, reliable and current information. This was one of the main purposes of Lloyd's agents, scattered throughout the world, as they kept the marine insurance market supplied with information such as ship movements. The receipt of information was transformed with the telegraph, immediate use of which was made by Paul Julius Reuter in 1851, when he exchanged Stock Exchange prices between Paris and London. There were also newspapers like Lloyd's List from 1734, or the *Financial Times* from 1888, which kept groups in the City informed about itself, rather than informing the City about the world within which it operated. Progressively, from the mid-nineteenth century onwards, electrical and then electronic development reduced the barrier of distance to almost insignificant proportions, allowing instant worldwide communications. The year 1866 witnessed the establishment of the first permanent telegraphic connection between London and New York, and this was eventually followed in 1937 with a telephone link. The level of sophistication continued to grow in the

post-war era with the use of satellite communications both reducing delay and expanding capacity. By 1989, Reuters maintained 184,300 screens worldwide, providing customers not only with instant access to information, but also allowing groups of them to communicate with each other, and so provide an international electronic market-place. Reuters generated 80 per cent of its revenues from abroad as a result.[63]

The City's investment in expensive and sophisticated communications equipment not only made it attractive as a centre for international business, but these services themselves could be supplied to clients worldwide, if easy access could be obtained to the information they carried. This was easy in the case of the newspapers as they were being produced to convey that information. As early as 1837, 20 per cent of Lloyd's List sales were abroad, and this had risen to 30 per cent in 1984, as they were providing a commentary on world shipping by then. In contrast, the *Financial Times* was slow to project itself onto the international market despite the international nature of the City business upon which it was commenting and the universal use of English as the language of business. Its rival, the *Financial News*, did publish a continental edition in Paris from 1907 to 1914, but this was not revived until 1950, by which time the *Financial Times* and the *Financial News* had merged, but it was killed off in the same year by the paper shortage. Although the paper shortage ended in 1956 it was not until 1979 that a continental edition was again tried, with a New York one following in 1985. By 1989, an estimated 30 per cent of the paper's circulation was abroad.[64]

In contrast, while it was in the interests of newspapers to sell information, that was much less the intention of the markets, which generated much of the price data. It was in the interests of the members of each market to confine that information to themselves since by denying access they disadvantaged their competitors, particularly the non-member. Thus, in the nineteenth century, the London Stock Exchange was loathe to allow the Exchange Telegraph Company access to its floor and even when it did, restricted the information it could collect and the subscribers who could receive it. These institutional barriers became more important in the 1980s when, according to the *Financial Times*:

> Electronic technology is, in fact, driving a powerful convergence between the role of a stock exchange in providing a market place and its role as a disseminator of information to its members and customers.[65]

It was in the interests of the wider community of the City that these information systems should be as sophisticated and as accessible as possible, for they improved the competitiveness of London over other financial centres, but the members of each institution providing the facility, and thus paying for it, would expect an exclusive privilege of use. The vesting of control over such information systems in the markets themselves, rather than a company providing a service paid for by a customer, could benefit particular groups in the City but would be bound to be detrimental to the whole. Certainly, if the provision of information to clients was to become yet another major City activity in its own right, it could not be left in the hands of those who obtained a degree of monopoly power through their privileged access to it.[66]

Consequently, derived from the City's commercial, credit and capital markets, were a series of client-based services that developed an independent existence of their own, supplementing, or even replacing, the activities that had brought them into being, as well as flowing out into other parts of the country or tax havens abroad. However, even the markets themselves and their participants became increasingly client-orientated, selling expertise and knowledge rather than acting as intermediaries. Within the commodities market, the International Commodities Clearing House not only settled bargains transacted in other exchanges, such as those in Australia and Hong Kong, but it also provided advice on how to set up such a facility.[67]

The merchant banks, though, underwent an even greater transformation. Before the Second World War, their principal function had been to raise capital for governments and countries, especially from abroad. For much of the period after 1945 they were barred from their overseas activities by exchange controls, and so had to develop a domestic business. This not only took the form of raising funds for local authorities and British industry, but also involved a growing participation in advising corporations, especially on mergers and acquisitions. Government control on dividends from 1945, combined with inflation, meant that the price of quoted securities was no longer an accurate reflection of asset value. This situation promoted the use of the take-over bid as a means of unlocking that asset value by property disposals or avoiding both controls and tax by creating larger groups that distributed funds internally. Such a procedure required experts to advise on the likelihood of success, the expected costs of acquisition, the income from disposals and the revenue from the remaining assets. Merchant banks were one of the main groups to

enter this field, and established themselves as the principal source of such advice and expertise, despite the competition of newcomers like Slater Walker. In 1986, Morgan Grenfell's mergers and acquisitions department handled 111 deals worth £15.2bn and this generated 32 per cent of the firm's revenues.[68]

The merchant banks also took advantage of the growing institutionalisation of savings, promoted by the tax system. Baring's, for example, managed only £9.5m for clients in 1914, and then largely as a favour for particular customers such as relatives. By 1987, they handled funds of £10.7bn and regarded it as a major part of their business. Other merchant banks, like Warburg's, also took up fund management both for pension funds, like that of the Post Office, and investment institutions, such as the unit trust. They did not have the field to themselves, however, for others also began to provide this service, such as the stockbrokers and accountants. Touche Remnant managed £20m in 1959 but £1bn in 1980. Altogether, the management of occupational pension funds was one of the fastest growing areas of the City in the post-war world. By 1986, their funds had reached approximately £170bn. Similarly, unit trust funds grew from £0.2bn in 1960 to £32.1bn in 1986.[69]

This service was not just confined to British investors, for the City's finance houses also began to provide investment advice to clients overseas. Faced with a lack of UK capital for investment abroad, but possessed of the international contacts and expertise, the City merchant banks began to cultivate the pension funds and investment institutions of other countries. Exchange controls before 1979 hampered this process, as it required the free movement of funds internationally, but the use of offshore centres like the Channel Islands, did allow these restrictions to be largely bypassed. The result was that the City of London was already emerging as the major centre for international fund management before exchange controls were removed in 1979. Both Canada's and Kuwait's external investment was managed from London, for example, mainly by City offices of their own financial institutions. By 1988 US pension funds had $16bn in foreign assets managed in the UK. Nevertheless, important as the City was, it was not dominant even within Britain. Edinburgh was an important rival centre, where it cost only half as much to operate a fund management firm as the City because of its lower rents and salaries. Internationally, tax havens offered an attractive appeal. In the Channel Islands, Jersey alone handled £5bn and Guernsey £4bn in 1987, while Luxembourg increasingly attracted US pension funds

away from London. Consequently, those merchant banks that survived in the City after 1945 did so by switching a substantial part of their business away from the raising of capital to selling their services to clients as experts in mergers and acquisitions and as professional fund managers. This represented a complete departure from the activities they had been engaged in before 1914, or even before 1945. Morgan Grenfell, one of the most successful merchant banks in making the transition, saw it staff rise from 100 in 1950 to 2000 in 1988 as a consequence. Other merchant banks, faced with a loss of their traditional business and a failure to develop new areas of expertise, simply faded away, disappearing when their partners retired. The expertise developed by these specialist City investment houses, like the merchant banks, made them attractive to foreign banks like Deutschebank, which took over Morgan Grenfell in 1989, after it had been weakened by the Guinness affair. In particular, European financial institutions could combine their extensive customer base with the long experience of the City in managing funds worldwide and handling mergers and acquisitions.[70]

Therefore it was not just distinct client-based services like insurance, law and accountancy that rose to prominence in the City after 1945. Previously market-orientated intermediaries, like the merchant banks, also began to sell their accumulated expertise to clients both through the demands for professional advice that developed from big business and institutionalised savings, and as a result of the disappearance of much of their traditional activities through government restrictions. Particularly before the Second World War, these services to clients were seen only in terms of the somewhat marginal contribution they made to the success of the City's established markets. After 1945, it was increasingly these services, and the wide range of expertise they incorporated, which helped to retain for the City participation in such market-based activities as futures trading, foreign exchange dealing, international capital and monetary flows.[71] In 1987, the *Financial Times* observed that: 'there is a wider range of experience in the structuring of cross-border financing and commercial operation to be found in London than anywhere else'.[72]

These client-based services also emerged from beneath the shadow of the City's markets and intermediaries to become independent activities in their own right, meeting the needs of customers from throughout the world. Shipping and insurance had already begun to do so before 1914, and accountancy was to follow suit by 1939. They were then joined by the lawyers and the merchant bankers, while the

market-based activities underwent slow relative decline. In addition, the facilities that London possessed, particularly in communications, backed by the wide range of professional services, helped to make the City an international administrative centre, especially for companies in the financial field, though the UK tax laws did divert a number to Switzerland or Holland. These client-orientated activities, whether the professions or administration, required little in the way of capital but generated substantial revenue, using talented people either to design and provide a service in increasing demand at home and abroad, or to manage an increasingly complex and international business.[73] Hopkins described accountancy in 1980, as follows:

> The firms had virtually no assets save the offices they leased and the furnishings inside. They brought in virtually no raw materials. Their only output amounted to personal service provided by a skilled staff.[74]

Thus, as Britain's domestic economic problems undermined the competitiveness of activities like shipping, and declining relative wealth combined with exchange controls, made it no longer a great creditor nation, the City of London survived after 1945 by concentrating on the sale of the expertise it possessed. Overall, around half of the City's overseas earnings after 1945 can be attributed to the income of these client-based services, with insurance being the major contributor (see Table 5 in Chapter 1).[75]

Thus, when the Client City is viewed in retrospect, it can be seen to have come to the forefront after the Second World War when the traditional market-based activities were circumscribed by government controls at home and abroad, and restricted by Britain's relative decline as a wealthy nation. Nevertheless, successful as they were, and indicative of the City's vitality in switching to alternative activities, client-based services alone could not sustain the City's position as the premier international financial centre. It had to share that with other cities, such as New York and Tokyo, seeking as an alternative the command of the European time zone, but even that involved challenges from Paris, Amsterdam and Frankfurt.

# Conclusion

> The accumulated knowledge and experience and character of those engaged in international finance in London should ensure the predominant position of our market for many years to come, a position which brings direct and indirect advantages to the whole country and one which should not be lightly jeopardised by uninformed criticism or by undue restrictive Governmental action.
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> B. Ellinger, *The City: The London Financial Markets* London 1940, pp. 358–9

The aim of this book has been to present a long-term perspective on the City of London. Such a perspective is rare in economic analysis where the past is usually confined to the previous five years or, if longer, the comments made are by way of background rather than as an integral part of the explanation. Similarly, it is rare for an historian to comment on current events as there are no terminal vantage points from which to gain a perspective. However, intimate familiarity with the past does suggest numerous parallels which can provide insight into the present and guidance for the future. The era before the First World War, for instance, may appear very distant to current practitioners but the operation of the world economy and the ethos of freedom have more in common with the situation today than the more immediate past, characterised as it has been by exchange controls, government intervention and restrictive practices. Anthony Harris, writing in the *Financial Times* in December 1989, was of the opinion that: 'Far too much past analysis has been based on a lost world of fixed exchange rates, a small international trade sector, and regulated capital flows.'[1] As a result policy prescriptions seem to have more to do with recreating this lost world than accepting the reality of the new set of circumstances and planning accordingly.

In the sixty years before 1914, the City was largely unregulated by the government. Essentially, control rested with the membership of each exchange or association, which took decisions in their own self interest. It was not an awareness of the need to organise trade, raise capital, employ idle funds or contribute to international equilibrium that promoted or prevented change, but a collective desire by the membership to improve their own prospects. This could, and did, have important consequences, for self interest could interfere with

efficient trading. Some limited form of outside intervention might have been welcome then. Nevertheless, these institutions existed in an open, competitive environment where it was impossible to resist either for long or totally the needs of the market, and this forced compromise or the appearance of alternatives. Institutions and their membership had to adjust to changing circumstances, and though that could take time, and itself influence the pattern of events, that is what each did in their own way before 1914.

The sixty years before 1914 were ones in which the prevailing mood was of reluctant and limited supervision and control, whether by the government or the institutions concerned. Individuals were left to profit from, or suffer by, the consequences of their own actions, with only the more flagrant abuses being punished and curtailed. Internationally, the prevailing ethos was also one of relative freedom for the movement of goods, labour or capital with, for instance, exchange controls being either absent or limited. This created an excellent environment for the establishment of world markets where trading gravitated to the most competitive centres, given the opportunities presented by the transformation in communications, the growth of international investment and the stability of major currencies.

Although restrictions elsewhere, as in Germany, did contribute to the City of London's dominant position in these world markets, of far greater importance was its own response to the new opportunities being created. Of particular importance was its acceptance of both foreign influences and foreign individuals for both provided vital channels to overseas markets and a dynamic force for change.

In complete contrast, the sixty years after 1914 were ones in which regulation at all levels greatly increased, affecting the operation of the national and international economies, as well as the world's markets. The period 1914–18 saw a gradual suspension of peacetime activities as the need to mobilise all resources for the war became paramount. Though there was a conscious effort to return to pre-war conditions in the 1920s, this was brought to an end by the world economic crisis of 1929–33, which was followed by an era of economic nationalism or autarky. This culminated in 1939 with the Second World War, which ushered in the age of economic management. In terms of foreign exchange, for instance, it was only between 1925 and 1931 that the pound sterling was left to find its own level in the market, being subject to various degrees and forms of control before 1979, and even afterwards. Internationally, trade, labour and capital

were all subject to regulation either by individual governments or by inter-government agreements and agencies. The consequence was that barriers were erected between individual economies as each, through its government, sought to control its own affairs and insulate itself from its neighbours either for protection against their actions or to make it easier to implement the policies decided upon.

Consequently, in the sixty years after 1914, the trends that had been established and were leading towards the creation of global markets, were thwarted primarily by world war and government intervention. Exchange controls, in particular, compartmentalised the world's money, capital and commodity markets and removed the spur of international competition that would have forced change. It was only natural that each institution would protect itself against outsiders and, without competition, there was nothing to make it do otherwise but the government. However, governments were less interested in creating progressive, innovative institutions than in using them to regulate the markets. The result was that, through legislative barriers, institutions were frequently given monopoly of their own national markets. This was a particularly important loss for the City of London as it had been so dominant internationally. At the same time the City had no real rival within the United Kingdom and so could ignore the pressure for change that might have forced it to alter and become a more competitive institution. This was not the case in the United States, where New York experienced continuous competition from other major centres such as Chicago.

However, this era of national monopolies bolstered by powerful institutions and backed by government legislation now appears to be under threat. The policies of economic management are discredited and there is a partial return to the more *laissez-faire* doctrines of the past, involving the dismantling of exchange controls, de-regulation of whole sectors of the economy and the sale of state assets. Within the European Community, for instance, the aim is the removal of all restrictions on money and capital flows both at the border and internally by 1992. As part of this move the financial sector's restrictive practices are also being liberalised, either by the institutions themselves or under the influence of government. Generally, there is a growing acceptance in the world that the market has a more active role to play in the allocation of goods, services and resources than it has done in the period since 1945.[2] Depending on the pattern that future events will take, and that continues to depend very much on the policies that governments pursue, the era from 1914 to 1971,

when the post-war Bretton Woods Agreement collapsed, can be seen as an Artificial Age, in which legal and institutional controls, and not market forces, held increasing sway and determined the nature and operation of the world's markets. Otherwise it is the period 1850–1914 that can be dismissed as a time when the markets were still at a formative stage, before they were subjected to the necessary regulation and supervision in order to make them behave in a responsible fashion. What the interpretation is to be remains open to question along with the future course of events.

For the City of London, regulation is going to be of vital importance for its long-term success or failure, for it no longer has so dominant a position that it can over-ride any disadvantages that are created. Unsympathetic or inappropriate legislation accompanied by the expense of regulation could alienate the market for bonds, equities, exchange and futures, and make it an expensive location for services and head offices. Conversely, the lack of any proper regulation to police the markets and protect the user, could lead to the diversion of business to centres possessed of the appropriate and expected safeguards. It is thus very important for the government to establish an inexpensive regulatory framework that exposes restrictive practices to competition, creates an environment where innovation is easy and prevents the exploitation of the customer. The country that gets the combination right is one that will attract both markets and services to it. However, within the European Community there is every prospect that regulations will be implemented which reflect the dominance of the Universal banks on the continent but ignore the diversity of specialist financial institutions and services which have helped to maintain the City of London as such a major and dynamic force within the world economy, despite Britain's own economic decline.[3] Many of the strategies implemented before 'Big Bang', which were based on the assumption that financial conglomerates would dominate, turned out to be badly misplaced and had to be reversed, for it was the specialists who showed themselves to be the more flexible and innovative in the face of changing circumstances.[4] Similarly, a great deal of damage has been done by governments passing laws to control markets or the provision of international services where these have to respond rapidly to changing requirements but are restricted from doing so by the legislation. The statement by Sir Kenneth Berrill, then head of the City regulatory system, that 'I'm a regulator, a watchdog and a policeman, in that order',[5] probably represents the wrong order of priorities for any

dynamic market or service in a new and changing environment. The reverse order might be more appropriate as time needs to be given for the form and shape of the market or service to become clear before regulation is proposed and implemented. Ideally, the government should let markets and services develop, stepping in only to remove the impediments of institutional restrictions and monopolies, though always being ready to legislate for, or refer to, the criminal law, obvious cases of fraud. Under these circumstances a trading system would develop that would cater for all types, at all levels and at all times, and thus attract business worldwide.

However, there must be considerable doubt whether governments will allow such developments to take place. The liberalising of international trade in agricultural products would benefit the world economy by approximately $72bn per annum through cheaper food and a more efficient allocation of resources, but there is little sign that that activity is to be returned to the free play of the market, as it was before 1914. Similarly, the securitisation of debt, whether public or private, and its trading on a global market is seen by central banks as undermining their ability to manage their own economies through monetary controls, and so attempts are made to limit its use. This is despite the fact that both borrowers and lenders desire the flexibility it delivers! Governments are reluctant to liberalise their markets because of the possible loss to competitors that might result. Even within the European Community member states are reluctant to remove barriers to integration, whether it involves flows of goods, capital or labour. Altogether, there remains an extreme reluctance by capitalist countries to trust their own economies to international market forces.[6] The years from 1914, and especially 1929 onwards, appear to have destroyed the faith that once existed in the power of an unmanaged economy both to allocate resources and maintain equilibrium. Possibly capitalism has something to learn from Karl Marx who said in the Communist manifesto: 'The workers have nothing to lose in this but their chains. They have a world to gain.'[7]

At present, the international market is in the midst of a transformation, especially in the financial field. International investment, for example, has grown rapidly, not only through government borrowings, but also as a result of large and successful companies outgrowing their domestic financial arrangements as they sell products on the world market. Further, financial institutions, facing strong competition, need both to keep all their funds employed constantly and to maintain a position of liquidity, which can best be achieved by

operating on a global market on a 24-hour basis.[8] For governments and companies whose equity or debt becomes traded on this global market, the gains would come via their ability to raise finance more easily and at less cost, since their securities constitute a form of quasi-money, being internationally acceptable. For those holding the securities the advantage is that they possess revenue-earning assets which are also extremely liquid, and can be used to facilitate payment worldwide on an immediate basis. For the world economy itself, the result is the existence of a mass of transferable assets of sufficient magnitude such that constant buying and selling on a global basis has the ability to provide a sensitive mechanism to cope with adjustments between economies over all time periods, making balance of payments crises, and their consequences, a rarity. These transferable assets also contribute to world economic growth as they represent the productive use of the underlying financial resources both in the development plans of corporations and the infrastructure projects of governments.

Acceptance of these new opportunities also creates a clear demarcation between those economies that participate fully in the new global markets, and enjoy the stability and finance they can provide, and those economies that remain separate from them, for the former would have the potential to grow more rapidly than the latter over the long run. Already the market, for example, has responded to the partial disappearance of managed currencies to produce financial instruments that allow fluctuations over time and between economies to be minimised, with the cost being borne by those who require such a service, rather than whole economies through monetary, fiscal and other controls. The financial market has shown that it can cope with the instability existing in and between modern dynamic economies without the need for constant intervention, given the opportunity to respond to demand.[9]

Consequently, the City of London as a whole has nothing to fear from a general move towards liberalisation in the world economy. Certain areas that have flourished because of regulations and taxes in such countries as the United States, Germany, Japan or Sweden, would lose business. However, the losses would be much greater in the smaller offshore centres lacking the spread and depth of services and facilities possessed by the major economies. Conversely, this liberalisation would create a rapid expansion of demand for the markets and services in which the City of London specialised. The continuing inflow of foreign financial institutions, both setting up

offices and purchasing existing City firms, indicates this trend. Too much credit has been given to the more liberal regulatory regime of the British government and the Bank of England, compared with other authorities and central banks, in attracting business to the City since the 1950s and not enough to the fundamental reasons why foreign firms and institutions gravitated to London in the first place. Between 1956 and 1988, for example, the cost of using a transatlantic cable fell from $2.53 to $0.04 per minute, making it more feasible to direct international operations from a base in the City than it had ever been in the past. In 1986, the UK accounted for 7.4 per cent of international phone traffic, or twice the level of its share of world GNP. Important as the lack of intervention by the Bank of England was – rather than positive support – more significant was the critical mass of facilities, expertise, contacts and experience that the City had acquired over a long time. The City of London was one of the few places with the range and depth of services and markets required by an expanding world economy in order to operate, even in the more interventionist years after 1945. It was also, probably, the only one of these centres with a sufficiently international orientation so that it was interested in catering for that demand. However, in order to meet this demand, the City of London has had to change quite radically since the Second World War, losing much of its earlier specialities while acquiring others.[10] Nevertheless, whatever its achievements – and they were immense – the City, like the rest of the British economy, experienced relative decline after 1945. The suggestion that there is a causal connection between the City and that decline was but a myth, as both were heading, broadly, in the same direction for much the same reasons.

In order to profit from the expanding opportunities in the world economy, and so not only maintain its position but increase its importance, the City of London must participate in the framing and operation of an appropriate regulatory framework, invest heavily in the latest technology and ensure that competitive forces pervade all its markets and services. The City cannot rely on the inertia of existing firms established there to preserve its position, especially if rival centres also possess the critical mass and foreign orientation necessary to attract international business. London is an expensive place from which to operate, with it costing, in 1989, an estimated £3m to set up a medium-sized branch of a foreign bank and another £1.7m per annum to run it. The Americans, for example, regard New York as the financial centre of the world, and have every intention of

maintaining it in that position. Within Europe the French are promoting Paris with considerable skill and vigour, and it already challenges London in particular areas, though it does not yet possess the range and depth of markets. In the Far East, Tokyo is emerging as a major competitor.[11]

Essentially, a commercial and/or financial centre creates its own momentum of growth for there is a tendency for business to congregate around the greatest pools of liquidity – for the markets – and expertise – for the client-based services. However, a failure to respond to changing requirements, either through externally imposed controls, institutional rigidity or general complacency can, over a long period of time, destroy that momentum and transfer the advantages to another centre, transforming a relative decline into an absolute one. The City of London has not always been the most important financial centre in the world, judged by the range and volume of its international business, and there are numerous rivals to claim the crown, such as Paris or Tokyo, or feel that they already possess it, like New York. It is worth remembering that the City of London is no longer the commercial centre of the world, although it did occupy that position until the Second World War.

At the same time, Britain's economic problems are far more fundamental and complex than can be explained by attributing them to the City of London, as the rather simplistic attacks of recent years suggest. Rather than blaming the City for consistently misallocating Britain's financial resources over the years, one must ask why savings were directed to particular activities since 1945, and what the causal connection is between the City and the inadequate skills, poor productivity, labour inflexibility and weak marketing that have bedevilled British manufacturing over the last forty years. The allocation of finance is only one part of the problem and, for much of the twentieth century, the responsibility for that lay large outside the City of London.

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