Linda Arch, *The regulation of the London Clearing Banks, 1946-1971: Stability and compliance*, Palgrave Studies in Economic History, Cham, Switzerland, Palgrave Macmillan, 2018, 125 pp.

Dr Linda Arch is a lecturer in finance at the ICMA Centre (University of Reading – Henley Business School). The book, *The Regulation of the London Clearing Banks, 1946-1971: Stability and Compliance*, published by Palgrave Macmillan in 2018, draws heavily on her doctoral research covering British banking regulation between 1946-79. Overall, the book is very well researched, the argument is both innovative and insightful, and the prose is entertaining and clear. Figures and tables depict relevant data and use well-reputed primary and secondary sources.

The usual process when researching issues in economic or financial history begins by identifying a shock, hopefully an exogenous one, to try to answer a research question. Regarding financial stability, for example, the standard approach is to identify crises, or some measure of financial instability, and then use econometrics and qualitative evidence to build a compelling narrative that disentangles the drivers, causes, and consequences of those events.[1] Dr Arch's approach in this book is entirely different. She has chosen the period of study, framed between the Bank of England Act 1946 and the Competition and Credit Control Bill of 1971, precisely because of the *absence* of crises. She argues that given that the goal of banking regulation is to promote stability, the interest of studying a stable period in the British banking sector is warranted. However, it faces all the difficulties that unavoidably come when trying to explain why something *did not* happen. Econometric techniques become useless to answer the research question, and thus the book's argument finds support in the analysis of qualitative information from primary and secondary sources. The only exception occurs in Chapter 4, where the author uses data to argue, albeit unconvincingly, for the presence of competition in the clearing banking sector.

Traditionally, the literature on the topic has argued that stability during the period was achieved at the expense of competition. Since London clearing banks colluded, prices, market shares, and asset levels remained stable, and the industry had no pressure to innovate.[2] This issue has been framed more recently in the debate regard-

1. See works by Bordo et al (2001), Jordà, Schularick & Taylor (2011, 2013, 2015, 2017), and Forero-Laverde (2019) among many others.
2. What we currently refer to as clearing banks are so called because they were members of the London Bankers Clearing House where checks were cleared and balances settled. It was

ing Britain's relative economic decline during the post-war period by indicating that financial repression combined with excessive risk aversion during the period had adverse effects on British industry because new endeavours were unable to obtain finance from banks.

Dr Arch's book offers evidence against the consensus on three accounts. First, she indicates that issues of industrial characteristics, domestic economic conditions, and structural features of the international monetary order limited the banks' incentives to take on excessive risks. While she tries to nuance the idea that there was no competition among banks (more on this later), she does indicate that cartel-style price-setting did hinder the need for competition between banks, which meant that rent-seeking as in Rajan (2006) was unnecessary. Second, she argues that the industry's structure further mitigated systemic risk: there was functional specialization across banks which set a natural limit to their growth opportunities, and there was a gentleman's agreement between 1918 and 1968 among the Big Five (Midland, Barclays, Lloyds, Westminster, and National Provincial) not to amalgamate. She further argues that this agreement explains why no too-big-to-fail (TBTF) institutions formed during the period. Finally, she indicates that the broad regulations in place during the period may have been more effective than the technocratic-led, well codified, highly specific regulation that gained traction all over the world since the 1970s.

The book is structured in five chapters: an introduction, a description of clearing bank regulation, a description of the context and the rationale for regulation, a comparison to current post-crisis regulation, and a concluding chapter which leaves open questions for bankers, regulators, and researchers. In what follows, I discuss each chapter in turn.

In Chapter 1, the author begins by describing the consensus explanation for the period of financial stability in Britain between 1946 and 1971. She then describes the industry by presenting the number of banks and offers measures of size so that the reader becomes familiar with the object of study. She argues that at the beginning of the period, clearing banks represented the lion's share of the British financial system, while this was not true by the end of the period. She discusses the period as one framed between two landmark pieces of legislation: the Bank of England Act 1946, which formalises the relationship between banks with the Bank of England (BoE) and Her Majesty's Treasury (HMT); and the Competition and Credit Control (CCC) bill of 1971, which begins the liberalization of the financial system and inaugurates a period of financial instability that runs until the present day. She offers a broader research question that is not sufficiently addressed in the book, and that is undoubtedly interesting for a host of researchers and researchers-in-training: did the London clearing banks fail British industry and thus contribute to British economic decline after the war?

In Chapter 2, titled "The Nature of Clearing Bank Regulation", Dr Arch presents a comprehensive overview of the regulatory landscape for clearing banks throughout the period. To make it palatable, she breaks the different types of regula-

mandatory that each bank had an office in London but they could also operate elsewhere. In 1946 there were 11; by 1976 only six clearing banks remained.

tions into three groups: codified regulation consisting of primary legislation, extralegal regulation made up of non-statutory regulations, and self-regulation. In itself, this thorough description of the regulatory landscape of the British banking system is a remarkable contribution.

Regarding codified regulation, after summarising the principal laws and acts that composed banking regulation during the period, she goes further and discusses the changes to the regulatory framework that came about with the CCC bill of 1971 and the Banking Act 1979. Furthermore, she offers an interesting contrast with current regulation by arguing that during the period of study the function of codified clearing bank regulation was not that of providing detailed rules but an overarching regulatory framework.

Concerning extra-legal regulation, understood as the rules of conduct beyond the sphere of legally binding and enforceable obligations, she indicates it may take six different forms: ratio requirements, deposit schemes, guidance of lending, provision of information, moral suasion, and indirect regulatory mechanisms. She offers an extensive description of each of these forms of "soft law" and suggests that they were forms of altering incentives without issuing new laws or writing excessively detailed regulation. The discussion of extra-legal regulation is vital because for it to function appropriately, it requires the cooperation of clearing banks both with the BoE and amongst themselves. This not only ensured that a culture of cooperation would persist and blossom in the British financial system but that the interests of banks remained anchored to those of the broad economy.

- Ratio requirements: these rations (cash, liquidity) are designed to alter the structure of the balance sheet to warrant that banks can pay out deposits. They were not codified in regulation but instead worked as a convention that clearing banks, but not other financial institutions, adhered to.
- Deposit schemes: designed by the BoE to demand funds directly from the clearing banks at a preset price. Insofar as it was the government who called for resources from clearing banks, it was both a form of fiscal policy, warranting newly borrowed funds, and of monetary policy, by contracting the monetary base and available credit. By 1967, with the decreasing participation of clearing banks within the British financial system, deposit schemes were no longer used for monetary policy.
- Guidance on lending: Arch presents a summary of both quantitative and qualitative controls on lending. Quantitative guidance took the form of ceilings on clearing bank lending and on hire purchase finance. She presents extensive coverage of quantitative guidance in Table 2.1. Qualitative guidance was concerned with the direction of bank lending rather than with its level. To direct lending to a given industry or sector, the Chancellor of the Exchequer would communicate with clearing banks through the BoE. She indicates that industries were promoted depending on whether they promoted the stability of the pound, as was to be expected during the stop-go policy (Offer, 2017; Scott & Walker, 2017). In response to the broader research question, this could have been used as an argument to indicate that the clearing banking system supported rather than hindered British

industry at the soft direction of the government during the period. However, the author never makes such a claim.

- Provision of information: according to the author, the requirement to submit information to a regulator is a low-intensity form of regulatory intervention in the clearing banking system. On the one hand, clearing banks had to publish their annual accounts. On the other hand they published monthly statements of average weekly balances, which were the centrepiece of London clearing bank reporting.
- Moral suasion: the author argues that this was the most pervasive form of extra-legal regulation during the period. It was how the BoE exercised its influence in the City where the high degree of concentration, primacy of personal contacts, and the dependence on the banks' goodwill made it extremely useful. Even though they had no legal obligation to comply, clearing banks felt compelled to adhere to requests by the BoE. One of the more puzzling issues for the international reader, and an issue that is barely covered, is why clearing banks would feel forced to comply with a request if there was no punishment or negative consequence to expect in the future.
- Indirect regulatory mechanisms: Arch indicates that indirect regulations that affected clearing banks were the discount market and the discount rate and exchange controls. She refers to them as indirect because the BoE delegated the day-to-day operation of foreign exchange transactions to banks.

The author's coverage of self-regulation highlights two main issues. First, the appearance of specific regulatory techniques that arose from within the banking sector, such as the cash and liquidity ratios. The second has to do with North's humanly devised institutions, such as codes of conduct, customs, and sanctions. As examples, she highlights the agreement between the Big Five not to amalgamate, the agreement between clearing banks not to take business from one another through price competition, and their proclivity to comply with regulation rather than avoid it in order to obtain some temporary gain.

In Chapter 3, Arch presents three different arguments, each in a separate subsection. First, she presents ten different macro variables and argues that the general economic position of the UK was deteriorating going into the 1970s. By the early 1970s, stability was done for, and market volatility was spiking. She gives a general description of the economic context in Britain, emphasising the period between 1967 and 1973. However, this section is lacking a description of important events that troubled the British economy during the period. She never discusses war-time demand management, the economic effects of rationing and fixed wages and prices, the role the Marshall Plan played in Britain, the complexities of managing the stop-go policy or the difficulties that Britain went through to achieve the full convertibility of the pound in 1958. While she discusses the devaluation that took place in 1967, little to no mention is made of the devaluation that took place in 1949.

Secondly, she argues that one of the main issues during the period was maintaining the stability of the pound and not only guaranteeing low financing costs for the government, which is the usual claim in the literature. This argument is not new and has been presented by Allen (2016) and Scott & Walker (2017). She indicates that since the Radcliffe Report (1959) two of the five goals of monetary policy concerned the stability of the balance of payments (BoP). The clearing banking system was critical to the stability of the currency because if there were BoP imbalances, the government would restrict credit growth to avoid people from buying imported goods. Additionally, the stability of the pound was necessary to guarantee that London would be central to global finance. Consequently, confidence in London was confidence in sterling and there was feedback between a stable banking system and a stable currency. This was challenging because a strong pound also signified expensive exports and pressures on the BoP.

In the final subsection of this chapter, probably the weakest in the book, Arch indicates that while stability was the guiding principle for regulation at the time, the direction of causality is not yet proven. While it may be that regulation brought upon stability, another possibility is that the stability in the system helped form the particular regulatory framework in place. To tend to this issue of causality she explores two different issues which, in my opinion, are not sufficiently tied to the causality argument. On the one hand, she queries whether the high level of regulation in the clearing banking sector led to regulatory neglect in other areas of the banking system. On the other hand, she asks whether stability was more a by-product of a lack of competition among clearing banks and not of the regulatory environment.

Regarding the first issue, Arch argues that regulatory responsibilities were shared by several institutions: Her Majesty's Treasury, the BoE, the Board of Trade, and the Board of Inland Revenue. This caused the regulatory perimeter of each of the regulators to cover a different set of institutions, where there was overlap only in the clearing banking system. She indicates that it was the birth of the euro markets (eurodollars in 1958 and eurobonds in 1963) which spurred the growth of an unregulated banking sector outside the purview of the BoE.

Concerning the topic of competition, the author presents two competing hypotheses. Either competition fosters stability, or it fosters fragility in the financial system. In her view, the fact that there were limited competition and stability is evidence of the former. The argument she makes is that historians have argued there was little competition only based on the number of entities. Additionally, newspapers and reporters contended that there was little competition when comparing the British financial system to its peers, Australia and Canada. A final argument about how competition was restricted comes from the rise of antitrust laws during the second half of the 20th century. According to the author, the evidence for competition in the clearing banking system is abundant. First, there were few barriers to the entry of competitors so that it was rather easy to open a deposit-taking institution. Secondly, there were numerous substitute products for those with savings. Thirdly, the assets of all types of financial institutions grew strongly between 1955-75.[3] Additionally, there is consider-

3. The share of assets held by clearing banks as a percentage of total assets in the financial system dropped from 47.8% to 17.3% during the period and their asset composition shifted from investments to loans and advances.

able evidence of innovation in clearing banking during the period: personal loans, credit transfer systems, the cheque and credit cards, the cash dispenser, and the computerised bank network.

In what may be the most exciting part of the book, Arch concludes the section by arguing that there were regulatory, institutional, and structural factors that discouraged excessive risk-taking by banks and hindered the accumulation of systemic risk. She addresses quite thoroughly how all the elements discussed in the book addressed liquidity, bank-run, exchange rate, operational, credit, and systemic risks. Additionally, she ties the argument in a self-explanatory table (3.2) on page 83. She then develops each risk and argues why the different factors aided in reducing the system's exposure to each of them.

Chapter 4 reviews the nature of banking regulation since the Great Financial Crisis. The author says that the detailed and highly technical regulation that has arisen from national authorities, the EU, the G20, and Basel may have come at the expense of more broad regulation. She breaks down the regulatory effort into two phases. The first one relates to containment and management of the crises and dealing with failing banks. The second phase was aimed at measures designed to restore, maintain and strengthen the stability of the system. She argues that the period since the 1970s has been one where informal rules were replaced by legal ones and unspoken rules with codified ones. She concludes by arguing that while a significant emphasis has been given to required capital and deposit insurance, little to nothing has been done to endow regulators with more legitimacy. The author does not discuss the more significant role that self-regulation has played since the 1970s, and that it is a relevant part of the Basel Accords since 1996.

Finally, Chapter 5 presents the evolution of the clearing banking sector between 1975 and the present day. Arch argues that several factors explain the decreasing participation of clearing banks in the financial system's assets. First, regulation allowed for the functional specialisation of the banking system to be eliminated. Secondly, there was considerable growth in overseas banks operating in Britain and competing both as deposit-takers and lenders. Finally there was a significant increase in non-sterling denominated assets and liabilities.

She then discusses the changes both in the British and international economic and monetary order that have brought financial liberalisation to the fore. The fact that macroeconomic variables are becoming more volatile, the rise of monetarism and the ever-growing presence of inflation targeting are noteworthy features of the period.

She concludes the book with two questions for bankers, regulators, and researchers. First, the higher prevalence of crises begs a critical reflection on the efficacy of highly codified, technical, and detailed regulation. Secondly, regulation is being made while trustworthiness of banking institutions has dramatically decreased. "How can banks be encouraged or incentivised to strengthen their integrity, to improve their competence and to prove that their intentions are benevolent?" (Arch, 2018, p. 119).

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