

How did a privately-owned Bank of England shape London as a financial center as we know of it today?

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Introduction

The City of London has held the status of the center of financial operations for more than two centuries. From one perspective, this status grounds on the power of the United Kingdom in the political international arena in the relations with the other countries and economic development of the region. With that, the City of London has managed to support its leading position in the financial market beyond the financial crisis that raised in the twentieth century in the United Kingdom. From the other side, the state authorities of the City have succeeded in the development and implementation of efficient management of financial market through the regulation of the activity of the Bank of England. Since second half of the twentieth century, the Bank of England was engaged in promoting of the status of the City of London with the creation of favorable conditions for conduction of transactions among business units from several jurisdictions. Consequently, the role of the Bank of England became pivotal in the creation of the Eurodollar market with the appropriate regulatory framework. Therefore, during the entire twentieth century the Bank of England exercised surveillance over the activity of the financial institutions across the region on their contribution to the development and strengthening of the financial market. In this respect, this paper will explore the power and role of the Bank of England in the formation of the attitude of the whole world to London as the financial center since 1950s.

Analysis of Evolution of Role of Bank of England in Regulation of British financial sector

The Bank of England was established in 1694 as the private institutions conducting financial regulation of the market for the state in form of the central financial organization in the region. The main purpose of the creation of this financial institution was facilitation of lending services in the region to the business units and other financial bodies with the subsequent governance of their activities (Capie, 2010). Besides, with the elections in 1946 the

Bank of England has become subject of the nationalization due to the preferences of the Labor government. Beyond this reformation, this financial institution continued to hold its power and autonomy in the financial market. This means that the leadership of the Bank of England was elected for the appropriate duration so that the government did not have authority to dismiss these managers from the offices. Accordingly, the Bank of England has continued to perform surveillance over the operation of the commercial financial institutions in the market in the City of London. In this regard, it should be noted that regulation of the financial market in this region is made through three dimensions as the interest representation of the financial institutions, conduction of decision-making, policy implementation (Saunders, 1967).

The availability of these dimensions to the regulation of the financial transactions has reflected the conduction of informal regulation of the Bank of England as the central financial institutions of the City of London. From this historical period, the development of the City of London as the financial centre was started. In fact, the existence of the meso-corporatists regulation of financial sector implies that it promoted the efficient regulation of financial sector in favour of realization of strict control over the financial institutions. Consequently, the appearance of the Eurodollar market in opposite to the position of the American financial institutions contributed to the formation of the position of the City of London among others. With that, the American financial institutions pursued the desire to avoid interference of the state authorities in the regulation of the nature and accomplishment of the transactions by these organizations in the domestic jurisdiction so that the appearance of meso-corporatism of the United Kingdom showed that the local surveillance is not as strict as American one. With the beginning of 1950s, the British state authorities took all measures in order to attract arrival of the foreign institutions for the operation in the United Kingdom. The increased transparency and less stringent regulation of the financial sector in the United Kingdom represented liberal attitude of the local state bodies in the regulation of the activity of foreign banks that exercised

significant influence over the formation of the environment in the financial market in the country (Schenk, 2010).

Due to the fact that the Bank of England was central in the City of London in the financial market, this financial institution supported the evolution and creation of the Eurodollar market. The notion and essence of the Eurocurrency market is one of the most controversial event in the financial sphere because the origins of this evolution are still not clear. It is clear that the Eurodollar market appeared in the United Kingdom as the City of London was ready to develop this proliferation to the foreign jurisdictions. In 1950s the Bank of England was engaged in the accumulation of the foreign currency reserves. In this regard, the people of the United Kingdom and other customers of the financial institutions have received an opportunity to hold financial assets in any suitable currency within the banks that were governed by the British authorities. This tendency was renewed because of the removal of the exchange controls in the United Kingdom that were applied to the British financial institutions. However, the British state bodies recognized the contribution and importance of the promotion of the foreign reserves accumulation as it strengthened the position of the local currency (Segal, 2002). With that, the British financial institutions did not use these reserves for state purposes while several credits and lending was issues to the third parties across the territory of the United Kingdom and in other jurisdictions where the City of London had interest. The accumulation of foreign reserves became important source of international capital that was properly appreciated by the financial institutions in the United Kingdom (Schenk, 1998).

The Eurodollar market was evolved with the beginning of the second half of the twentieth century. From one side, this tendency grounded on the fact that the United Kingdom took all relevant measures so that to implement principles of the Bretton Woods financial system with the relevant development of the current account convertibility among several

currencies and facilitated removal of barriers between companies in trade operations. Furthermore, the United Kingdom appeared at the risk of the rise of inflation in the country because of the instability of the currencies in the foreign jurisdictions so that strengthening of the local currency should have contributed to the economic development of the country in comparison to the position of other states (Henderson, 1950). With that, in 1952 the British state authorities announced its plan on the liberalization of the trade relations between the companies and simplification of the financial operations. Therefore, the British government proclaimed introduction of the extensive convertibility of the currencies that was controlled properly by the Bank of England since 1950s as the main financial institution in the region. With that, the British banks appeared deprived of the limitations in the engagement in the exchange market with the other financial institutions (Schenk, 1998).

In 1955 the Bank of England took the responsibility to control submission of official information on the substantial financial transactions that took place in the exchange market by the other financial institutions as the Midland Bank. The activity of the Midland Bank was regarded as suspicious by the leadership of the Bank of England due to the fact that this financial institution was engaged in the collection of dollar funds of significant volumes that was out of ordinary business practice. Given the fact that the exchange transactions of the Midland Bank exceeded the allowed limits, the local state bodies should have taken care of the creation of the Eurodollar market so that to save local economy in favour of its stability. Moreover, the actions of Midland Bank fell within the scope of the innovative strategy through which the additional protection was given to the foreign investors in the United Kingdom (Levin, 1974). Given the fact that this financial institution did not have other offices in the additional list of jurisdictions, the defense of the international operations should have been supported with the interference of other financial institution of the United Kingdom beyond the presence of Midland Bank in the country (Schenk, 1998).

Given the abovementioned statements, it should be noted that the British state bodies should have taken all relevant measures to withdraw available restrictions so that to boost development of the other financial institutions in the market. In this regard, the Bank of England was afraid of the fact that the Midland bank was in pursuit of the exchange control while the interests available for the dollar deposits should have been reduced so that to facilitate the activity of the financial institutions in the region. Therefore, the Bank of England should have taken measures so that to control the volumes of the accepted American currency in form of the deposits as it appeared that several financial institutions in the region relocated the focus of the transactions to this currency beyond the necessity to strengthen the national one (Burn, 2006). Hence, the new strategy to the regulation of Eurodollar market was in place so that to diminish the desire of the financial institutions in pursuit of dollar deposits at the expense of other currencies. The proliferation of the non-resident convertibility actions in the second half of the twentieth century gave rise to the appearance of the several other financial institutions for the acceptance and proliferation of the dollar deposits (Hogan and Pearce, 1983). In addition to this tendency, the British financial market observed the evolvement of new actors in the market that have found opportunities for the allocation of dollar deposits for the business purposes (Levin, 1974).

In fact, the role and contribution of the Bank of England in formation of the proper image around the City of London as financial sector is not clear. However, this financial institution has managed to revitalize the development of the financial sector of the economy of the United Kingdom with the introduction of capitalization as the suitable instrument so that to provide asymmetric information about transactions related to the usage of Eurodollar in the City of London. In 1950s the members of the City of London as the strong financial organization has developed new instruments for the maintenance of the profitable activity of the foreign business units in flow of the American currency (Ehs.org.uk, 2016). This instrument

and practice was invented in form of Eurodollars. Given the fact that in 1959 the British authorities decided to return to the practice of convertibility of the currency, the Eurodollar market gained popularity and specific attention from the foreign institutions across the world while the state bodies of the other jurisdictions widely supported this initiative as the efficient measure aimed to govern activity of the business units in the financial market (Ehs.org.uk, 2016). However, during the period of introduction of the Eurodollar practice, there was no relevant institution that should have been responsible for the maintenance and regulation of the nature and accomplishment of the transactions. Besides, this institution was more than necessary so that to hold stability in this dimension of the financial market and keep confidentiality of the transactions between business units (Valentini and Hunt, 1972). Furthermore, the existence of the centralized institution was in need for the prevention of spread of this practice to the other financial markets while the local bodies did not have appropriate capabilities and resources so that to enter competition on the flow and usage of Eurodollars in the business environment. In this regard, the two primary peculiarities of Eurodollar market were formed. Namely, the appearance of the notion of end-user and double-counting which were considered in view to the scope of the financial market where Eurodollars were used (Ehs.org.uk, 2016).

With this in mind, the Bank of England exercised its functions as supporter of the development of the Eurodollar market regardless risks and implications it had. Given the fact that the Eurodollar market was subject of wide discussion among the financial regulators, there was a necessity for the creation of the appropriate regulatory environment. Because of the absence of such regulation, the usage of Eurodollar was considered as form of speculation pertaining to the illegal practice (Burghardt, 2003). For the prevention of criticism around the presence of Eurodollar market in the region, the Bank for International Settlements was engaged in the removal of these concerns in reference to this currency. In particular, the Bank

for International Settlements requested the Bank of England to enter cooperation on the development of the regulatory environment for the Eurodollar market. The pivotal purpose of this request grounded on the desire to create collaborative practice in regulation of Eurodollar bonds with the subsequent removal of the risks arising with the availability of this currency. Hence, the Bank of England was considered as the linkage between the financial institutions of the United Kingdom, London banks, in particular, and American organizations. The Federal Reserve Bank of New York stood to the position that the creation of the appropriate regulation of the Eurodollar market can be achieved through the analysis of the statistics on usage of Eurodollar currency by the local banks (Kendrick, 1980). Therefore, the Bank of England should have collected this information and processed it accordingly. Given the nature and status of the Bank of England in the financial market of London, this request was reasonable and justified. Moreover, the Bank of England as the central institution of the country was regarded as appropriate to collect confidential information from the other financial units on the transactions they made. With that, it should be said that the Bank of England has succeeded in satisfaction of this request, while the Bank for International Settlements did not managed to consider the implications and risks of emerging Eurodollar market. Consequently, this financial institution gave up any attempt to create relevant regulatory framework for the usage of Eurodollar so that it appeared up to the Bank of England in fulfilment of this task and contribute to the development of this instrument (Ehs.org.uk, 2016).

In 1950s London did not have quite strong position as the financial centre on the global scale. In turn, the status of London as the centre for the business activity and financial transactions was received with the development of Eurodollar market beyond the borders of the United States. The Eurodollar was highly appreciated by the traders across the world as the instrument for conduction of trading operations and receipt of lending opportunities. Moreover, London managed to cope with the needs of the business units in view of the issues arising in

the global finance that turned London in the trading centre of Eurodollar loans (Kane, 1983). With the appearance of Eurodollar market, the American financial institutions should have used this instrument for the creation of deposits flowing to the Eurodollar market where the British banks had capabilities to provide customers with increased rates. This tendency formed positive image around London as the strong financial centre in the region (ZeroHedge.com, 2017).

The 1960s were marked as the period where the British financial institutions decided to enjoy all benefits arising from the presence of Eurodollar market. The ongoing Cold War contributed to the expansion of Eurodollar market as the companies were looking for increased interest rates that were not provided by the American financial institutions in comparison to the activity of the Bank of England. Namely, this financial organization retained popularity and importance in the region as it did not create barriers in the currency exchange market that were used by the state bodies of the United States in the regulation of the financial market. In this regard, several states of the Eastern Europe and their business units opted out to cooperate with the Bank of England in comparison to the approach of the United States in maintenance of the adverse polity in the provision of lending to the business units from several jurisdictions. The storage of financial assets in London as proper management of the Bank of England shaped the City of London as the emerging financial venue (ZeroHedge.com, 2017).

One of the most indicators of the growth and economic development of London as financial centre was the uncontrolled flow of the American banks to the territory of the United Kingdom where the corporate interests were resembled in the deposits with the Eurodollars. Given the fact that the City of London welcomed this tendency with the removal of the strict regulation and creation of favourable conditions for overseas banks, the amount of the Eurodollar deposits was increasing for several years. In the domestic jurisdiction the American financial institutions were subject to the stringent limitations including restrictions as to the

branching activity, high ceiling rates on the interests according with the provisions of the Regulation Q that existed in the United States. In addition, the American financial institutions were obliged to create reserve deposits. However, the banks were in need to meet the interests of the customers so that to support their needs in the United Kingdom. Due to the fact that the United States experienced the problems with the US balance of payments with the adoption of the subsequent policy on the removal of any increase on the lending provided in American currency, the regulation of the United Kingdom was suitable for the American financial institutions. Moreover, the government of the United States adopted the new legislation as the US Interest Equalization Tax of 1963 based on which the American currency could be held in other jurisdictions. Furthermore, the American government tended to control the flow of the American currency in view of the political events where the United States was engaged. Under these events one should understand the Suez War, Cold war (Kynaston and Milner, 2012). The restriction on the usage of the American dollars by some companies because of the temporary ban existing in the country, the companies had to refer to the model of the Eurodollar that was developed by the United Kingdom. During that time, the Bank of England succeeded in investigation of the needs and interests of the American financial institutions and used all benefits arising from the policy of convertibility. Hence, the Bank of England supported the raise of popularity of the certificate of deposit as the efficient instrument for the companies and several other holders in the financial market (Levin, 1974). The existence of the certificate of deposit allowed to the holder of this instrument to create appropriate deposit of significant amount for the limited period of time. In this regard, the bank as the financial institution ensured that the holder had suitable level of certainty on the integrity and safety of the deposit by the bank until the holder requests it. Despite the fact that the certificate of deposit was initially founded in the United States, the City of London has managed to raise its usage in the financial market by the banks. Therefore, the British banks participates in the proliferation of

the certificates of deposits in the financial market of the United Kingdom was widely supported by the financial organizations from the other jurisdictions (Massaeo, 1972).

Considering the abovementioned statements, it is possible to state that the City of London was shaped because of the reasonable approach to the management of sterling as the national currency of the United Kingdom. When the currencies of the other states started to decline, the Bank of England as the central financial institution in the region exercised its role in the governance of the activity of the commercial institutions in appreciation of national currency and support to the Eurodollar operations. This approach saved time and resources for the Bank of England in reformation of the system of transactions with the foreign partners and companies where the overseas financial institutions were involved. Moreover, the Bank of England understood the importance of the development and implementation of the suitable instrument of influence over the other commercial institutions in the region so that to affect the volume and size of the balances of the other financial institutions. This activity should have supported the level of the cash reserves during the crisis that was ongoing in several jurisdictions. Through the appreciation of the bank rate, the Bank of England received an opportunity to affect these rates in reference to the available discounts that were paid to the financial institutions in request for money while the bank received legal standing to define the most relevant prices for particular assets. Therefore, the Bank of England referred to the practice of the liability management that was not used widely before. In turn, the massive arrival of the American financial institutions to the British market forced the leadership of the Bank of England to take care of the status of local institutions in favour of the development of the position of the City of London on the global scale (Bell, 1973).

Given the above-mentioned practice, it should be noted that the popularity of the City of London as the financial centre with the introduction of Eurodollar market was contributed with the availability of several innovative schemes of the liability management. These

achievements were used for the receipt of increased profit by the companies enjoying services of the British financial institutions in the founding and maintenance of the reserves and several other forms of deposits in London. Due to the fact that the British central bank did not impose restrictions on the convertibility of the currency and used it for the personal purposes. Besides, in 1973 the British financial system appeared in the deep crisis so that the Bank of England should have used all relevant methods so that to save the existing reserves against the collapse of the whole banking system of the country. In this regard, in 1973 the Bank of England introduced the scheme titled as “Lifeboat”. Under this mechanism, the leadership of the Bank of England proclaimed the importance of the maintenance of the close control over the activity of all financial institutions in the region including the secondary banks. In this respect, the head of the board of the Bank of England undermined that it was the direct mistake of the Bank of England that several financial transactions of the secondary banks in the United Kingdom were out of control of the central bank of the country. Due to this omission, the leadership of the Bank of England believed that it was high time to provide this controlling mechanism so that to save the financial and banking system of the region. Hence, the Bank of England reaffirmed its status and capabilities to hold the position of the central financial institutions in the country against the disasters caused with the imbalances in the financial operations out of the unlimited convertibility of the currency in cooperation with the overseas partners (Quennouëlle-Corre and Cassis, 2011).

As the result of the lifeboat policy, more than thirty of the secondary financial institutions in the country were saved and governed through new mechanism of control. Consequently, the same amount of the banks gained any other form of assistance from the Bank of England so that to stabilize situation in the financial market against new threats and risks. The maintenance of the proper protection over the activity of the secondary banks, the Bank of England achieved that all depositors did not lose any piece of the reserve during the crisis of

1973. Furthermore, several banks were subject of the deliberate restructuration and merge operations with the other financial institutions that were much stronger in the banking system of the country. At the same time, the Bank of England and the City of London entered into cooperation with regard to the establishment of the proper control of the transactions in the banking system of the United Kingdom with the purpose to avoid similar situations for the future. For the confirmation of such cooperation, the Bank Acts of 1979 and 1987 were signed by the City of London and the Bank of England as two parties to the same process (Fung and Leung, 1993). In addition, these institutions took obligations to create new financial system that should have been grounded on certain pillars as follows:

- No one financial institution in the country had the right to provide single loan of the interest rate of 25% out of the free capital base without appropriate approve from the management of the Bank of England;
- The loans with the interest rates from 10% to 25% should be notified properly to the Bank of England in terms of the owner of the loan.

The above-mentioned statements should have reformed the mechanism of the cooperation of the financial institutions with the central bank of the country. Accordingly, the leadership of the Bank of England proved its power to govern the situation in the market against illegal practice that was widely used by the secondary banks with the introduction of Eurodollar market (Davies, 2002). The Bank of England took all relevant measures so that to improve liquidity of the local currency in comparison with the other financial assets that arriving to the United Kingdom with the purpose to create appropriate reserve. Meanwhile, the stable orientation to the reorganization of the secondary financial institutions in the country and reconsideration of the liquidity of the currency, Eurodollar mechanisms affected positively the development of the City of London as the financial centre in this region. The reliability of the financial transactions and integrity of the reserves beyond the crisis contributed to the image

of the Bank of England as the reliable institution that could cooperate with the overseas partners under different situations (Sgambati, 2015).

Regardless the fact that the policy of the Bank of England was regarded as partially suitable and efficient in addressing tough time, the period of 1950s and further years was regarded as the tough time in terms of the cooperation of this financial institution with the Labour government. Namely, the Bank of England started initiative aimed to dismantle transactions pertaining to the realization of the strategic goals of the Labour government. Under the measures used by the Bank of England, one should understand the decrease of the rate of the Treasury bill to the minimal level so that to implement own rules of the behaviour in the financial market (Tomlinson, 2015). Moreover, the Bank of England claimed from the representatives of the Labour government to start simplification of the monetary policy and liberalization of the rules applicable to the practice of the foreign institutions in the territory of the United Kingdom. However, the Labour government did not take opinion of the board of the Bank of England into account due to the development and realization of own plan of reorganization of the financial sector. In this regard, the Bank opposed to the policy of the British government with the increase of the Bank rate to 7% that undermined the position of sterling in the market. This approach only reaffirmed the role of the Bank of England in the financial system of the country. This means that the Bank of England had all levers of the control over the implementation of the monetary policy in the region. Due to the fact that the management of the Bank of England pursued the desire to restore the role of the national currency in pursuit of the full employment. The Bank of England opposed to the quantitative measures so that to find balance in the relations with the Labour government while the policy on the maintenance of the stability of the market and development of the region as financial centre was supported accordingly (Tily and Tily, 2017).

Beyond the policy of the Bank of England in saving the secondary financial institutions and maintenance of the convertibility in view of the Eurodollar market, the central bank had several other options and functions that contributed to the development of the region as the financial centre. In particular, the Bank of England exercised function of the governance of the daily fixing of gold prices for certain period of time. After the reformation of the British financial system in the end of twentieth century, this function of the Bank of England was terminated and delegated to the other secondary financial institutions. Besides, it should be noted that the Bank of England performed supervision of the policy in the gold market as it is part and parcel of the banking system as the whole. The leadership of the Bank of England cooperated with the financial actors participating in the exchange of the gold reserves so that to control the flow of the financial assets in this dimension of the banking system and avoid high increases in prices for these items (Bussière and Cassis, 2005). The existence of close supervision of the gold reserves and daily gold prices prevented increase of the deficit in the United Kingdom. Therefore, the Bank of England was regarded as physical representative at the fixing policy. This institution acted on behalf of several other institutions that had interest in purchase of the gold. However, in the end of the twentieth century, the government of the United Kingdom decided that the Bank of England should be independent institution in the financial system of the country. This reorganization grounded on the desire to change approach of the state bodies in the country to the surveillance of the transactions in the financial market due to its emergence and development. The Bank of England proved its capability and efficiency in the resolution of the challenges during the crisis so that the receipt of the independent status and removal of function on gold fixing prices were reasonable stages in the further development of London as the confident venue for the business activity of the companies from different parts of the world (Manly, 2015).

Conclusion

The Bank of England is the main financial institution of the United Kingdom. It has the long evolution history on the development of the financial market in the country with the development of appropriate measures and legislative documents. The role of the Bank of England in reformation of London as the financial centre was started with the nationalization of the Bank in the middle of twentieth century. This period was marked with the tough situation in the American financial market as the companies and financial institutions were restricted in the flow and convertibility of the American national currency. Given the fact that the American government maintained strict regulation of the activity of the companies in the financial market by virtue of several restrictions, the leadership of the Bank of England and the government of that time took the advantage of the liberalization of the conditions in the domestic jurisdiction for attraction of overseas partners for cooperation. For the achievement of this purpose, the Bank of England performed strategy of the government on the stabilization of the national financial market with the foundation of the Eurodollar market and liberalization of the transactions. With that, the Bank of England has supervisory functions in reference to the actions of the secondary financial institutions. This means that the central financial institution participated in the development of Eurodollar market through adoption of relevant regulation that allowed to attract companies from several countries and promoted their desire to allocate financial assets in the banks of the United Kingdom. Moreover, the reasonable strategy of the Bank of England and maintenance of the secrecy around the transactions of the companies operating with the banks of the United Kingdom proved status of London and trustful and reliable jurisdiction where the company can not be afraid of the failures and crisis as the Bank of England has proper management of liquidity and stability of the foreign exchange processes.

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