Sovereign debt management and the globalisation of finance: Recasting the City of London's 'Big Bang'

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Abstract

This article focuses on the central position of sovereign debt securities in the financial system to challenge existing accounts about the 1986 'Big Bang' deregulation of the City of London's securities market. The reforms are often cast as an iconic moment of neoliberal deregulation and a key episode in the globalisation of financial markets. Such accounts stress that the state played an active role constructing the reforms and upholding the global market relations they produced, yet they remain unclear about the state's direct interest in pursuing financial market liberalisation. The article contends that domestic concerns over sovereign debt management were central to the state's pursuit of regulatory change. The Big Bang reforms greatly expanded the size and liquidity of the market for British sovereign debt. This empowered the state, improving its capacity to conduct monetary policy and to raise finance on better terms. In doing so the article demonstrates the necessity of examining sovereign debt management in order to specify the state's role in the construction of financial globalisation.

Keywords

sovereign debt management; monetary policy; Bank of England; neoliberalism; globalisation

Introduction

An important strand of political economy literature has emerged examining the issue of sovereign debt management. This previously under-investigated area has invigorated the debate about the role of the state in financial markets. Rather than question whether states have been the passive victims of rapidly expanding financial markets or have been agents facilitating their growth, focussing on sovereign debt management instead looks directly at the state-market nexus and how state and non-state institutions combine in the task of policymaking. This article contributes to this nascent literature by revisiting the iconic 1986 'Big Bang' deregulation of the City of London. By drawing upon historical material about the drivers and impact of the Big Bang, it proposes that domestic concerns over sovereign debt management and its impact on broader monetary policy were central to its design. In doing so it captures the direct interest the state had in pursuing regulatory change.

This counters the common depiction about the Big Bang in both popular and academic literature. The reforms are often presented as an iconic moment in the globalisation of financial markets, marked by anniversary newspaper commemorations (for example Guthrie, 2013; Economist 1996). Reflecting both the political commentary of the time, and the broader significance of the 1980s as a reformist decade, many political economy writers present the Big Bang as a local product of global competition (Baker, 1999). Driven by competitive pressure from New York in particular, critical writers like Helleiner (1995) and Green (2016) show how the state led the changes, pursuing a 'liberalisation' of restrictive rules that had governed the securities market, and instilling a competitive order instead. Institutionalist literature on the case, meanwhile, illustrates how liberalisation was part of the broader transformation of the British state that was becoming more 'pro-competition' and prepared to adapt its regulatory structure to instil and stabilise that new competitive order (Moran, 1990; Vogel, 1996). These accounts *note* the role of the state in the Big Bang, yet they do not capture its direct interest and direct stake in the reforms. At most the state is acting to support the City.

I instead argue that domestic state interests were central to the Big Bang reforms. The London Stock Exchange (hereafter 'the Exchange') is the principle place where the state secured long-term finance, and in the two decades leading up to the reforms, policymakers were becoming increasingly frustrated by the inability of the small and lightly-capitalised firms on the Exchange to underwrite the state's increasingly large debt issues. It left the Bank of England (hereafter 'the Bank') having to absorb its own issues, creating excessive liquidity in the financial system. The result of which meant that the operation of debt management was too often contradicting the aims of monetary policy which at the time was dedicated to squeezing credit creation. By changing the rules on membership and trading in Exchange, the Big Bang worked to greatly expand the size and liquidity of the market for British sovereign debt, the gilt-edged market. At the time of the reforms gilt sales accounted for a significant proportion of all deals traded on the Exchange, making up 20 per cent of its revenue (Reid, 1988: 26), and the reforms allowed international financial conglomerates to underwrite far bigger gilt issues than was the case under the old system (Bank of England, 1989).

By recasting the Big Bang in terms of the management of sovereign debt, I offer a way to bring the state's interest into the centre of the account. This not only offers a new perspective on financial globalisation but also speaks to the growing interest in financial statecraft and the impact of sovereign debt in the contemporary global political economy (Streeck, 2014; Livne and Yonay, 2016; Dyson, 2014; Di Muzio, 2016; Hager, 2016; Trampusch, 2015). Often this literature risks casting the state as a passive recipient of creditor agendas when it raises public finance, but as I show through the example of the British state and the Big Bang, global financial markets also present opportunities for states to shape and improve the terms by which they obtain finance. This necessitates an examination of the place of sovereign debt securities in the financial system and the mechanisms through which domestic policy decisions come to affect the workings of global financial markets. In doing so I demonstrate the importance of the internal factors driving the British state's pursuit of regulatory change in London's securities market, and offer a perspective on the politics of public debt by showing how sovereign debt management links to broader questions of economic governance and the continued capacity of the state to shape economic life at a time of globalised financial markets.

The paper is divided into four sections. I begin by analysing how existing accounts of the Big Bang stress the importance of global competition in driving the reforms while underplaying the impact on debt management. In the second section, I examine the place of sovereign debt securities in the financial system to show how deeply embroiled state debt is in the operation of broader economic governance. I then examine the place of the gilt market in British capitalism and the struggle the monetary authorities had maintaining gilt liquidity through the 1960s and 1970s. I show how constant attempts at intervention by the Bank eventually ran up against the mechanism for selling gilts itself, which resulted in the demand for reform of the Exchange. Finally, I show how the Big Bang reconfigured the gilt market to enhance the government's capacity to raise finance and use monetary policy to intervene in the economy.

Saving the City or saving the state?

The debate over the globalisation of financial markets has focussed on two main questions. First, the extent to which competitive pressure forced the state to deregulate financial markets, and second, the extent to which political and social institutions can still play a role shaping global financial market relations. The Big Bang reform of the City's securities market in 1986 is widely recognised in academic (Baker, 1999; Cerny, 1991;

Hall, 2009) and popular (Economist, 1996; Guthrie, 2013) literature as a key episode in the globalisation of financial markets. At the time the governing Conservative party, led by Margaret Thatcher, explained the changes as necessary to uphold the City's place as a financial centre and was keen to present the reforms as "a showpiece for Government policy on deregulation and increased competition" (PREM19/1718 f81, TNA). This account focussed on the external drivers of change, arguing that London faced new competition from all over the world which meant that without significant reform the City would become a financial backwater. It seemed to fit the broader historical moment where global financial markets were apparently overwhelming domestic autonomy, and many commentators – both at the time and since – depict the Big Bang in these terms. Philip Augar (2000), for example, suggests that the Big Bang was driven by the worry that British financial houses would not be capable of competing with international investment banks in the market for corporate equities, and an in increasingly footloose, global capital market, investors would simply take their business to where terms were most favourable. This external pressure was facilitated by another important change in the character of financial markets that came through the growth of institutional investors. Where once the sellers of securities could dictate terms, large institutional investors now gave market power to the buyer (Laurence, 1996; Sobel, 1994). Charles Goodhart (1987: 7), the Bank economist who would later serve on its Monetary Policy Committee, summarises this perspective on the Big Bang with his argument that "all UK financial operations were subject to international competition, so change was necessary".

Yet as Andrew Sobel points out such outside-in explanations that stress American competition as necessitating reform are misleading. He argues overseas demand did not increase dramatically after the changes (Sobel, 1994: 96). Moreover, the actual fact of the matter was that the City was thriving in the lead up to the Big Bang, and had been since the mid 1970s (Plender, 1986: 42). The presence of the Euromarkets in London meant the City hosted international financial houses in an incredibly modern market (Green, 2016). Though the Euromarkets were not within the Exchange itself, they were in the City and by 1983 had deposits in the region of $1,050 billion (Burn, 2006: 16). By the 1980s, they were also developing into a potent source of corporate finance (Eurobond issues reached $150 billion in 1985 (Plender, 1986: 43)) and were populated by banks from across the developed world (Cassis and Battilossi, 2002). Even popular commentators at the time recognised that the development of the Euromarkets was a 'Bigger Bang' than the 1986 reforms (Congdon, 1986). While the Exchange may have shrunk in the face of new international competition, there was never a question of the City more broadly becoming a financial backwater (Plender, 1986). As even Thatcherite commentator Tim Congdon (1986) put it on the eve of the reforms: "Today [the City] is the hub of a new and vast capital market without rival anywhere. It is surely preposterous to describe the City as 'uncompetitive'."

Another important challenge to the 'competitive market pressure' account is that the instigator for reform was not a pro-market ideologue like Thatcher, nor newly dominant domestic market players like the institutional investors as Laurence (1996) and Sobel (1994) suggest. Rather, it was the previous Labour government (Webb, 1987). It made the initial move when it launched an Office of Fair Trading (hereafter 'OFT') case in an effort to clamp down on City corruption. The OFT referred the Exchange to the Restrictive Practices court in 1978 and the case was only dropped when Thatcher came to office and her government pushed for alternative reforms in financial services, all of which were designed more by government bodies - the Treasury, the Department for Trade and Industry, and the Bank - than by private sector players (Vogel, 1996).

These factors demand a reassessment of the dominant claim that regulatory change can be understood simply in terms of the necessity to save the City that was facing external competition. Clearly there was more at stake. It is on this ground that critical political economy literature has found an opening. A key purpose of political economy literature is to correct the end-of-history triumphalism of commentators who saw in financial globalisation an inevitable subjugation of political and social institutions to market forces.

In the case of the Big Bang, this literature has been crucial in demonstrating the ways in which the creation of liberalised securities market depended on the decisions of particular policymakers, and illustrating how the success and stability of the liberalised market relied on political and regulatory institutions. Phillip Cerny, for example, argues that drive to "impose market oriented rules" on the City was necessarily accompanied by a plethora of regulation through the subsequent Financial Services Act of 1986 that was "far more complex [than] the previous cosy self-regulatory regime" (Cerny, 1991: 177).

Moran (1990; 2003; 2006) explains how the Big Bang was part of the transformation of the British regulatory state led by Thatcher to better prime Britain's economic institutions for the new pressure of international competition. As he argued, the Big Bang revolutionised the old self-regulated system, putting in place a more codified, formal arrangement. Previously members of the Exchange were protected from competition between each other (through fixed commissions) and from outside (through membership rules) but these were undone by the reforms and London's financial houses were forced to compete with firms from abroad.

What is useful about both Cerny and Moran's accounts, and also that of Steven Vogel (1996), who examined the new regulatory "rules" that accompanied "freer markets", is that their attempt to bring the institutions back in to the story of financial globalisation necessitated a recasting of key assumptions. For example, they stress that the reforms were initially resisted by the City's financial houses (Vogel, 1996: 107). These small, specialist firms knew they would never survive the exposure to global rivals and in that sense, financial globalisation could never be cast in too straightforward a way as a triumph of 'financial interests' as some Marx-inflected scholars describe (for example Duménil and Lévy, 2004).

Yet throughout this work there remains an ambiguity over how to conceptualise the interest of the state in the reforms. Symptomatic of some of the broader political economy literature on the role of the state in financial deregulation, state actors are presented as constructing liberal financial regimes because they were persuaded by "power of financial ideas" that had blossomed in the wake of the 1970s crises. By this account the belief that liberal markets were the optimum form of managing macroeconomic governance prompted the US and Britain to lead the way in liberalising their markets, including both countries' stock exchanges (Blyth, 2003: 241). Yet such accounts depict state agency in curiously stunted terms. State actors are crucial in *facilitating* deregulation and creating market rule (Helleiner, 1995) but make little difference to how global financial markets work once established.

It is here where literature investigating how states mobilise markets for particular policy aims is so crucial. Konings (2007, 2009), for example, examines how state and non-state institutions have combined to give the US government an "infrastructural power" within a private financial "empire" made in its own image. He point out how, even in moments of crisis, US financial assets are still seen by global investors as safe-haven securities, granting the state a flexibility not afforded to others. Similarly, there is an established literature on financial statecraft that looks at how states use financial and monetary policies, like reserve accumulation or regional currency promotion, for foreign policy aims and to shape the broader, structural economic conditions in which they operate (Armijo and Katada, 2015). This work, though, focuses on the way states shape their external economic environment. For examining how state and non-state institutions combine in the pursuit of *domestic* macroeconomic governance, the literature on sovereign debt management provides fertile ground. As Fastenrath et al (2017: 274) describe this implies examining not just the actual level of debt but instead exploring "how and from whom governments borrow money" and "the manipulation of its structural composition".

Given that one of the state's most crucial tasks of economic management is securing the public finances, sovereign debt management is a crucial area of inquiry. Within this, Daniella Gabor's (2016) work has shown the deep material interdependence between private financial institutions and sovereign states in the working of global finance. In managing the public finances, the British state draws on an assemblage of public and private institutions, of which the Exchange is one of the most important. It is the primary place where the state secures long-term finance, intimately tying the operation of the Exchange to government interests. For this reason, sovereign debt management is not a cold, technocratic issue. It has implications for economic governance as a whole and is embroiled with issues of monetary policy and macroeconomic stability.

In my account, it is clear that state action takes place through an amalgamation of institutions, both public and private. In that sense, I does not subscribe to a "unitary vision of the state" (Copley, 2017: 6), the state is nether wholly autonomous nor entirely functional to other forces. Rather, my focus on state *capacity* comes from a recognition of the difficulty state actors have in turning policy into practice. The gap, which is filled by a network of public and private institutions, means that whatever intentions policymakers may have, translating these into the desired outcomes is never straightforward. Indeed, one of the reasons for examining the expansion of financial markets through the lens of sovereign debt management is precisely that it necessitates breaking with the vision of the state as a static entity.

It is my contention that to capture the importance of the state's role in the reforms, and the *direct stake* it had in the changes, we must shift the gaze away from the pressure of external competitive forces and instead look at the domestic drivers, specifically by examining the effects the Big Bang had on the mechanism and terms by which the government manages sovereign debt. As I have mentioned, the structure of the Exchange had been a matter of debate for years before the reforms were finally announced. Not only was there the OFT case but more broadly, following the economic instabilities of the 1970s, there was debate over what impacts raising public sector debt had on the broader economy. Put simply, the effort to squeeze credit creation in the private sector and the inflation it was thought to bring, contradicted with the effort to secure long-term sovereign debt on favourable terms. It is only from a historical vantage point, that places the operation of debt management at the centre of the story of postwar macroeconomic policy, that it becomes possible to grasp the domestic drivers of the 1986 Big Bang. As such, in what follows, I track the role of sovereign debt in Britain's postwar political economy and the growing contradiction between the state's monetary policy objectives on the one hand, and the operation of debt management on the other by the time of the Big Bang. In doing so I substantiate my claim that if political economy literature is to capture the role the state plays in imposing and upholding global financial relations, it must make sovereign debt management a central part of its analysis.

The problem of sovereign debt in the postwar financial system

"Debt management has become a major problem of policy" - Radcliffe report, 1959.

The management of public finance is a crucial domain in which state institutions engage with private market actors. Raising sovereign debt requires a state to issue a range of different financial securities to private investors, a process that in Britain - as I show - involves both public and private institutions. Moreover, because sovereign debt is used by private banks as a basis of credit, it is central to the operations of private actors. For that reason, sovereign debt has long been a fertile medium of state intervention into the private economy, vital to monetary policy and, ultimately, state power. As I argued above, a focus on sovereign debt management provides a powerful lens through which to analyse the state's continued role in globalised financial markets. By considering the process by which sovereign debt is raised and the way sovereign debt securities fit into the private banking system, an important aspect of state agency is opened up for consideration. When the Big Bang financial reforms are considered in this light it becomes possible to see what precise effect financial reform had on the state's capacity for economic governance in a context of globalised financial markets.

In Britain, the management of sovereign debt has been an important part of economic governance since the seventeenth century Financial Revolution and the establishment of the Bank of England (Brewer, 1990). Though more sophisticated techniques to issue debt and use debt securities to guide economic activity began to develop in the nineteenth century, as the Bank of England secured a monopoly on banknote issuance (Knafo, 2013), it was in the twentieth century that the management of sovereign debt became integral to the functioning of British capitalism. The two world wars, and the Keynesian period that followed, grew the national debt substantially and changed its role in broader macroeconomic policymaking. In brute quantitative terms the first world war pushed the national debt to £7.41 billion, the second to £21.4 billion, and over the postwar years, the national debt increased even further, standing at £95.3 billion by 1980 (Nield, 2012)[1]. Qualitatively, through Keynesian techniques of macroeconomic management allied to the wartime apparatus of planned national economic industries, sovereign debt was integral to government policy. For that reason, debt management was a significant concern for Britain's monetary authorities throughout the postwar period

[1] As a proportion of GDP the national debt stood at 127% in 1919, 225% in 1945 and 43% in 1980 (Nield, 2012). The fall was driven by the rapid expansion in economic growth during the three decades after the war, and inflation. Yet given its importance to this growth, the gross level of debt and the management it necessitated must be considered.

(Allen, 2014). Indeed, one of Clement Attlee's first moves as peacetime prime minister in 1945 was to establish a National Debt Enquiry Commission to examine how government could ensure its financing remained stable and what this would imply for monetary policy (Tily, 2010).

As indicated above, the reason why debt management is of such concern to policymakers is because of the way public financial securities connect to the broader banking system affecting both fiscal and monetary policy objectives (Gabor, 2016; Preunkert, 2017). After the war, the responsibility of managing the state's finances - including the control of the way a substantial proportion of sovereign debt was raised - was given to the newly nationalised Bank of England. This was in part a recognition of how deeply intertwined state authority had become with the central bank and it is telling that both the 1959 Radcliffe Committee and 1980 Wilson Committee reports into Britain's financial sector used the term 'monetary authorities' when describing the regulatory apparatus in British finance. The state and nationalised central bank had shared responsibility in managing British finance until the first moves towards Bank independence emerged with Britain's ignominious exit from the European Exchange Rate Mechanism in 1992 (Cukierman, 2008: 726).

The majority of sovereign debt was raised in two ways. First, the Bank could issue long-term securities, called 'gilts'. Gilts were sold at tender but underwritten by the Issue Department at the Bank, which as a result was the main buyer at tender. It would then sell the majority of the gilts to external dealers on the secondary market on 'tap' at a set price (Allen, 2014). These secondary market transactions were crucial and took place exclusively through the Exchange at the behest of the Bank and through the Government

Broker, Mullens, who had held the role for over a century (Thomas, 1986). The Bank was prevented from dealing directly on the Exchange because that was a privilege only open to members of which it was not. For that reason, the Exchange was the main site upon which sovereign debt securities were sold to non-state investors. The second way in which the state raised debt was by the Treasury issuing short-term securities, called Treasury Bills, directly to the banking system (Allen, 2014). The part of the debt raised by selling gilts, bought by investors, was often called the 'funded' part of the national debt, while the debt financed through Treasury Bills, issued directly to the banking system, was referred to as the unfunded, or 'floating' debt (Wadsworth, 2013: 60). Crudely, gilts could be considered like the state's mortgage debt, while Treasury Bills could be considered its overdraft.

The difference mattered because Treasury Bills were accepted as a reserve asset in private banks, which meant that the greater the number of Treasury Bills in circulation, the greater the stock of loanable funds which the banks had available to advance as credit to private borrowers (Allen, 2015). For this reason, banks were always happy to take on Treasury Bills, often at yields lower than longer-term gilts (Allen, 2015). This was to become very important because when the British state attempted to curtail bank lending, it would try to fund its debt more through gilts than Treasury Bills. This was because issuing Treasury Bills, a reserve asset, added to stock of loanable funds in the banking sector, while issuing gilts, on the other hand, removed liquidity from the banking system, because investors (be they banks, institutional investors or companies), would buy them with cash (Allen, 2014).

The complicating factor, however, was that after the war, it was Bank practice to intervene in the gilt market by buying and selling its own issues in order to maintain price stability in gilts, which it felt was crucial to the stable financing of sovereign debt. Buying its *own* gilts from the banking system, however, meant releasing liquidity into the economy, because in effect it swapped private banks' holdings of a long-term debt security (gilts) for cash. As a result, there was often a tension between the objectives of debt management and those of monetary policy. As Conservative chancellor Rab Buttler found in the 1950s, and Edward Heath found again in the 1970s, the ability of the state to govern the economy through active monetary policy often contradicted with concerns over how to fund the national debt (Allen, 2012). This conflict came to a head in the 1980s when both the Conservative government and especially the Bank, felt that the only way stability could be ensured was by fundamentally changing the way gilts were sold (Bank of England, 1984b). By then the general problem of ensuring stability in the gilt market ran up against the architecture of the market itself.

Put simply, the firms involved in underwriting and selling gilts on the secondary market in the Exchange were too small and too limited in their base of customers (Wilson Committee, 1980). It meant that in comparison with competitor countries, the British gilt market was tiny. While the US Treasury-bill and bond market turned over $24 trillion in 1986, and Japan $21 trillion in government securities, there was just $630 billion worth of deals in British gilts (Reid, 1988: 106). This was in large part because until 1986 the jobbing role was dominated by two firms, Wedd Durlarcher and Akroyd & Smithers. Between them they held an estimated 80 per cent of the dealing market (Kerr, 1986), and they sold predominantly to British institutional investors with whom they already enjoyed longstanding relationships. The limitations of this arrangement frustrated the Bank especially, because without a large private underwriting market, the Bank itself had to be the main “market maker of last resort” in its own securities (Allen, 2015: 2), which both affected the ability to enact tighter monetary policy (for the reasons outlined above) but also curtailed the size of the gilt market. They wanted private jobbing firms to absorb much larger issues on their books (Bank of England, 1984b) in the hope of creating a market “more robust” and that “the changes would also bring the market more into line with similar structures overseas” (Bank of England Archives (G4/211), ‘Minutes of the Court of Directors’, 1984, 112). Yet this was impossible for the domestic, small-scale specialist British houses who simply lacked the capacity to take on big gilt issues (Plender, 1986). To be more like the Federal Reserve there would need to be a major overhaul of the dealing mechanism with a much larger capital base and a willingness to take large inventory positions (Thomas, 1986: 68). The Big Bang reforms did precisely this, and in doing so *trebled the size of the market for gilts* (Reid, 1988: 108). As William Allen, who worked at the Bank from 1972 to 2003 and is now at Cass Business School, argued, the reforms helped move debt management from the centre of monetary policymaking to the margins. “New issuing techniques and new capital markets since the 1980s,” he wrote, “have all helped to reduce concerns about how the quantity of debt impinges on monetary control, to the point where the two issues could now be seen as almost distinct” (Allen, 2012: 16).

In what follows I substantiate this claim by delving into the history of the gilt market with the intention that a historical perspective on the development of financial policymaking in Britain in the lead up to 1986 will shed light on both the Big Bang itself and the politics of financial reform more broadly. By revisiting historical sources – such as Bank of England reports and commentary from the time - that are frequently neglected in contemporary debates about financial globalisation and the state, I re-align our understanding of the Big Bang with established facts. When these are taken into account, the reforms and their broader attachment to our conception of financial globalisation are profoundly changed.

Instability and intervention in the gilt market: 1960-1986

The path to the Big Bang reforms looks very different when posed from the perspective of sovereign debt management and its relation to broader macroeconomic policymaking. Rather than doubtful claims about the necessity of upholding the City's place as a centre of global finance, the reforms mattered because they transformed the operation of debt management and monetary policy and the interaction between the two. As I show, the Big Bang provided a longed-for solution to the problem of combining attempts at monetary control with stable debt management. These were issues that grew in importance in the two decades preceding the Big Bang.

Sovereign debt management and 'monetary control'

The 1967 devaluation of sterling brought about the first concerted effort in Britain to actively control credit creation, which as a result, was to have a profound effect on the operation of sovereign debt management. It provides a useful starting point for a reassessment of the history of the Big Bang reforms. In an effort to solve the balance of payments problem that had dogged the British economy throughout the postwar years, Harold Wilson's Labour government hoped to jump-start Britain's export industries by cheapening sterling (Cairncross, 1995). Devaluation, however, came with consequences. To reassure gilt investors, whose holdings had just fallen in value, the Bank Rate was raised from 6.5 to 8 per cent (Needham, 2014: 23). Despite that, with foreign currency reserves already strained and confidence in sterling shaken, Wilson needed a £1.4 billion IMF loan to back the currency (Needham, 2014). IMF support only came with the condition that Britain would limit domestic credit expansion (Clift and Tomlinson, 2012), a measurement of the money banks lent to customers, which they felt drove the inflation and the excessive imports that were the root of Britain's currency problems (Goodhart, 2014). Though the IMF wanted a £500 million a year ceiling (Clift and Tomlinson, 2012), Britain's monetary authorities rightly pointed out that a fixed limit was not feasible in the British financial system where borrowers preferred overdrafts to more long-term and predictable bank credit, and could always access finance from secondary, unregulated banks anyway (Einzig, 1971). Wilson's government fought off direct IMF conditions, but the desire to actively control credit expansion soon spread.

This was to have a profound effect on the gilt market and sovereign debt management because a key issue with trying to control credit expansion was the size of the national debt (Allen, 2014). To squeeze credit creation, the monetary authorities thought it necessary to fund the national debt more through long-term gilts than by borrowing directly from the banking system through issuing Treasury Bills, since the latter implied an expansion in credit that the monetary authorities were explicitly trying to control. Though other instruments existed (such as national savings), gilts were the Bank's primary mode of meeting its key remit: the stability of government financing. At the time, the monetary authorities felt this stability stemmed from gilts remaining highly marketable (Needham, 2014).

This is because the long-term investors who bought gilts, like the pension and insurance funds that had grown substantially since the 1950s, bought them primarily as a safe store of long-term value (Goodhart, 2014). Yet long-term investing did not actually mean holding gilts until maturity, but rather constantly updating an investment portfolio by selling gilts on before the cash dividend became available and 'switching' to a new gilt (Thomas, 1986). The problem for the monetary authorities was that they could never be sure that a market for switching in this way would exist. The Bank was particularly doubtful because it was convinced gilts were inherently unstable and "driven by 'extrapolative expectations' where 'higher interest rates would create the expectation of yet higher rates", and vice versa (Needham, 2014: 17), and undermine the stability of the gilt switching market as a result. To compensate, the Bank acted to continually influence and stabilise gilt prices, precisely because it saw volatility as being hard-wired into the market and a threat to stable government financing.

By virtue of the arrangement where the Issue Department was the main initial buyer of gilts, the Bank was able to intervene by buying back gilts from external investors on the secondary market to facilitate 'switching' (Thomas, 1986). Despite the long-term nature of both gilts and, in general, gilt investors, liquidity was therefore an important criterion. Though the Bank was the primary dealer it was still imperative for government financing that secondary market jobbers had the capacity to buy and sell large quantities easily, which is why the Bank also acted as a buyer of last resort (Allen, 2015). This key line of support allowed jobbers to meet investors' constant demands (for switching maturities, interest rates and so on) and was something the Bank felt broadened the market and made gilts more attractive to investors (Thomas, 1986). The Bank's interventions to facilitate 'switching' also gave it a capacity to influence prices. If the Bank felt investor confidence was weak, it would buy up a load of gilts and edge prices up. In turn, when the market was strong, it would try to sell more gilts to edge prices down. Any gilts issued, but not required by investors, were taken back by the Bank's Issue Department for later sale (Thomas, 1986).

It was a system that worked smoothly as long as new issues were infrequent and price levels reasonably stable, and it was the handle through which the state had the capacity to manage its own debt without resorting to what the Bank described as a less preferable option of more "arbitrary and capricious intervention" that could "alienate the larger investor from the market" (in Thomas, 1986: 61).

Yet the 1967 sterling devaluation, and accompanying IMF call to curtail credit expansion, put this arrangement under scrutiny. This was because when the monetary authorities acted to stabilise *prices* in the gilt market in the way described above, they lost control of the money *supply*. If, for example, the Bank 'leant into the wind' to edge prices up it would buy gilts, in cash, from the private bank and non-bank holders, which meant increasing the private banks' reserves of loanable funds and thus allowing credit creation (Goodhart, 2014). Such an arrangement would be fine if the monetary authorities could be sure the larger reserves of loanable funds would not translate into more lending. But they were not, because though they had direct controls over the amount of credit the clearing bank cartel could advance, they had no control over the unregulated secondary banks (Reid, 2003). As such by the late 1960s, with inflation beginning to climb, the monetary authorities faced a major problem. They could either control the money supply by withdrawing gilt market support, and risk volatility with the potential of a public financing crisis. Or lose control of the money supply and let unregulated secondary banks lend unchecked, and risk spiralling inflation. In that sense, though other countries like France had significant public debt burdens (Lemoine, 2016), it was the emerging emphasis on monetary control in Britain that put particular pressure on the mechanism of sovereign debt management.

If the national debt was smaller, gilt market volatility would scarcely matter. But by the late 1960s it was pivotal. And given the Bank's belief that gilt prices were inherently unpredictable, the Bank felt it had no option but to support the market (Hotson, 2010). Active monetary policy needed the Bank to let go of its belief that gilt market intervention was a necessity.

In the summer of 1970 a solution was thought to have been found. Michael Hamburger, who was on a secondment at the Bank from the New York Reserve, published research showing that gilt market volatility was better explained by external factors - Euromarkets, expected inflation, dollar-sterling relations - than the support, or lack thereof, from the Bank (Needham, 2014). It hardly seems a major moment but the change in perspective had enormous consequences. It finally freed the Bank of its perceived responsibility to intervene in the gilt market and meant that in the June 1970 Quarterly Bulletin the Bank announced it was ready to "unleash 'the interest rate weapon' that [the] Radcliffe [report] had specifically warned against" (Needham, 2014: 34).

As a result, in 1971 Edward Heath launched the Competition and Credit Control (hereafter 'CCC') policy. It was one of the most significant monetary experiments in contemporary British history, which made monetary targeting, through the use of variable interest rates, the centre of macroeconomic management for the first time. What this historical perspective on sovereign debt management already demonstrates is that public financial securities interact with the private financial sector in such a way that it affects the broader design and implementation of monetary policy.

Competition and (no) credit control: Pressure on the gilt market

The CCC policy entailed abandoning the previous direct quantitative limits on clearing bank advances, which the unregulated secondary banks circumvented anyway, and moving instead to a system where the general level of credit creation would be controlled through variations in the Bank Rate. This had immediate effects on sovereign debt management because it made the gilt prices more unstable and, as a result, demand less reliable. This was because the monetary authorities' gilt operations would no longer be directed at stabilising price, but instead was about trying to vary interest rates in order to curtail the supply of money. This it did partly by selling gilts to private banks, who paid for them in cash, which meant the stock of liquid assets fell, which in turn increased the general rate of interest. This arrangement implied less Bank of England support for gilt prices and more stringent terms for the jobbers who dealt in the market. The Bank no longer guaranteed to buy stock outright (except those gilts with a maturity of under a year) and instead would only buy stock at prices of its choosing (Thomas, 1986). Before this the large investors could sell back to the Bank – through the jobbers – at near market prices because the monetary authorities were committed to keeping market prices stable

(Thomas, 1986).

While the old arrangement allowed investors to ‘switch’ easily, the new emphasis on monetary control meant this was curtailed. The effect was much greater short-term fluctuations in gilt prices which threatened the marketability of gilts that was deemed so important to the stable financing of the national debt. Insiders at the time like Anthony Coleby (quoted in Lombard Street Research, 2006: 5), head of the gilt-edged division at the Bank, recall the impact CCC had:

> “When, in 1971, the Bank resolved to change its earlier practice of routinely supporting the market by buying stock in at close to prevailing market prices, it recognised that that could create a problem for the ability of the gilt-edged jobbers to maintain their market-making function.”

Though the Bank had been convinced that factors outside its control drove gilt volatility, these volatile effects made it reluctant to abandon the gilt market entirely. The primary responsibility of the Bank, after all, was to ensure stability of government financing. As such, the monetary authorities clearly needed to find new ways to support the market if monetary policy was to work along CCC lines. This was becoming increasingly important because it was around this time – the mid 1970s – that inflation made gilts less attractive (Thomas, 1986: 64), and low growth made the government's borrowing requirements really expand. Adding further volatility was the fact that CCC proved a massive failure on its own terms (Davies, 2012). In the lead up to the policy, the monetary authorities had been convinced that interest rates alone could be used to curtail expansion of credit creation, and this persuaded them to remove the quantitative limits on bank advances that were previously in place (Burnham, 2011). It was a significant miscalculation, as the broad sterling money supply (£M3) shot up 20 per cent while bank borrowing, and subsequent inflation and spending on imports, boomed (Needham, 2014:

52). CCC was abandoned in 1973 but not before the 1972 Budget raised the estimated PSBR for 1972/3 to a record £3.35 billion (Needham, 2014: 52), which again placed an enormous strain on the gilt market. All the while inflation was climbing (between 1970-78 it ranged from 7.5 to 27 per cent (Rogers and Sedghi, 2013)) which heightened the problems the monetary authorities faced trying to ensure smooth gilt sales. In response, the Bank experimented with new gilt products in the hope they would be more attractive to investors. These included issuing gilts on a partly paid basis; issuing convertible stock (in 1973); and issuing variable-rate stock (in 1977) (Thomas, 1986). To overcome the uncertainty created around expected future rates of inflation, the Bank introduced index-linked stocks in 1981, insuring investors against inflationary shocks.

Though the Bank created all kinds of new products and intervention strategies to stabilise the gilt market, they were piecemeal and insufficient in the face of climbing national indebtedness and inflationary worry. As Nigel Althaus, the head of the government broker, Mullens, later put it (quoted in Lombard Street Research, 2006: 3): "The monetary control period put huge pressure on gilt-edged sales, such that they became the most important workman of economic control, which the old market was not designed to be or to do."

As such the monetary authorities' twin objectives of ensuring monetary control and government financing were at this stage working against each other and the CCC policy had only worsened the problem. It is this dynamic that the state was looking to overcome leading into the 1980s, pushing it towards the significant shift in sovereign debt management that took place through the Big Bang.

The roots of the Big Bang reform

The volatility in the market that emerged with the CCC reforms meant that by the time Thatcher came to power the gilt market was no longer fit for purpose. The Wilson Committee report into the financial system, published a year after she took office, outlined how, while the monetary authorities could be confident that the existing gilt market structure would cope when general market conditions were favourable, prospects for gilt sales in harsher conditions were much less certain. The early 1980s especially was a difficult time of low growth and high inflation, and as such the authorities were unsure investors would subscribe to new gilt issues and were fearful of a looming crisis in government financing (Wilson Committee, 1980).

The report argued that much of this tension could be resolved by ensuring much bigger gilt issues, but as I mentioned in the previous section, this was limited by the relatively small size and tiny capitalisation of the jobber firms that arranged gilt sales on the Exchange. The inability of the private sector to underwrite large issues had direct implications for dynamic between sovereign debt management and monetary control because gilts that went unsold were bought by the Bank itself. Formally this involved them entering the Bank’s balance sheet (through the Issue Department), in exchange for Treasury Bills. This left the Bank’s overall asset size unchanged (Goodhart, 2012: 124) but swelled the number of Treasury Bills in the financial system, driving credit creation at precisely the time Thatcher’s regime had committed to bringing it down. The authorities were in a bind of trying to meet seemingly contradictory objectives. At once they wanted to achieve three aims: control the money supply, fund a growing national debt, and maintain liquidity in the gilt market.

The solution that was really needed was a fundamental overhaul of the mechanism through which gilts were sold. It was thought that moving to an auction system for gilt sales could resolve some of the tensions. Yet as Coleby later outlined (quoted in Lombard Street Research, 2006: 8), this would require substantial reform. "The most coherent alternative to our existing way of operating," he said, "was to move to a system based on the auction technique, but that would not have provided a quick fix because it needed to be set up as a comprehensive programme."

Under the old arrangement gilts were issued on both the primary and secondary market at prices set by the Bank, with investors dictating yields. Under a possible auction system, the Bank would announce its intention to issue a certain volume of securities to be taken up on a particular date (or over a given period), and investors would determine both the price and yield at which they were prepared to buy them (Wilson Committee, 1980). Provided private sector jobbers were sufficiently capitalised to absorb them, the Bank would be able to make much larger issues, for example six months' worth of gilts at a time. This would ensure smooth sales, in the sense that a price would always be found to sell all the gilts.

By the early 1980s there was a general acceptance that moving to an auction system, based on large private sector underwriting, was a preferable system for selling gilts. The main difficulty remained the structure of the market itself which was still dominated by small British financial houses who lacked the capacity to make an auction system successful. As Coleby later summarised (quoted in Lombard Street Research, 2006: 7): "My judgment, which was widely shared in the Bank, was that we did not have a compatible structure… the [feature being] an absence of a body of strong, wellcapitalised, market-making intermediaries who were the core players in an… auction method.”

When it finally came to it, the resolution came not directly from the Bank itself but actually as a result of the City’s opponents in the Labour party who had grown tired of the corruption and insider trading scandals that had blighted the City in the 1970s. Though the economy at large was suffering from the global economic slowdown of the 1970s - and would ultimately lead to the Labour party’s expulsion from government - the City itself was booming. The fact the City could prosper seemingly independently of the rest of the nation was something that frustrated Labour MPs and, as such, when the City was beset by a raft of scandals, the government was keen to force through reform. This meant that at just the time when the Bank was first trying to find ways to better manage the tensions on the gilt market, the Labour government instigated the OFT case against the Exchange (Kandiah, 1999). The body’s officers had visited regulators in America and Canada and found they were able to draw on an electronic audit trail that could never have happened under the structure of London’s Exchange (Kandiah, 1999).

As such, there was pressure on Thatcher to do *something* about the City when she took power in 1979, and that was only heightened by both the Gower Report into investor protection which was commissioned in 1981 (Sobel, 1994), and also the Wilson report that stated how the Exchange could not continue in its current form. Importantly for Thatcher, the Wilson report also insisted that OFT action was not the best solution to the City’s problems, and the Conservative government was only too happy to oblige and drop the OFT case. Instead, Thatcher and her trade and industry secretary Cecil Parkinson, bargained for a promise to open up the Exchange, and this created the space to overhaul the market in the way any move to an auction system would require. In July 1983 it was announced in the House of Commons that the jobber-broker split would not continue, and in April 1984 the full details of the changes to be made to the Exchange were announced in its Discussion Paper.

"The Stock Exchange has... clear objectives in designing and developing a new market structure," wrote the Discussion Paper (London Stock Exchange, 1984: 8). "The system of dealing must aim for the best possible level of liquidity or depth of market and wherever possible to provide continuous two-way trading" (London Stock Exchange, 1984: 8). To achieve this there were four commitments laid out: first, a deeply capitalised market system to ensure liquidity; second, admission of outside houses; third, a system that served large and small investors - wholesale and retail; fourth, the gilt market remaining an integral part of the Exchange.

Given the monetary authorities' frustration with the lack of capitalisation of British houses, and the plan to open up the Exchange to foreign firms, it was clear to people organising the reforms that there would follow a great period of instability. At the time Conservative chancellor Nigel Lawson correctly foresaw that "[t]here would be strong pressures on British-owned businesses from American and Japanese competition" (Pickard and Thompson, 2014). Once the Discussion Paper set out the changes and date for the Big Bang there was a flurry of merger and acquisition activity as financial houses tried to prepare for the inevitable onslaught that Lawson was eluding to. Banks that had previously had very little experience of both sides of securities dealing (jobbing and brokering) joined together, with brokers especially gaining enormously. In the buyout boom that occurred between the announcement in 1984, and the implementation of the changes in 1986, 750 millionaires were created as old, partnership firms were paid off in deals where selling prices vastly outstretched the real worth of the firms' equity (Augar, 2000: 81). This story of mass buyouts and the introduction of American 'culture' to the London dealing rooms - alongside the new electronic trading screens - dominates memory of the reform. But often overlooked, as I will show, is the extent to which the gilt market after the Big Bang barely resembled what had gone before.

After the Big Bang

The history of how the state public finance needs and monetary policy objectives ran up against the previous mechanism for managing the sale of sovereign debt on the unreformed Exchange puts the Big Bang into a different perspective. It becomes clear that it is insufficient to assert that the reforms were about the state 'establishing the City as a financial centre' or 'forcing capital to be free' in the pursuit of neoliberal financial globalisation. Rather, the state's own interest becomes clear throughout. It needed to find ways to better manage the national debt so as to make possible an alternative monetary policy, and the Exchange was a key site where it could exercise its agency. By remaking the rules on the Exchange, the Big Bang made the operation of the gilt market substantially different and in that way empowered the British state. Previously, two jobbers dominated nearly 80 per cent of the market (Kerr, 1986). After the reforms there were 27 (Bank of England, 2013). Whereas previously British companies ruled, now American banks joined too. The effect was to deepen capitalisation in the market and widen the network of possible buyers of gilts (Bank of England, 1989), which together extended their marketability beyond recognition.

One crucial change was replacing the single-capacity system with new integrated financial houses. Previously, the brokering role for gilts was separated from the jobbing role with different firms managing each. The Big Bang worked to unite these two aspects as newly formed Gilt Edged Market Makers (hereafter 'GEMMs'). These are firms that purchase gilts directly from the Bank and sell them directly onto their own clients. In this way the trading and sales of gilts worked in a single operation (Bank of England, 1989). For the newly registered GEMMs - which now included the likes of Goldman Sachs, JP Morgan and Salomon Brothers - this meant the Bank would originate and tender a variety of different gilts and the GEMMs would fix their price by buying them at a certain rate of their choosing before selling them on (Bank of England, 1989). The direct access these GEMMs had to the Bank meant that after two hundred years there was no longer intermediation provided through the Government Broker.

Moreover, now the whole set of GEMMs were granted the technical and fiscal privileges enjoyed only by a very limited number of gilt-edged jobbers previously (Thomas, 1986: 76). Before the reforms the two big gilt jobbers had the unspoken privilege of borrowing from the Bank. In the restructured gilt market this lending facility was codified and made available to all 27 GEMMs. These GEMMs, as I mentioned, were not narrow banks specialising in gilt trading either. They were high street names and international investment houses (Bank of England, 1989). It meant that a large group of big financial houses had direct backing from the Bank. This was money that could be borrowed on a secured basis, and was available at the initiative of the GEMMs themselves when their routine sources of financing were not available. Though they rarely needed it, the implicit promise of support meant that the GEMMs were able to raise cash from other sources on better terms (Thomas, 1986: 76). It is precisely why when the plans for the reforms were announced and the Bank sent out a call for applications to become GEMMs over 50 firms initially expressed an interest. Though in the end 27 were taken on they all agreed that they would be prepared to take on larger amounts of gilts than ever before. As the Bank wrote three years later, when evaluating the "gilt-edged market since the Big Bang", "the new structure [was] successful in providing a continual and liquid market for investors and official operations" (Bank of England, 1989: 49).

The result was a massive increase in capitalisation in the market. Whereas previously the capital of the gilt-edged jobbers was estimated at around £100 million, the capital of the 27 GEMMs amounted to £595 million, and by 1989 stood at £610 million (Bank of England, 1989: 51). This large capital base is what allowed the GEMMs to absorb much larger issues of gilts, and their international client base meant finding customers proved not to be a problem. Even on other measures of liquidity the new market structure proved more sophisticated. Turnover of gilts increased from around £1 billion a day before the Big Bang to around £4 billion a day by 1989 (Bank of England, 1989: 51). This was in large part because the bigger pool of GEMMs traded with each other but there was also a big increase in customer turnover. Investors, of course, gained through the end of fixed commissions, with a reduction in wholesale costs of almost 60 per cent (Bank of England, 1989: 51). These lower costs for investors meant they were more willing to take on gilts at lower margins, cutting the spreads in half, this despite the number of deals increasing (Bank of England, 1989: 51).

These may sound like arcane intricacies when set against grand conceptual themes about the role of the state in financial globalisation, but in such empirical detail theoretical clarity lies. The great expansion in liquidity of government securities and the great swell in the size of the gilt market meant that the monetary authorities were able to construct monetary policy differently. As I outlined in the previous section, managing liquidity through variations in interest rate was ineffective previously, because debt financing through Treasury Bills only served to increase the broad money supply. After the reforms, if the Bank wanted to reduce liquidity in the financial system, it was able to sell gilts much more broadly to non-banks, and in this way "exert some control on broad money growth by absorbing from the non-bank private sector liquidity created by bank credit" (Allen, 2012: 25). The problem of having to 'lean into the wind' and manage the pace of gilt sales - which was impossible in the old system where brokers and jobbers could not underwrite government issues of gilts - was resolved by the new dealing mechanism that Bank insiders had longed for in the 1970s.

Conclusion

The Big Bang reforms of the City were an important part of the globalisation of financial markets. As this article has suggested, examining how public and private institutions are mobilised in the task of sovereign debt management provides a strong foundation for investigating how states act in financial markets. The Big Bang was not simply a case of financial market competition overwhelming state institutions and demanding regulatory reform, nor was it simply driven by the British state's desire to maintain London as an international financial centre and constructing a regulatory infrastructure to meet that aim. Rather, its lasting impact was to improve the mechanism by which the British state managed its debt. By limiting the examination of state agency to the question of regulatory apparatus, scholars neglected the way in which financial reform affected a crucial avenue for state action in the economy: the way sovereign debt securities interact with the private banking system and shape monetary and fiscal policy decisions.

The Big Bang reforms opened up membership and removing fixed commissions in the Exchange, and in doing so transformed the way the state sold government debt securities. It brought highly-capitalised, international financial houses to the Exchange, the outcome of which was to increase the turnover in the gilt market three fold (Reid, 1988: 26). At a time when the national debt, which had long been a permanent part of British capitalism, was growing and inflation and unemployment was still high, this was a crucial change. It gave the state greater capacity to raise finance more easily and, in doing so, allowed it to pursue monetary policy in a way that was impossible before. By deepening the market for government debt securities, the Bank no longer had to intervene directly in the gilt market.

The broader arguments and evidence presented in this article should prompt IPE scholars to examine the continued ways in which sovereign debt affects global financial markets, and in that light how what may appear on the surface as financial liberalisation, can also affect and enhance the state’s capacity to act in financial markets and govern the economy more broadly. In the years since the Big Bang reforms the size and liquidity of the market for British government debt has only grown, with the recent Quantitative Easing programme demonstrating the continued ways in which the Bank acts as a dealer in its own securities. That the state has the ability to do this is precisely because of changes made to the mechanism of raising and managing sovereign debt and should be a key line of inquiry for scholarship aimed at understanding the role of the state in globalised financial markets.

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