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# Futures of Europe: The City of London's Commodity Exchanges, the European Economic Community, and the Global Regulation of Futures Trading (1960s–1980s)

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Since the mid-1970s, the U.S. commodity futures exchanges have increasingly been the focus of tight government regulation, which resulted in strong control by a specific agency: the Commodity Futures Trading Commission. In Europe, the regulation of futures diverged from the U.S. model. No regulation at the communitarian level was implemented; at the national level, the United Kingdom emerged as a model of self-regulation of commodity markets. This article explores the historical causes behind this lack of regulation in Europe, placing it in the context of global commodity trading and arguing that the European regulation of futures trading was reshaped by a dialogue established between the European Commission and big players of commodity futures trading in the City of London. Since the mid-1960s, the City of London has become a pivotal global market venue for commodity futures, which has increasingly attracted players from abroad, thanks to its financial integrity and self-regulatory model. Both established London merchants and emerging players in the global trade of financial products cooperated to stave off any attempt at regulating the London futures exchanges. The inference here is that those attempts were instrumental in setting the conditions leading to the regulatory fragmentation that still characterizes futures trading in the global market.

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**Keywords:** Business-government Relations, Commodities, International Trade, International Finance

Well-informed professional speculation, by carrying supplies from periods of low to periods of high price, can partially, but only very partially, offset these fluctuations. Ill-informed and perverse speculation may accentuate the fluctuations in price.<sup>1</sup>

## Introduction

In the early 1970s, two concomitant changes reshaped the global trade of commodities. The first and most important was so-called financialization. Financialization has been defined by

1. Meade, "International Commodity Agreements," 20.

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Published online April 11, 2022

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Greta Krippner as a pattern of profit making that “occurs increasingly through financial channels rather than through trade and commodity production,”<sup>2</sup> and by Gerald Epstein as “the increasing role of financial motives, [...] markets, [...] actors, and [...] institutions.”<sup>3</sup> Recently, Jurgen Kocka stressed that the rise of financialization in the last forty years is part of the process whereby speculation overtook investments in mature capitalism.<sup>4</sup> In the field of commodity trade, financialization resulted in a growth spurt in the commodity futures trade.<sup>5</sup> Futures contracts were not a new financial tool in the 1970s: their history can be traced back to the second half of the nineteenth century, when they came to the fore as a key financial innovation in the global trade of commodities. Essentially, the trading of futures does not entail the delivery of commodities but only of the contracts representing them. By setting the price of commodities before delivery, futures aimed at hedging buyers and sellers from the risk of price fluctuations.<sup>6</sup> Even though it is often debated whether futures reduce or exacerbate price instability and speculation,<sup>7</sup> we can maintain that speculation is essential to these markets because it provides the liquidity necessary to carry out hedging operations and that, broadly speaking, it plays a key role in setting exploratory price functions.<sup>8</sup> For decades, futures were a fraction of physical trade and their turnover was stable; in the early 1970s, futures trade surpassed the physical market of many commodities. Their turnover exploded with a growth rate of about 20 percent per year, becoming the target of investors from outside the field of commodities.<sup>9</sup> The other development of some importance, which was strictly connected to the first, is found in the fact that the dramatic expansion of futures trading stimulated divergent regulatory actions. A strong governmental regulation of the commodity exchanges was put in place in the United States, thanks to the establishment in 1974 of the Commodity Futures Trading Commission (CFTC) after decades of regulatory experimentations. This did not occur in other major trading places, such as in the United Kingdom and in particular in the City of London, which was becoming a dynamic market venue for commodity futures.<sup>10</sup>

In the United States, futures trading had a long history of regulation, first put in place in the 1920s, to regulate only national commodities, like grain, potatoes, and onions. The long-term goal of U.S. regulation was to reduce the impact of speculation on the futures markets and to provide a legal framework against the abuses of big speculators, the impact of which was considered detrimental to the interests of the farmers and national agricultural businesses.<sup>11</sup> In the early 1970s, a shift occurred in the United States through the CFTC, which extended regulations to all commodities traded in the country, including imports such as cocoa, coffee,

2. Krippner, “Financialization of the American Economy,” 14.

3. Epstein, *Financialization and the World Economy*, 3.

4. Kocka, *Capitalism*, 87–88.

5. Newman, “Financialization and Changes”; Seddon, “Merchants Against the Bankers”; Bertilorenzi, “From Cartels to Futures”; Wellum, “Energizing Finance.”

6. About the economic functions of futures, see for instance, Goss, *Theory of Futures*; Stein, *Economics of Futures*; Streit, *Futures Markets*.

7. Engel, “Futures and Risk”; Levy, “Contemplating Delivery.”

8. Jacks, “Populists Versus Theorists.”

9. Simon, *Bourses de Commerce*, 136; Santos, “History of Futures Trading.”

10. Rees, *Britain’s Commodity Markets*, 176–178; Rees and Jones, “International Commodities Clearing House.”

11. Jack, “Populists Versus Theorists.”

and sugar. Up until this time, these commodities were unregulated.<sup>12</sup> In contrast to United States, the City of London's exchanges continued their self-regulation by so-called self-regulated organizations, which became the model for the entire European Economic Community (EEC).<sup>13</sup> At the EEC level, no agency was created to supervise futures markets, and since the 1970s an approach based on national regulations has prevailed over a communitarian approach. This article illustrates the rise of financialization in commodity trading and the importance of regulation, focusing on the factors that influenced the emergence of regulatory divergence. It shows that the London commodity exchanges were crucial to this outcome because they retained their self-regulation model in futures trading, even after the United Kingdom joined the EEC.

In the aftermath of the global economic crisis of 2008, scholarly studies have increasingly focused their attention on the broader theme of financial regulation, which emerged as a major feature of our current globalization after the end of the Bretton Woods era.<sup>14</sup> In the field of commodities, the lack of a consistent global regulatory framework—thus, fragmentation—has often been emphasized as a main issue for international trade.<sup>15</sup> Regulatory fragmentation was also considered a threat for global financial stability and a main source of shocks and financial crises.<sup>16</sup> Moreover, regulatory fragmentation can result in inefficient markets in which resources are not optimally allocated.<sup>17</sup> Some scholars, like Calomiris and Haber, maintained that ineffective and fragmented financial market regulation often arise from deals among regulators, politicians, and special interests.<sup>18</sup> Laffont and Tirole also shed light on the issue of regulatory capture, which is the ability of business interests to shape regulations and to impose their views on regulatory bodies.<sup>19</sup> However, aside from these macro-economic downsides, regulatory fragmentation is also central for competition between market venues. According to Gehrig, markets compete on indirect factors, such as the integrity of the underlining financial centers and especially their regulations. Divergences in terms of regulation could help one market venue to emerge over others.<sup>20</sup> As we shall see, the regulatory framework of the City's futures market has been an important factor in the competitiveness of this market venue. Although this framework existed in past decades, it was strengthened by a constant dialogue between the City's actors and the European authorities during the 1970s, a period of global regulatory experimentation.

At the European level, scholarly studies have often focused their attention on the rise of a communitarian regulation for banking and financial services. Since the mid-1960s, there has been increasing harmonization of European member-state banking legislation, cooperation of supervising authorities, and convergence of clearing methods. As shown by Mourlon-Druol,

12. Markham, *History of Commodity Futures*, 65–66.

13. Spence, *Introduction to Futures and Options*, 102–104.

14. Schenk, "Regulation of International Financial Markets"; Mourlon-Druol, "Trust Is Good, Control Is Better." See also the more recent edited volume, Drach and Cassis, *Financial Deregulation*.

15. Cottier et al. "Fragmentation and Coherence in International Trade Regulation."

16. Helleiner and Pagliari, "The End of an Era."

17. Claessens, "Fragmentation in Global Financial Markets."

18. Calomiris and Haber, *Fragile by Design*, 182–183, 296.

19. Laffont and Tirole, "Politics of Government Decision-Making."

20. Gehrig, "Competing Markets."

European institutions, through the European Commission's Directory General (DG) II (economic and financial services) or the DG XV (financial institutions), started processes of harmonization with the goal of encouraging greater market integration.<sup>21</sup> Futures trading has until now been disregarded by historiography. It followed a different path: The initiative was taken by private actors and focused not on harmonization but on conserving the status quo of a specific trading venue. Moreover, the European Commission was involved only via the DG IV: the competition policy authority. In fact, the City's futures traders and European regulators started an ongoing dialogue in June 1973 in the aftermath of the U.K.'s accession to the European Treaty, and six commodity exchanges in London simultaneously notified the DG IV of their rules and structures and applied for a negative clearance.<sup>22</sup> In the jargon of the European antitrust legislation, a negative clearance is the request for authorization regarding trade agreements or market rules that the antitrust authorities provide when these agreements do not fall within articles 85 and 86 of the Treaty of Rome. Four exchanges—the Coffee Terminal Market Association of London, the United Terminal Sugar Market Association, the London Cocoa Terminal Market Association, and the Rubber Terminal Market Association of London—obtained negative clearance in 1985, while another two (wool and vegetable oils) withdrew their request before the DG IV undertook a decision.<sup>23</sup>

At the European level, the outcome was also different from banking legislations. Instead of creating the foundation for harmonization, the two most important trading places in Europe took very different paths—London avoided adopting the U.S. model of regulation while Paris adopted it, producing a striking divergence inside the EEC about futures trading regulation. This article aims to fill the gap in the literature about the regulation of futures by showing the importance of the dialogue between business players and regulators in this outcome. During the twelve-year period extending from notification through to final decisions, the London terminal markets carried on with their business organizations without any interference from European authorities. Before the issuance of a decision, the applicants could continue using these agreements without legal consequences.<sup>24</sup> Because of this legal action, the EEC ended up trusting the City's commodity markets organizations and eventually authorized London's futures industry to keep its "self-regulatory organizations," as the decision openly stated.<sup>25</sup>

Despite occurring only a few months after the United Kingdom joined the EEC, the notifications that the London terminal markets sent to the European Commission in 1973 were not a consequence of that political event but instead were the result of a broader goal that can be understood by looking at the confrontation between London commodity markets and its main competitors, New York and Paris. Like other British businesses, London's commodity

21. Murlon-Druol, "Banking Union in Historical Perspective."

22. BAC 386/1998 (Coffee Affaire IV/27592 and /27951) and BAC 386/1998 (Sugar Affaire IV/27590), Archives of the European Commission, Brussels (hereafter AEC). All three notifications were sent on June 29, 1973.

23. Only decisions about sugar, rubber, cocoa, and coffee were issued. No decision about vegetal oils and wool were published in the Official Journal of the European Communities (OJ), L 369, December 31, 1985.

24. Wils, "Notification, Clearance and Exemption."

25. In all EEC decisions, these markets were described as such. OJ, L 369, December 31, 1985.

exchanges and the firms that operated in those markets aimed to avoid economic and political risks arising from the new institutional context and new regulation that might have arisen from European institutions.<sup>26</sup> Although it has received scant scholarly attention, those legal actions contributed to maintaining the London market self-regulation model and spreading it into the European framework. The literature about European antitrust and market regulation almost exclusively focused on cartels, mergers and acquisition, and abuses of dominant positions.<sup>27</sup> More recently, Rollings and Warlouzet emphasized the role of European antitrust regulation in determining the strategies of firms not only in terms of legal constraint but also in the opportunities and macro-economic development of markets.<sup>28</sup> In some cases, the European Commission played a performative role in framing the architecture of markets. In the case of the aluminum industry, for instance, in the late 1970s, the European Commission openly helped settle futures trading for this metal to curb the industry's price fixing.<sup>29</sup> In other cases, scholarly studies have shown that economic actors were able to shape economic regulations at the communitarian level.<sup>30</sup>

This article examines the system at work behind the notifications of the City's commodity exchanges toward Brussels, putting it into the context of the global commodity trade from the late 1960s, when London started to emerge again as a major center for commodity futures, to the mid-1980s, when the European Commission ruled on the authorization of London's markets. The notifications of the London exchanges to the European antitrust authorities should be analyzed in the broader framework of the rising financialization of commodity trading. By shedding light on the nexus between U.K. commodity markets and European institutions, this research shows the importance of regulation in the global competition among market venues. In the same years in which the London exchange defended its self-regulatory model, other approaches emerged as an answer to the financialization of commodity markets. Regulatory approaches became key factors in shaping the global working of markets. The article is organized as follows: the next section defines and describes the financialization of commodity trading in the early 1970s; this is followed by a discussion of the City's futures exchange model and its self-regulation. The third section analyzes the regulation outside the United Kingdom and, in particular, focuses on the U.S. system and its impact on the modification the French took in regulation of its own futures markets. The fourth section looks at how fragmentation occurs, spotlighting its causes within the competitive framework in which terminal markets were placed. Finally, the fifth section accounts for the agreement between the City's traders, their exchanges, and the European authorities, and explains how the European Commission considered self-regulation as an optimal model for the governance of this kind of financial market.

26. Rollings, *British Business in the Formative Years*; Andry et al., "Rethinking European Integration History."

27. Compare with the cases indicated in Patel and Schweizer, *Historical Foundations of EU Competition Law*; and with the recent literature about the history of EEC antitrust, in Gerber, *Law, Markets, and Globalisation*; McGowan, *Antitrust Revolution in Europe*.

28. Rollings and Warlouzet, "Business History and European Integration."

29. Bertilorenzi, "From Cartels to Futures."

30. Laurens, *Lobbyists and Bureaucrats*; Drach, "From Gentlemanly Capitalism to Lobbying."

## Futures and the Global Commodity Trade in the 1960s and 1970s

The literature on the history of futures trade focuses mostly on the birth of commodity exchanges and futures contracts during the second half of the nineteenth century, when market integration, trade openness, and globalization made them important tools in the global trade of primary commodities.<sup>31</sup> By contrast, relatively little is known about futures after World War II.<sup>32</sup> In a retrospective publication from 1953, the International Chamber of Commerce reported that, in the interwar period, futures exchanges experienced a massive decline globally because of the general fragmentation of global trade following the 1929 economic crisis.<sup>33</sup> After a lukewarm recovery at the end of the 1950s, futures fully recovered by the late 1960s, and by the mid-1970s they dramatically expanded, becoming decisive tools in the governance of global trade in commodities.<sup>34</sup> According to Simon, from 1968 to 1983, futures contracts grew on average by 20 percent per year, passing from 9.3 million contracts in 1968 to about 59 million in 1974 and finally to a staggering 140 million in 1983.<sup>35</sup>

This growth did not match the much smaller growth of global output. In the 1970s, the global economy was characterized by a great expansion in so-called financialization, which in the trade of commodities is often measured as a ratio between physical trade and futures.<sup>36</sup> From Figures 1a–1c, we can observe that this ratio has reversed since the late 1960s in the relationship between the global physical trade in cocoa, coffee, and sugar, and the futures trading for these commodities in London terminal markets. During the early 1960s, futures were a fraction of the physical trade (ratio about 0); by the mid-1960s, futures reached physical trading (obtaining a ratio of 1) and then surpassed it, arriving at a ratio of about 4 for coffee, 6 for cocoa, and 7 for sugar (Figure 2).

There are many explanations for the influence the boom had in the demand for futures. According to Goss, for example, four conditions for successful futures trading are (1) the significant variations in prices, (2) the presence in the market of economic agents with a high commitment in futures operations, (3) the high standardization of commodities traded in futures exchanges, and (4) a high demand for risk hedging facilities.<sup>37</sup> The trade in futures soared in the 1970s when prices recorded severe fluctuations, but trade had already seen firm growth in the 1960s when price fluctuations were not sharp. Other scholars, such as Stein and Streit, linked the growth of that market to the ability of the exchanges to disseminate information: terminal markets came to the fore as decisive tools for pricing commodities, thanks to their transparency, to data gathering, and to the standardization of contracts.<sup>38</sup> Slade also

31. Stanziani, *Rules of Exchanges*, 258–260; Lipartito, “New York Cotton Exchange”; Baker and Hahn, *Cotton Kings*, 126–127; Rischbieter and Lubinski, “Sound Speculators.”

32. Exception can be found in Rees, *Britain's Commodity Markets*, which also analyzes some post-World War II development; Markham, *History of Commodity Futures*, which discuss the U.S. regulation on the long run.

33. International Chamber of Commerce, *Les marchés à termes*, 25–28.

34. Morgan, *Merchants of Grain*, 219–220.

35. Simon, *Bourses de Commerce*, 134.

36. For instance, see Seddon, “Merchants Against the Bankers”; Newman, “Financialization and Changes.”

37. Goss, *Theory of Futures Trading*, 4–6.

38. Stein, *Economics of Futures Markets*, 46–47; Streit, “Futures Markets.”

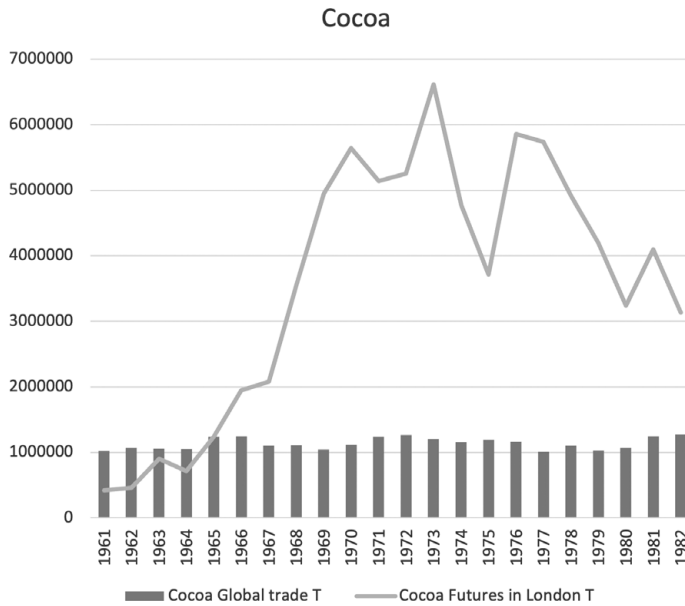


Figure 1a. Financialization in cocoa—the position of the London Terminal markets, 1961–1982

Source: Figures 1a-1c and Figure 2 are elaborations of the author. Quantities are in metric tons. Table 1 includes futures contracts; statistics about physical trade are from the Food and Agricultural Organization of the United Nations for annual production (see <https://www.fao.org/faostat/en/#home>).

pointed out that a certain degree of market openness is necessary to the work of futures exchanges, suggesting that they work better in periods of rising globalization and reduced trade barriers.<sup>39</sup> The opening up of markets following the General Agreement on Tariffs and Trade Kennedy Round negotiations in the 1960s, and their increasing instability from the dollar gap and from the disintegration of the Bretton Woods system after 1971, set the stage for the global instability that also affected primary commodities.<sup>40</sup> By the early 1970s, the decline of cartels and intergovernmental commodity agreements also stimulated a rise of futures that replaced them in the global price governance of commodities, which allowed the extensive adoption of futures exchanges in the fixing of commodity prices.<sup>41</sup> As Maier put it, the rise of futures can be linked to the decades-long paradigm of instability being replaced with the paradigm of stability in the 1970s (Table 1).<sup>42</sup>

The rise of London commodity exchanges was part of this global process. Since the mid-1960s, all “soft” commodities, a term that traders often used to identify cocoa, coffee, and

39. Slade, “The Two Pricing Systems.”

40. Coppolaro, *Making of a World Trading Power*, 178–180; James, *International Monetary Cooperation*, 218–219; Eichengreen, *Globalizing Capital*, 188–190.

41. Hillman, *International Tin Cartel*, 364–365; Bertilorenzi, *International Aluminium Cartel*, 348–352; Bertilorenzi, “From Cartels to Futures”; Favero and Faloppa, “Price Regimes, Price Series and Price Trends”; Schenk, “Oil Market and Global Finance”; Wellum, “Energizing Finance”; Dejung, *Commodity Trading*, 307–308.

42. Maier, *In Search of Stability*, 262–263.



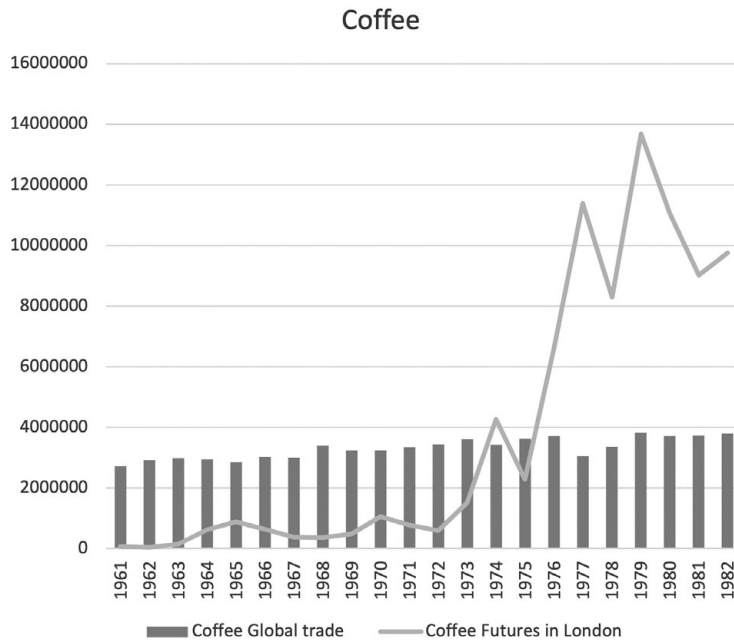


Figure 1b. Financialization in coffee—the position of the London Terminal markets, 1961–1982

sugar, have undergone staggering expansion. The only exception to this is trading in wool, which declined because of the opening in 1969 of a terminal market in Sydney (Australia is the main wool-producing country). Between 1959 and 1974, raw sugar futures contracts cleared by the London clearing house increased from sixteen thousand to about one million; cocoa increased from fifty-eight thousand to about one million; and coffee increased from twenty-five thousand to about half a million.<sup>43</sup> As Table 1 shows, the contracts for coffee, cocoa, and other commodities grew rapidly during the 1960s and the 1970s, especially after 1974. According to global data on global sugar output, in the early 1960s, future contracts covered a mere 1 percent; by 1989, futures accounted for more than 500 percent<sup>44</sup> (Table 2). Before the 1970s, futures trading was secondary to the activity of economic actors (e.g., producers, consumers, traders, and brokers); afterward, it became crucial.<sup>45</sup> One reason for the rise of futures can be seen in a decisive change in the users of commodity markets. By the early 1970s, the terminal markets increasingly moved to providing services only to the commodity industry (e.g., commodity producers and traders), which allowed investors not directly involved in commodities (e.g., institutional investors and hedge funds) to diversify their portfolio in commodities.<sup>46</sup>

43. Rees and Jones, “International Commodities Clearing House.”

44. LeClair, *International Commodity Markets*, 89.

45. Rees, *Britain's Commodity Markets*; Morgan, *Economic Study of the City of London*.

46. This point was originally observed in a 1974 study published by the United Nations Conference on Trade and Development. See Labys, “Séculation et instabilité des prix sur les marchés à terme.” On the rise of



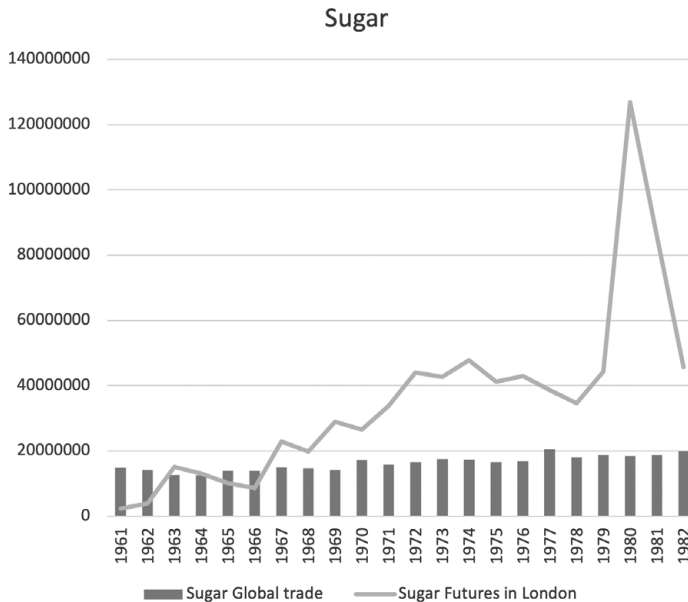


Figure 1c. Financialization in sugar—the position of the London Terminal markets, 1961–1982

### The Self-Regulatory Model of the City's Commodity Futures Exchanges

The specific institutional framework of London's futures exchanges made these market venues quite attractive for investors in the 1970s. The City's terminal markets were not young institutions. A futures market for raw sugar and coffee (robusta variety) was created in 1888; for rubber in 1889; and for cocoa in 1928. Although these markets rose in the global economy of the belle époque, they declined during the interwar period, and endured a slow recovery after World War II. They were fully recovered by the mid-1960s, along with greater market openness and integration, and boomed in the 1970s. Until the end of the 1980s, these terminal markets were independent and autonomous because each commodity belonged to a specific exchange.<sup>47</sup> According to Rees, while they had formal autonomy, the City's commodity exchanges used a kind of self-regulation model based on three common traits: specialization of the exchanges, membership of brokers to these exchanges, and the clearing system that was adopted.<sup>48</sup>

Specialization of the exchanges was at the core of the City's model, unlike other commodity exchanges outside the United Kingdom. Those in the United States, for instance, were usually

institutional investors, see Seddon, "Merchants Against the Bankers"; Newman, "Financialization and Changes"; Fichtner, "Hedge Funds."

47. It was only at the end of the 1980s that these exchanges merged into a unified London Commodity Exchange. Moreover, in 1996 the London Commodity Exchange merged with the financial futures exchanges of the City, creating the London International Financial and Futures Exchanges (LIFFE). In 2012, LIFFE was taken over by the Intercontinental Commodity Exchange, becoming ICE Futures Europe.

48. Rees, *Britain's Commodity Markets*, 180–186; Rees and Jones, "International Commodities Clearing House."

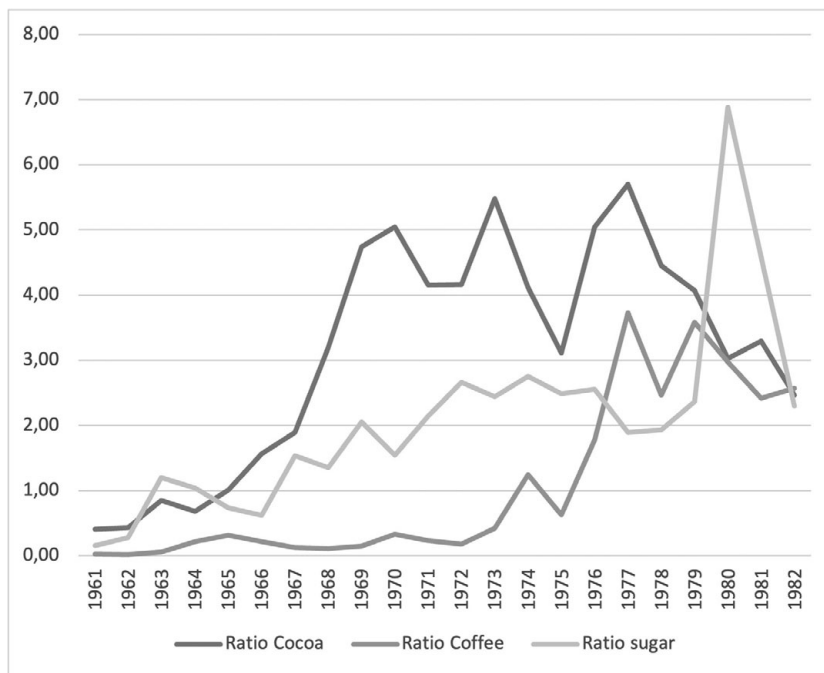


Figure 2. Ratio of financialization in cocoa, coffee, and sugar, 1961–1982

multicommodity trading centers. The second feature of the City's exchanges—membership—was decided by the committee of the exchange itself on the basis of the reputation and reliability of the traders and merchant firms. Each exchange had a chairperson who represented the interest of the exchange with public powers. There were eventually three groups of memberships. One was the “floor brokers,” and there only so many in these markets: fourteen brokers in rubber, eighteen in sugar, thirty-five in coffee, and forty-six in cocoa. The number allowed was according to each exchange's rules on the “open outcry” on the floor. Another group was the “home members,” who were the traders and brokers who specialized in the specific commodity traded in the exchange.<sup>49</sup> Until the 1970s, they were required to reside in London and be employees of the major London merchant companies, such as Czarikow; Golodetz; ACLI; Pacol; Wolff; Bache; Rayner; Dalgety; EDF Man; and Ralli Brothers.<sup>50</sup> The third group was “associated” or “overseas” brokers, who were mainly large producers, consumers, and global traders (e.g., Coca-Cola; Nestlé; Hershey; Tobler; Cadbury; Suchard; Leibig; Goldman Sachs; Merrill Lynch; Billington; Cargill; Louis Dreyfus; Mitsui; and Mitsubishi).<sup>51</sup>

The third feature—a common clearing house—refers to the London Produce Clearing House (LPCH), which later became the International Commodities Clearing House (ICCH).

49. Morgan, *Economic Study of the City of London*, 346–349.

50. Jones, *Merchants to Multinationals*; Chapman, *Merchant Enterprise in Britain*.

51. The source of this information was taken from the complete list of members of these terminal markets, which is available in BAC 386/1998 (Coffee Affaire IV/27592); BAC 386/1998 (Sugar Affaire IV/27590); BAC 386/1998 (Cocoa Affaire IV 27951), AEC.

Table 1. The Expansion of the London Terminal Market Association, post-World War II

	Sugar	Cocoa	Coffee	Wool	Rubber
1959	16,101	58,570	25,433	57,007	
1960	22,978	51,578	22,896	54,035	
1961	45,125	84,085	7,997	53,156	
1962	79,346	91,879	5,330	29,818	
1963	302,420	180,310	15,839	48,652	
1964	261,858	142,442	63,148	46,986	
1965	202,654	248,736	89,693	32,594	
1966	172,046	389,231	64,836	24,340	
1967	457,491	416,932	38,369	28,217	
1968	395,557	707,898	37,567	18,925	
1969	579,479	990,045	48,537	8,392	
1970	530,870	1,129,252	106,344	5,308	
1971	676,146	1,028,948	78,240	2,874	
1972	879,020	1,050,504	60,321	3,922	
1973	854,045	1,322,946	152,227	3,460	
1974	956,598	954,370	427,277	2,654	12,371
1975	824,263	742,577	228,293	4,097	39,802
1976	857,567	1,171,706	660,188	13,601	62,182
1977	773,398	1,147,727	1,139,185	4,588	63,135
1978	692,834	982,631	830,308	949	93,399
1979	885,403	839,751	1,368,052	662	104,112
1980	2,537,015	647,397	1,104,739	5,972	128,575
1981	1,717,636	818,979	902,531	11,576	84,173
1982	912,984	626,693	976,373	15,381	78,882

Source: Number of lots (5 tons for cocoa, 10 tons for coffee, 50 tons for sugar) of futures contract cleared at the London Produce Clearing House. Only 1 percent of the futures were delivered. For data to 1974, see Rees and Jones, "International Commodities Clearing"; for data from 1975 onward, see International Commodities Clearing House, *Yearbook*.

Table 2. Commodity futures contracts at the New York Coffee, Sugar and Cocoa Exchange (in percent of world output)

	Sugar	Cocoa	Coffee
1974	46.5	324.4	68.9
1975	61.1	276.0	24.6
1976	61.7	300.4	67.3
1977	56.1	312.5	99.7
1978	51.1	200.4	65.5
1979	101.0	210.3	161.5
1980	214.9	276.5	313.7
1981	141.9	332.2	169.2
1982	102.9	350.0	160.7
1983	160.5	752.4	147.9
1984	130.2	730.0	159.2
1985	156.9	407.0	204.0
1986	184.3	399.7	317.4
1987	188.3	444.6	344.2
1988	284.8	572.8	315.6

Source: LeClair, *International Commodity Markets*, 88–89.

The LPCH was founded in 1888 concomitantly with London's first futures exchanges; it was not owned by the exchanges or their members but acted as an autonomous institution to offset the daily operations of the exchanges.<sup>52</sup> According to Rees and Jones, the LPCH and the reputation of the traders together created the cornerstone for self-regulation of the City's terminal markets.<sup>53</sup> The LPCH avoided systemic risks, making governmental control over the terminal markets unnecessary. The LPCH was under nonstatutory control by the Bank of England, which received information directly from the LPCH (then from the ICCH) but had no power of inspection.<sup>54</sup> For instance, according to a report by the Bank of England about a meeting of the Sugar Liaison Committee that supervised London's sugar terminal market, statistical data on sugar futures were provided thanks to the "club atmosphere" of the sugar market and to the traders' commitment without any rules established by the government.<sup>55</sup>

It was not unusual for some interlocking relationships to exist among the City's exchanges, which helped spread similar approaches among themselves. In many cases, the same brokerage firms were in each exchange, while in other cases the associate members of one exchange were also home members of another. This occurred with Merrill Lynch, an associate member in most of the exchanges but a home member only in cocoa. Two more examples are Czarnikow and Bache: both were associate members in all terminal markets, but Czarnikow was a home member only in sugar and Bache was a home member only in cocoa. Frequently, the actors involved in one exchange determined the global trade for those types of commodities. Chalmin epitomizes this in the adage that "when the analyst of Merrill Lynch coughs, the market catches a cold."<sup>56</sup> Global firms trading in one type commodity, such as Cargill or Louis Dreyfus for wheat,<sup>57</sup> also held positions, respectively, as associate members in cocoa and coffee exchanges, showing an aptitude for diversification in their commodity investment portfolios. Both members and nonmembers could hold positions on the exchanges, but their fees, linked to market operations, were quite different: members paid small fees while nonmembers were charged with extra fees. According to Rees and Jones, the nonmembers' higher fees were aimed at avoiding venturing behaviors and speculation by those outside the industry.<sup>58</sup>

### Soft Commodities Exchanges and Regulations Outside the United Kingdom: New York and Paris

New York, and to a lesser extent Paris, contended London's "leading" role in global futures trading in soft commodities.<sup>59</sup> These two trading venues shared similar origins and timelines,

52. Rees, *Britain's Commodity Markets*.

53. Rees and Jones, "International Commodities Clearing House."

54. Miller, "Role of the ICCH."

55. 10A324/1, Commodity Liaison Meetings—Sugar: Report on the Sugar Liaison Meeting, June 30, 1976, Bank of England Archives (hereafter BEA).

56. Chalmin, *Traders and Merchants*, 295.

57. Morgan, *Merchants of Grain*; Broehl, *Cargill, Going Global*.

58. Rees and Jones, "International Commodities Clearing House."

59. Chalmin, *Traders and Merchants*, 178; Simon, *Bourses de Commerce*, 40–41.

being set up in the late nineteenth century, a period characterized by an increase in international trade and a rise in globalization. U.S. grains and cottons represented the most important commodities in futures trading,<sup>60</sup> and so New York City emerged over time as an important trading place for coffee (arabica), raw sugar, and cocoa. The New York Coffee Exchange started its operations in 1882, and in 1914 it launched a trade in raw sugar, becoming the New York Sugar and Coffee Exchange.<sup>61</sup> In 1925, a terminal market for cocoa was also opened in New York.<sup>62</sup> In 1979, the New York Sugar and Coffee Exchange merged with that of cocoa, giving birth to the New York Coffee, Sugar, and Cocoa Exchange.<sup>63</sup>

Paris already had coffee and raw sugar contracts by the end of the nineteenth century, and it opened a “white sugar” contract in the 1960s, thereby gaining importance in the global trade of this commodity.<sup>64</sup> Despite similar origins to London, New York and Paris showed important differences in relation to their clearing systems, specializations of the trading venues, and role of government surveillance. In the United States, each commodity exchange had its own clearing house owned by the members themselves. The U.S. clearing system model has often been referred to as a “mutual clearing” without guarantees. This was the same in Paris. Their mutual clearing system could become unstable if one or more members were in a weak position within the exchange, which could in turn trigger a domino effect resulting in a lack of liquidity for the entire terminal market. This model clearly represented a systemic risk for these markets.<sup>65</sup>

The United States has a long history of governmental regulations for futures trading, yet regulations evolved inconsistently until the CFTC. Before World War I, U.S. markets were unregulated, like those in London. After World War I, the U.S. government increasingly enacted controls and regulations to reduce speculation, which was frequent in the exchange of commodities (i.e., grains or cotton) in Chicago, New York, and New Orleans.<sup>66</sup> Grain was the first commodity to be regulated with the adoption of the Grain Futures Act in 1922 and the creation of the Grain Futures Administration, a specific regulatory body that operated on a daily basis. Governmental controls led to the public authorities providing licenses to brokers and traders, inspecting contracts, monitoring the exchanges, and putting their operations on hold when fluctuations in prices were too wide. Regulations were extended to all U.S. produce (cotton, grains, and onions, for instance) via the Commodity Exchange Act of 1936 and the creation of the Commodity Exchange Authority under the U.S. Department of Agriculture (USDA), which replaced the Grain Futures Administration.<sup>67</sup> The U.S. government had to regulate domestic produce because it was not uncommon for commodity “kings” to corner markets of the exchanges. Another reason was because of structural weaknesses within the U.S. exchanges. There was no differentiation in fee prices, and the absence of rules on

60. Lipartito, “New York Cotton Exchange”; Baker and Hahn, *Cotton Kings*.

61. Brunn, “New York Coffee and Sugar Exchange.”

62. Canalizo, “New York Cocoa Exchange.”

63. Markham, *History of Commodity Futures*.

64. Stanziani, *Rules of Exchanges*; Simon, *Bourses de Commerce*; Chalmin, *Traders and Merchants*.

65. Markham, *History of Commodity Futures*, 204.

66. Levy “Contemplating Delivery”; Baker and Hahn, *Cotton Kings*, 13–14.

67. Markham, *History of Commodity Futures*, 14–16.

membership drew poorly informed speculators into the market, making the mutual clearing system a source of permanent risk for the exchanges.<sup>68</sup>

Before creation of the CFTC in 1974, U.S. futures regulation was inconsistent. National commodities, like grains, onions, and cotton, were strictly regulated on a day-to-day basis by the Commodity Exchange Authority, while other commodities, and especially imported commodities, like cocoa, coffee, and sugar, were either unregulated or not surveyed by government agencies. In the 1950s and 1960s, the U.S. government made attempts to apply the same regulations to all futures exchanges because the unregulated markets were cyclically hit by cornering or untrained speculation.<sup>69</sup> According to Markham, an expert in the history of U.S. futures and a former CFTC regulator, the unregulated soft commodities exchanges made them attractive for the most speculative of players of the U.S. commodity markets. Despite ongoing attempts to regulate them, the sugar, coffee, and cocoa futures markets remained self-regulated until they came under the control of the CFTC in 1974.<sup>70</sup>

In the early 1970s, the USDA extended the powers of the Commodity Exchange Authority; and in March 1973, Congress amended the Commodity Exchange Act so as to regulate all remaining unregulated commodities.<sup>71</sup> This amendment was welcomed by Clayton Yeutter, then an assistant secretary in the USDA and later the secretary of Agriculture, who called it “one of the most important agricultural bills to emerge from the Congress in a long time.”<sup>72</sup> The newly created CFTC was a concern for market actors, and regulations eventually ended the spectacular (if uneven) growth of futures trading. As reported in 1975 in the first annual report of CFTC, the number of contracts stagnated in 1974. Meanwhile, before 1973 (when congressional debate started and first drafts on futures regulations were published) and after 1975 (when the regulations came into full operation), the number of contracts grew by about 25 percent a year.<sup>73</sup> In the in-between year, 1974, there was a swift switch from an unregulated model to strong CFTC regulation. Traders perceived this as dangerous for futures trading, because all the exchanges and brokers (in 1973, there were approximately twenty-five thousand brokers operating on the U.S. unregulated exchanges) were required to obtain authorization from the CFTC. If they did not, they “must either discontinue operation or they will [...] be operating in violation of the law [...]; must either cease business [...] or operate in violation of the law.”<sup>74</sup> Shortly after the CFTC regulated New York’s coffee, cocoa, and sugar markets, Paris’s terminal market was also reformed. As mentioned earlier, before 1974, the French market was like the U.S. market, with poor regulations on membership and a mutual clearing

68. Markham, *History of Commodity Futures*, 26–27.

69. U.S. Senate, *Regulation of Coffee Futures Trading*, 1954; U.S. Senate, *Sugar Prices*, 1964.

70. Markham, *History of Commodity Futures*, 45–47.

71. RG 16, Box 5742, Records of the Office of the Secretary of Agriculture, General Correspondence, Marketing, Year 1973, Memorandum, March 5, 1973, National Archives and Record Administration (hereafter, NARA).

72. RG 16, Box 5742, Records of the Office of the Secretary of Agriculture, General Correspondence, Marketing, Year 1973, memo from Clayton Yeutter to W. R. Poage (Chairman of the House Committee on Agriculture), December 26, 1973, NARA.

73. Commodity Futures Trade Commission (CFTC), *Annual Report of the Commodity Futures Trading Commission*, 13.

74. RG 16, Box 5818, Year 1974, Committees, Commission Commodity Futures Trading, Draft memo by CFTC, December 20, 1974, NARA.

system. During the commodity boom of 1973 and 1974, the Paris market was hit by severe speculation, leading to a quick, dramatic drop in prices that drove Central Clearing House of Paris markets to fail, as most people had anticipated.<sup>75</sup> After this failure, futures trading underwent regulation and the Commission des marchés à terme (COMT), designated to control the operation of markets, was set up with similar features to the CFTC.<sup>76</sup>

### A Global Competition Among Trading Venues: The Role of Regulation as a Competitive Edge

While futures trading was expanding in the global economy of the 1970s, few market venues competed to attract investors and expand their relative turnover. In sugar, coffee, and cocoa futures trading, some competition existed among New York and London, and to a smaller extent with Paris. Scholarly studies often underline the cooperation among terminal markets. According to Chalmin, until the 1960s, a certain “division of labour” existed among the futures markets.<sup>77</sup> For instance, in the case of coffee, New York was historically the center for arabica quotations, while London was the base for the robusta variety.<sup>78</sup> With sugar, New York and London were important markets for raw sugar while Paris specialized in refined white sugar.<sup>79</sup> Such cooperation was, however, replaced by ongoing competition. For example, the Coffee Terminal Market Association of London tried several times to open futures trading on arabica to take market quotas from New York,<sup>80</sup> and the United Terminal Sugar Market Association of London developed a white sugar contract when the terminal sugar market of Paris was in turmoil in 1974.<sup>81</sup> In retaliation, Paris developed a market for robusta coffee and cocoa to respond to London’s white sugar contract.<sup>82</sup>

Scholars have shown that, from a theoretical standpoint, terminal exchanges usually compete on a two-dimensional basis founded on the (1) geographical proximity of the markets from production sites, and (2) the maturity and reliability of their contracts related to market competitiveness. Neither London nor New York had decisive advantages in terms of distance from production sites to places of consumption, and both offered similar contracts in terms of reliability and maturity. Similar considerations can also be applied to Paris, at least before the failure of its clearing house. Gehrig, after studying the competition among these commodity terminal markets, emphasized that indirect factors became central to their competitiveness. In particular, he discusses the attractiveness of market venues, which could emerge from either fiscal authority

75. Cooper and Lawrence, “The 1972–75 Commodity Boom”; Bignon and Vuillermey, “Failure of a Clearinghouse.”

76. Simon, *Bourses de Commerce*, 130–132.

77. Chalmin, *Traders and Merchants*, 78–80.

78. Daviron and Lerin, *Le Café*, 70–71.

79. Bignon and Vuillermey, “Failure of a Clearinghouse.”

80. Traces of the arabica contract are contained in the 386/1998 (Coffee Affaire IV/27592), AEC. The Coffee Terminal Market Association of London communicated each contract while the decisions were pending.

81. BAC 386/1998 (Sugar Affaire IV/27590), AEC.

82. Box 19910031-20, Dossier 2, Compagnie des commissaires agréés, Marchés réglementés de la bourse de commerce de Paris, January 13, 1975, Archives nationales, Pierrefitte sur Seine.



(in reducing transactional costs on the exchanges) or from the financial center where the exchange is located. Either of these factors could reduce the cost of borrowing money for market operations.<sup>83</sup> This approach was recently advanced by Hautcoeur and Riva in their study of stock exchanges, who show that not only fiscal policies and financial power but also regulation have played determining roles throughout history in setting competition among markets.<sup>84</sup>

The revolution in regulation of U.S. futures markets, represented by the creation of CFTC in 1974, both threatened U.S. exchanges, in particular those involved in cocoa, sugar, and coffee, and created an opportunity for London to improve its competitiveness in attracting new actors to those markets. Traders who had relied on the relative freedom of the U.S. market for soft commodities now started to look for other marketplaces.<sup>85</sup> The attractiveness of the London terminal markets in the global scene largely depended on the City being a financial center that contributed to the provision of capital and the necessary liquidity for futures operations.<sup>86</sup> The more relaxed and self-regulated environment of the City gave a competitive edge to London, where U.S. financial actors found better opportunities, thanks to the growth of Eurodollar markets.<sup>87</sup> Many U.S. banks opened branches in London, and U.S. traders gradually invested in the City's markets. For example, Merrill Lynch had a strong position in City commodity exchanges. A study by Seddon on the London Metal Exchange provides insight into U.S. investments made in this terminal market of the City.<sup>88</sup> The Bank of England was aware of the appeal of the City's soft commodity futures market venues, which drew increasingly large numbers of investors from hedge funds and institutional investors.<sup>89</sup>

London was no longer the only self-regulated market, but it was the largest for futures in the world.<sup>90</sup> The notification of the City's exchanges to the EEC antitrust division should be seen against this backdrop: the self-regulatory model of the City's exchanges was perceived in the first half of 1973 as a competitive edge in the promising field of futures trading, which were expanding not only in commodities but also to other fields of activity, such as currencies and public debts. This is the same time when the U.S. Congress was debating on extending regulations over its commodity futures exchanges. The goal of the notification was to increase London's competitiveness as an international financial center, which was the same goal of the British government.<sup>91</sup> The Bank of England clearly understood this. In 1975, the governor of the Bank of England, which, remember, had nonstatutory control of the commodity exchanges, was convinced by the strong performance of the soft commodity exchanges and of the Bank's "approach to supervision [that] encourage[d] the markets to regulate themselves and to respond promptly to the Bank's persuasion when necessary."<sup>92</sup>

83. Gehrig, "Competing Markets."

84. Hautcoeur and Riva, "Paris Financial Market."

85. Schenk, "Rogue Trading."

86. Cassis, *Capitals of Capital*, 223–225; Michie, "The City of London."

87. Altamura, *European Banks*, 33–36; Schenk, "Regulation of International Financial Markets."

88. Seddon, "Merchants Against the Bankers."

89. 12A67/1 Exchange Control Commodities, Investments in commodities, November 30, 1975, BEA.

90. Schenk, "Regulation of International Financial Markets."

91. Kynaston, "Banks and Yanks"; Warlouzet, *Governing Europe in a Globalizing World*, 140–141; Michie, "The City of London"; Schenk, "Regulation of International Financial Markets."

92. 12A67/1, Exchange Control Commodities, memo from the governor of the Bank of England to Harold Lever, December 12, 1975, BEA.

Many actors, both in the United States and Europe, looked to London as the most efficient market to perform hedging operations because of its relative freedom from statutory controls and the security of its clearing house, especially after the failure in Paris. Additionally, the City's main financial actors were looking for growth and a sharp competitive edge in order to open new futures contracts in the financial sector.<sup>93</sup> The International Commodity Clearing House, which secured the clearing operation of the London terminal markets, sought to establish a financial futures exchange in London, such as for currencies and interest rates. According to a report by the ICCH in the late 1970s, "the introduction of a market for interest rate futures took place in Britain with less administrative difficulty than was the case in America. This was because the supervision of commodity markets in Britain was carried out by one agency, the Bank of England, which operated a largely informal system not subject to juridical review."<sup>94</sup>

### London's Exchanges Meet the European Commission: Crafting a European Model

The U.K.'s accession to the Treaty of Rome in 1973 and the new regulations of the EEC could be seen as threats for the growing position of London's exchanges in the global economy of the futures trade.<sup>95</sup> Thus, the Federation of Commodity Associations, which represented all of London's commodity exchanges, coordinated a common action with regard to the European Commission. Each exchange was to notify the antitrust authorities of the Commission—the DG IV—of their rules and ask for a negative clearance. All notifications were represented by a single party: Coward Change, a leading law firm in the City.<sup>96</sup> In 1973, the same year of the notifications, Coward Change opened an office in Brussels and boasted expertise on the new European legal framework.<sup>97</sup> After the first set of applications for negative clearance was submitted in 1973, other London commodity exchanges followed suit, including: Grain and Feed Trade Association, Soya Meal Futures Association, London Grain Futures Market, London Potato Futures Association, London Meat Futures Exchange, and International Petroleum Exchange of London Ltd. The decision on the negative clearance asked by these exchanges arrived in 1986, one year after the decision on the original applicants.<sup>98</sup>

The officers of the European Commission were aware of the importance of these notifications, not only for the European market but also for the global regulatory framework of commodities. A member of the DG IV, who was in charge of a particular case, wrote an internal note: "toute intervention de notre part sur la situation existante risque d'avoir des

93. 12A67/1, Exchange Control Commodities, Cabinet, Official Group on Commodity Market, Supervision of the Commodity Markets, note by the Secretaries, November 15, 1975, BEA.

94. International Commodities Clearing House (ICCH), *Financial Futures in London*, 23.

95. Rollings, *British Business in the Formative Years*, 183–184.

96. All the notifications were sent in June 1973 by Coward Change as legal representative of both FCA and the City's terminal markets. See the Commission files about the cases: BAC 386/1998 (Coffee Affaire IV/27592); BAC 386/1998 (Sugar Affaire IV/27590); BAC 386/1998 (Cocoa Affaire IV 27951), BEA.

97. Slinn, *Clifford Chance*, 154.

98. These cases were analyzed using the archives of the EEC.

répercussions sensibles à l'échelle mondiale" (our intervention on the existing situation risks relevant impacts on the global scale).<sup>99</sup> This statement extends the idea recently noted by Drach about EEC banking regulations: in the regulation of futures trading, the EEC played a pivotal role, following a very different direction from the U.S. approach so as not to disturb the functioning of markets.<sup>100</sup> The commissioners had neither previous experience nor sufficient knowledge to regulate futures trading. Meanwhile, the expertise of the DG IV, which received the notifications from the futures markets, was in antitrust and law, and its core activity was breaking up cartels, so it too knew nothing about the complex financial services of futures.<sup>101</sup> These limitations clearly surfaced in the types of questions that Marco Piccarolo, the DG IV official handling the notifications, asked of the British Office of Fair Trading in obtaining information about the work and scope of futures markets. The British Office of Fair Trading provided him only basic information about terminal markets:

Do not set themselves up to trade in their actual commodities; instead, they each trade in futures—to use a technical term [. . .]. What this exactly means is difficult to explain in a few words [. . .]; a terminal market is not a market to which one goes when wishing to buy or sell a commodity. It is rather a market to which buyers or sellers of a commodity, which is subject to considerable price fluctuations because of variable production and demand, have recourse if they wish to limit possible losses regarding their actual transaction in the commodity.<sup>102</sup>

Piccarolo had no knowledge of what futures market did, how they functioned, and their technical needs. His experience was in political science and law, not finance.<sup>103</sup> In the early 1970, futures were understood only within a narrow circle of commodity traders. A few theoretical studies existed on their working and a general approach to futures was still expanding.<sup>104</sup> The Black-Sholes model for derivatives pricing was published in 1973, and only later became the basis for understanding pricing behaviors in futures and options.<sup>105</sup> The first attempt made by the European Commission to regulate futures was via public servants with no knowledge of futures trading and its abuses. This was the reason behind the massive difference in regulatory frameworks. In the United States and France, CFTC and COMT, respectively, were specific agencies created to supervise the working of futures markets. They were separate agencies from those doing antitrust work and, especially in the United States, the officials had the practical experience of supervising regulated commodities. The European Commission seemed keen to avoid the creation of new agencies, which could interfere with the working of markets at the continental level. It never

99. Author's translation. BAC 386/1998 (Coffee Affaire IV/27592), note by Marco Piccarolo, January 21, 1974, AEC.

100. Drach, "Globalization Laboratory."

101. Warlouzet, *Governing Europe in a Globalizing World*, 158–160.

102. BAC 386/1998 (Sugar Affaire IV/27590), memo from the Office of Fair Trading (London) to Archer (EEC, DG IV), January 3, 1974, AEC.

103. Interview 236, with Marco Piccarolo, November 23, 2011, Oral Archives, EUI Archives.

104. See, for instance Newman, *Theory of Exchange*; Goss, *Theory of Futures*. The main studies on futures trading appeared later, such as the seminal work of Streit, who published the edited volume *Futures Markets* in 1983.

105. MacKenzie and Millo, "Constructing a Market, Performing Theory."

attempted to create a regulatory body as in France and the United States. The European Commission limited assessments to whether the rules of the futures exchanges fell within European antitrust laws.<sup>106</sup>

Against this background, the London terminal markets tried to impose their own preferences on the commissioners. In February 1974, the Futures Commodity Association of London, which coordinated the notifications sent to the Commission, invited the EEC to visit the London terminal markets. The visits were not limited to cocoa, sugar, and coffee exchanges; it also included the London Metal Exchange (which had not sent any notification to the Commission) and its common clearing house (which was not directly involved in notifications anyway).<sup>107</sup> The approach taken by the European Commission was based on the information that applicants provided, which resulted in a general leniency in the market. After the visit to London, the Commission's officials remained in contact with the head of the Merrill Lynch agency of London, L.A. Brighton, who provided them reports on the working of futures and trading in commodities.<sup>108</sup> The London commodity exchanges then updated the Bank of England on the evolution of their talks with the European antitrust authorities (i.e., DG IV).<sup>109</sup>

After all of this, the commissioners still showed no inclination to regulate futures trading. Rather, their sole preoccupation was to ascertain whether this trading went against the competition policies of the European Economic Community. The Commission simply wanted to understand whether the terminal markets were a direct or indirect form of price fixing. Significantly, throughout 1974, the only questions that Brussels asked the U.S. authorities were related to antitrust and price fixing, not about broader regulations. From the information gathered from the markets and the U.S. Federal Trade Commission, the Commission understood that, even though futures prices had some relationship to real market prices, they were "fully competitive elements of the markets."<sup>110</sup> The Commission gradually understood that futures markets were an alternative to anticompetitive pricing systems, such as cartels and other commodity agreements, because they did not limit production, markets, or investments. Furthermore, these markets did not set production or market quotas. The DG IV of the European Commission began to associate that the development of futures markets could improve free market forces and curb the influence on market prices of the commodity schemes operating in the 1970s.<sup>111</sup>

According to internal notes, it seemed that the Commission officials did not comprehend the significance of some actors in the commodity markets (both for physical commodities and futures), such as Merrill Lynch in cocoa or Czarínov in sugar.<sup>112</sup> They not only disregarded an

106. BAC 386/1998 (Coffee Affaire IV/27592), Note from Marco Piccarolo, January 21, 1974, AEC.

107. BAC 386/1998 (Coffee Affaire IV/27592), memo from FCA to M. Archer, December 23, 1973, AEC.

108. BAC 386/1998 (Cocoa Affaire IV/27591), L.A. Brighton (Merrill, Lynch, Pierce, Fenner, & Smith Brokers and Dealers Ltd) to M. Archer, February 18, 1974, AEC.

109. BEA, 11A135/7, Exchange Control Commodities, note for record, London Terminal Market–DG IV, October 24, 1979, AEC.

110. 386/1998 (Cocoa Affaire IV/27591), Letter from Vincent Grogan (DG IV) to Joe Davidow (U.S. Federal Trade Commission), September 11, 1974, AEC.

111. BEA, 11A135/7 Exchange Control Commodities, note for record, EEC Competition Policy and the LCE (London Commodity Exchange), October 30, 1979, AEC.

112. No information about the market shares of these firms in futures trading are present in the dossiers.

investigation of the market power of the biggest players in the City but also considered them a reliable and impartial source of information to understand the working and regulation of futures trading. For instance, information about the meaning of futures trading was taken from “the attached photocopy from the booklet we received from Mr. Brighton [head of Merrill Lynch in London] dealing with cocoa [that] is a very good illustration or example.”<sup>113</sup> This item was *Cocoa*, by Merrill Lynch, a short booklet designed to inform investors in cocoa futures, which was sent to the Commission after the visit to London with *How to Buy and Sell Commodities*, a promotional booklet that the firm gave to investors. These were *not* scientific publications but promotional papers intended to attract investors in commodity futures in the U.S. terminal markets. They provided scant information about the actual working of futures. Moreover, because these were published before the establishment of the Commodity Futures Trading Commission, they inaccurately portrayed the self-regulatory system of soft commodities futures in the U.S. as efficient and safe.<sup>114</sup> Without seeming to question this tilted information about the nature of futures, the Commission agreed to futures trading self-regulation. An official who inspected futures notifications in 1979 wrote in a note: “In view of the particular nature of the markets, their worldwide importance, and their undoubted price stabilizing effects, the Commission sees benefits in business being channeled through these selfregulating [*sic*] markets.”<sup>115</sup>

It is safe to conclude that the Commission considered futures trading exclusively from an antitrust perspective because this market lacked the typical anticompetitive characteristics (price fixing, market sharing, and the like). A specific form of supervision or regulation was not proposed because futures were not considered a dangerous financial tool, but had only positive effects on markets. Creation of a regulatory body would have required a different and broader approach to futures, which was incompatible with the DG IV’s approach to the market, the antitrust perspective adopted for notifications, and the entire Commission’s agenda. A different approach might have also been in contention with the U.K. government, which fostered the growth of markets in the City of London.<sup>116</sup>

An interesting point came from the nexus of relationships between national and European regulations. In banking regulations, the principle of the “home country control” prevailed, but in futures trading any interference on the functioning of the market was avoided. The Commission preferred to let each nation-state be responsible for their own regulation in the futures market, considering it as a strictly national matter. As a result, the creation of the COMT in France did not change the attitude of the European Commission toward the City of London or the Bank of England’s noncompulsory control. Moreover, it believed that futures markets were instrumental in keeping price stability, which was a goal of the international policies regarding commodities and raw materials. Meanwhile in the United States, futures were perceived as potentially risky, at least without some regulation. The European Commission instead

113. BAC 386/1998 (Cocoa Affaire IV/27591), note from M. Archer, Re: DG IV/B Letter Fm/mm to Mme Espion of the Directorate IV/A, August 5, 1974, AEC.

114. Merrill, Lynch, Pierce, Fenner & Smith, *Cocoa*; Merrill, Lynch, Pierce, Fenner & Smith, *How to Buy and Sell Commodities*.

115. BAC 386/1998 (Coffee Affaire IV/27592), note from Jean Ferry (EEC DG IV) to the head of DG IV, January 20, 1979, AEC.

116. Schenk, “Regulation of International Financial Markets.”

adopted the optimistic view about the reliability of these markets in self-regulating themselves. According to the DG IV, futures were aligned with both the broader European agricultural policies and the policies Europe had adopted from former colonies, both of which had the goal of stabilizing commodity prices.<sup>117</sup> The officials also seemed to think that futures markets, instead of having simultaneous hedging and speculative goals with ambivalent outcomes on the global economy, were simply aligned with the price stabilization policies of the United Nations Conference on Trade and Development. Indeed, a report compiled for the general commissioner stated that “futures trading could provide some forms of price stabilization.”<sup>118</sup>

Despite this general optimism toward futures and futures exchanges, the European Commission tried to change the operating mechanisms of the London terminal market, which contributed to delays in the delivery of negative clearances requested in 1973 until 1985. The DG IV was concerned about some of the specific rules of the terminal market related to the differing fee rates to distinguish members from nonmembers. As already seen, this differentiation in the City of London terminal markets was a specific feature of that market venue, which the U.S. exchanges did not have. In accordance with this U.K. rule, a trader who often used these markets was prompted to become a member, thus paying smaller fees to trade in futures. The London terminal markets considered members as being more reliable than nonmembers, who only occasionally used these markets based on little information. A clause about differentiation in fees, however, according to DG IV officials, was market discrimination; to provide authorization to the negative clearance, they asked for it to be eliminated.<sup>119</sup> This change made the U.K. exchanges more like the U.S. market but without changing the self-regulation model of the City’s exchanges.<sup>120</sup>

## Conclusions

The legal actions undertaken by the London terminal markets simultaneously were linked to the expansion of global commodity futures trading and responded to the European regulatory framework that risked becoming more like the U.S. model. From the 1960s through the 1980s, London’s commodity exchanges experienced rapid growth through several competitive advantages over other markets. Starting in the mid-1960s, London’s commodity markets emerged as key players in the global futures trading of sugar, cocoa, and coffee. In the early 1970s, London was a large, if not the major, financial center for futures operations in commodities; and it competed with other terminal markets, in particular those in the United States, to take advantage of a dramatic expansion in futures trading. London’s self-regulatory approach was central to its competitiveness with global competitors. Through the notification of futures market rules to the European Commission, the City of London successfully

117. Bargawi et al., “Low-Income Countries,” 454–455.

118. BAC 386/1998 (Coffee Affaire IV/27592), note by M. Archer, August 4, 1974, AEC.

119. BAC 386/1998 (Coffee Affaire IV/27592), memo from DG IV to LCE, attention of Anthony Rucker, executive director of LCE/Terminal Market Association (TMA), August 4, 1978; memo from DG IV to London Cocoa Terminal Market Association, December 15, 1980, AEC.

120. BAC 386/1998 (Coffee Affaire IV/27592), memo from Jean Ferry (DG IV) to Rucker (TMA), December 1, 1983; note by Franco Giuffrida (DG IV), February 15, 1984, AEC.



established financial tools and rules for commodity exchanges at the EEC level, to which European authorities had a positive attitude. These notifications were equally crucial from economic and regulatory standpoints. At the same time, they played a performative role in crafting the rules of trade in Europe and had a deep impact on global futures trading.

By the 1960s and 1970s, London's markets were no longer only of national interest. They had attracted non-UK traders, who found in the City of London a reliable market location in which to operate. The stability of its financial center was crucial in London's appeal and reputation as a reliable market, which was also related to its history. These were some of the factors behind the rise of London in the futures global trade. Self-regulation was also essential in making London an attractive market venue for both domestic and international investors. Self-regulation has clearly been linked to London's competitiveness as a financial center.<sup>121</sup> The main difference between the United States and the United Kingdom was the relationships between political powers and trading actors. While U.S. political powers adopted supervision of markets and its actors, U.K. leaders organized the markets to be self-regulatory—and their reliability was considered sufficient to avoid needing governmental interference. Domestic self-regulation was based on a nonstatutory survey by the Bank of England, whose task was not comparable with the day-by-day survey of the U.S. CFTC. Any new market regulations from the EEC might represent a threat in this context.

In this interplay, the concomitant strengthening of U.S. regulation via Congress occurred in the same year that the United Kingdom joined the European Economic Community. The United States followed a model of particularly tough governmental supervision, which hindered the development of U.S. futures trading. The U.K. exchanges, on the other hand, acted preemptively to secure a different outcome and save their long-established self-regulation. The adoption of the U.S. model by the French commodity exchange is proof that U.K. financial markets could have been affected by new regulations outside of the United States, although the evolution of French regulations was also based on serious concerns within the sugar terminal market of Paris. Paris futures exchanges, unlike those in the United Kingdom, showed weakness after the failure of their clearing system; as a result, the exchanges were put under strong governmental regulation.

One inference of this article is that the approval of futures trading rules by European authorities was a key step toward the EEC's (among other organizations) de-regulation of markets during the 1970s.<sup>122</sup> The EEC's approach to futures trading had a global impact because the City of London was becoming a leading center for financialized and dematerialized commodity markets. Financialization of commodity trading was concomitant with the emergence of a large, unregulated market for soft commodity futures based in London, which became the model for the European Commission. Future research should analyze whether the European Commission helped establish futures trading in London for certain political or economic goals. For instance, after the United Kingdom joined the Common Market, London was perceived as a strong financial center on which both EEC and the United Kingdom could rely. According to Ionescu, in her critical study on European market integration, a

121. Stringham, "Emergence of the London Stock Exchange."

122. Warlouzet, *Governing Europe in a Globalizing World*, 92.



common goal of the EEC and the Bank of England (the agency with nonstatutory control over the City of London's terminal markets) was to take back control from New York and the Eurodollar markets to make London the global center of the commodity market.<sup>123</sup> Following this idea, the process for London terminal markets to obtain negative clearances from the European Commission was most likely intended to help London develop its markets with a global reach. This was the same goal as the U.K. political and monetary authorities.

In the context of futures trading regulation, the Commission preferred to hold each nation-state as responsible for their own regulations to avoid serious confrontations with member-states' governments. The notifications by trading interests to antitrust European authorities was an entrepreneurial measure, inasmuch as it endorsed a model of self-regulation and avoided friction among different national market specialties. The result was a global market with regional (and national) fragmented regulation that nonetheless was functional and led to the explosion of futures trading in the global economy. One conclusion of this research is that the United Kingdom and the United States diverged not only in terms of regulation but also in approaches, because the actors involved influenced outcomes. The regulatory fragmentation in the 1970s in expanding futures markets led to two very different views of futures as financial tools and two very different regulatory models.

In the United States, the regulation of futures trading was not linked to antitrust issues but to the ambivalent nature of these financial tools. Futures markets consisted of both untrained speculators and knowledgeable actors hedging against the risk of severe price fluctuations. The spectacular growth of futures trading sharpened U.S. regulation to reduce negative behaviors and enhance best practices. The new regulations and their associated administrative burden shocked the trading community. By contrast, in Europe, market regulation was only related to antitrust because European antitrust authorities had a poor understanding of the technicalities and potential problems in futures trading. According to documents produced by European officials in the antitrust division (i.e., DG IV) and used for this research, futures markets were tantamount to free markets; however, a free market approach did not automatically guarantee financial stability, price stability, and economic development. The self-regulatory model in the United Kingdom could have helped create new development opportunities for global trade, and global financial actors could have counted on a diversified architecture of markets. Self-regulation by futures exchanges was instrumental in making the City of London emerge as the center for global trade of commodity futures, as was the coordinated action of the business actors involved in these exchanges.

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## Acknowledgment

I would like to thank Neil Rollings and Pierre Eichenberger for inviting me to start the inquiry that led to this article; it began with the research network "Transnational Business Encounters in the Twentieth Century,"

123. Ionescu, *European Alternatives*, 227.

started at Zurich University in 2018 and continued at the World Economic History Congress in Boston. Thomas Davis, Matthieu Leimbruger, and Glenda Sluga offered me fruitful comments on these occasions. Early versions of this article benefitted from the reading by Carlo Fumian, Giovanni Gozzini, and Luciano Segreto. Valerio Cerretano deserves special mention: His attentive reading made my arguments stronger and clearer. The anonymous reviewers of *Enterprise & Society* provided invaluable suggestions that significantly improved the original manuscript. This research would be impossible without the work of the archivists at the Bank of England, in London; at the National Archives and Record Administration, in College Park, Maryland; at the Archives Nationales, in Pierrefitte sur Seine; and at the of European Commission, in Brussels. As usual, I am solely responsible for all mistakes.

This work was supported by the program “Rita Levi Montalcini” of the Italian Ministry for Education, University and Research (Grant MIUR–DM 352–01.06.2016).

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**Cite this article:** Bertilorenzi, Marco. "Futures of Europe: The City of London's Commodity Exchanges, the European Economic Community, and the Global Regulation of Futures Trading (1960s–1980s)." *Enterprise & Society* 24, no. 3 (2023): 731–758.