

The State, the Financial System and Economic Modernization

edited by

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1 Introduction: comparative historical perspectives

Richard Sylla, Richard Tilly and Gabriel Tortella

The more one studies the historical origins and development of modern financial systems, the more it becomes apparent that at most of the critical points when financial systems changed, sometimes for better and sometimes for worse, the role of the state was of paramount importance. That is hardly surprising. Long before private economic entities – trading, transportation and manufacturing enterprises may be cited – came to require financing on a scale beyond the capabilities of individual proprietors and partners, governments had needs for large-scale finance. The most durable reasons for these needs involved the political ambitions of governments: solidifying and extending their authority, unifying the disparate components of their states under a central administration, promoting state-led and state-financed economic development projects as a means of increasing state power, and, perhaps most important of all, waging wars against other competing states. But the state not only had a need for large-scale finance. It also had the coercive power of taxation that, among other things, gave it a stronger credit, that is, a greater ability to borrow and pay debts, than was possessed by any private parties. Moreover, the state had the power to create financial institutions and markets, and to shape their development through legislation and state regulation. States used all of these powers from the European middle ages up to and including the eighteenth century, when the modern industrial era commenced.

Curiously, the insights into financial development coming from the pre-industrial era, insights that point to the primacy of the state's role, have not carried over into the historiography of the industrial era itself. Here the fascination with industrialization reigns supreme, with commercial, agricultural and financial developments relegated to secondary, ancillary, facilitating roles, and with the role of the state itself pushed well into the background, where, many have argued, it not only was, but also ought to have been. The *laissez-faire*, anti-mercantilist traditions of classical and neoclassical economics were in major ways responsible for this shift of historical emphasis. So has been the division of labour among

modern economists, which has made public finance and private finance into separate sub-disciplines, each with its own practitioners, courses of study, students, textbooks and journals, and with few interactions between the two groups.

Those of us specializing in financial history have not been unaffected by these strong currents of thought. For one thing, they relegated us to the study of something that was inherently less important than the one big thing that was important, namely industrialization. For another, they fragmented finance itself into two fields, private and public, each with its own sub-fields, and each having seemingly little to do with each other. Most of us studied private finance – the economics of money and banking, other financial intermediaries, money and capital markets, the rate of interest and the returns of equity shareholders. Public finance divided itself into two sub-fields, the economics of taxation and of governmental expenditures, neither of which had much to do with any of the private-finance fields.

As financial historians buffeted by these currents, our strategy to be relevant was a simple one. Private banks were the one type of financial institution present throughout the era of industrialization in one form or another, and so we would gain attention for our work by studying what banks did, how their nature and functions changed over time, and how banks did or did not contribute to industrialization. This we did, in numerous dissertations, articles and books.

Since the 1960s, consequently, the literature on the role of banking in economic development has grown enormously. This represented at the time an overdue correction of the older view that ‘money and banking’ had much to do with short-run cyclical phenomena, but little to do with long-run economic change. In the meantime, however, the fields of finance, monetary economics and even financial history have moved on. It has become clearer that finance involves and involved much more than banking. Developments in economic theory (the theory of expectations, the economics of information and especially the economics of institutions) have helped here by making the interactions between financial markets, institutions such as banks and shifts in public policy more amenable to systematic generalization. We have begun to see new significance in the breadth and variety of institutions incorporated within financial systems – non-bank intermediaries, money, debt and equity markets, and stock exchanges.

In tracing these variegated institutions and markets back to their origins, we are no longer distracted by finding that the financial needs and intents of the state were of primary importance; that public or state banks to serve state financial interests arose almost simultaneously with private

banks; or that these public banks set patterns that private banks sometimes followed; and that they also evolved into central banks that regulated and controlled the activities of the private banks. New significance can be attached to the discovery that private banks themselves, though they may have begun in many instances as proprietorships and partnerships without governmental sanction or interference, evolved towards business corporations chartered and regulated by the state, in the state's financial interest. And it is no surprise that the money, debt and equity markets that eventually became mainstays of industrial and business finance, invariably began as issuing and trading markets for government debt obligations before there were many private obligations.

In our historical work we learned further that financial systems did not develop according to some uniform pattern dictated by the logic of industrial finance. Instead, there were divergences of systems. In Continental Europe, financial systems came to be dominated by large banks; open debt and equity markets were of relatively minor significance. In the 'Anglo-Saxon' countries, however, banks played a lesser role, and relatively more financing of enterprises, especially long-term financing, took place through the open bond and equity markets. What accounts for the differences that emerged among financial systems? Very often they resulted from the ways in which the state formulated financial legislation and regulated financial institutions and markets.

And yet these various insights, these rediscoveries being made for different sets of national historical experience, have not yet been brought together in a coherent, systematic manner. That is the purpose of this book. Its intent is to demonstrate, through comparative historical analysis, the richness of the history of modern financial systems, and to restore the state to its primary role in the shaping of those systems. The financial history of the era of industrialization, to repeat, is much more than the history of banks. And in this era the role of the state in determining its own notions of proper financial legislation and regulation, is far greater than one would gather from earlier accounts.

Economic historiography has of course long recognized that the state has exerted ongoing influence on the financial system through rules and regulations, e.g. through controls over the money supply, interest rates and so on. What has not always been appreciated, however, is that the non-intended consequences of state operations, especially the handling of public finances, could have had long-lasting effects upon the development of private financial arrangements. Take the emergence of the modern national state in the early modern period (since *c.* 1500). That development involved war-making and hence public borrowing from private sources on an unprecedentedly large scale. In some cases this generated

financial distress among private wealthholders, and produced long-lasting results; in others, initially pernicious effects could be rapidly overcome. A brief survey of the historiography can illustrate the connection.

A key historical concept here is that of 'financial revolution'. Originally developed to describe the history of English public finance between the 'Glorious Revolution' of 1688 and around the middle of the eighteenth century (Dickson 1967), its basic idea can be generalized: the rising importance of bourgeois, capitalist wealthowners coupled to the above-mentioned increase in governmental financial needs led European states to adapt their financial practices to capitalist standards, e.g. by making their financial accounts more transparent, by improving their revenue bases or – in the extreme case – by making the power to spend and tax contingent upon the approval of a political body dominated by property-holders. The end result was emphasis on an appeal to the self-interest of capitalists in the form of an offer of assets that had an attractive combination of return, liquidity and risk of default. All of this represented a radical departure from such time-honoured practices as debasement of the coinage and confiscation of wealth through forced loans or default.

In one sense, the story of financial revolution should begin with the Netherlands. For in the seventeenth century, the Netherlands, or rather Holland, emerged as the first nation with public finances based on the honouring of capitalist principles, above all a power to spend and tax subject to the scrutiny and approval by legitimate representatives of the bourgeoisie – which dominated political affairs to an extent matched nowhere else in the world. The financial demands of the Dutch state consequently reached an entire class of investors, not just a privileged circle of wealthy capitalists, as was the case in all other countries at this time (De Vries 1976: 211–13, 218, 220). The combination of private wealth and the consent of the citizenry made for a strong state and provided the basis of the Netherlands' amazing great-power status (Kennedy 1988: 101–2). Since the emergence of an identifiable Dutch state was coterminous with capitalist-oriented institutions of public finance, there was no 'financial revolution', only evolution. For reasons which need not detain us here, the Netherlands were unable to exploit their head start in financial institutions as the basis for a head start in industrializing (Riley 1980). Instead, the country's main, lasting contribution to European economic modernization was in serving as an example for England and, indeed, in supplying the latter with a monarch, William of Orange, whose presence eased the implementation of the modern, Dutch principles of public finance.

At the heart of England's 'financial revolution' was the emergence, at the end of the seventeenth century, of a balance of power there between

the executive branch of government (the king and his ministers), on the one hand, and the legislative branch (parliament), on the other. The executive initiated policy, but its executing depended upon parliamentary approval. As North and Weingast (1989) have pointed out, this represented a division of labour which was favourable from a transaction costs point of view and one which – applied to the government finances – had enormous implications. The fact that the state's finances depended upon parliamentary approval did not merely enhance capitalist confidence in the former; it also encouraged the state to adopt financial measures likely to impress private capitalists: e.g. the chartering of the Bank of England, the creation of more liquid (and more tradable) forms of government debt, the publication of annual government budgets, and the development of a more efficient and centralized system of tax collection (Dickson 1967; Neal 1990; O'Brien 1988; Brewer 1989). These arrangements can be viewed as institutions which offered, in North's phrase, 'credible commitments' by the British state to a policy of monetary and fiscal soundness – which coincided with the interests of British capitalists.

There are good reasons to see this set of changes as an important basis for Britain's subsequent economic development. As a recent survey of Britain's 'industrial revolution' (Deane 1996: 23) commented:

The upshot of this transformation in the English (and after the 1707 Union with Scotland, the British) system of public finance was twofold. In the first place it strengthened the economic power of the central government by giving it virtual immunity from the financial crisis that plagued most of its European rivals. In the second place, and as a by-product of the massive increase in the National Debt, it contributed directly to the modernization of the nation's credit institutions, to the integration of its capital market and to the development of a prosperous and efficient financial sector.

And as Larry Neal has recently argued, the declining risk and increasing liquidity of government debt made its yield an increasingly convenient indicator of the opportunity cost of capital to private investors throughout the country, enhancing the integration of its capital markets (Neal 1994: esp. 153–5, 171–81; also Pressnell 1960). Indeed, it has been argued that falling yields through much of the eighteenth century may have induced ('crowded in') more investment in the private sector, while the increased demand of government war finance from the 1790s temporarily led to a 'crowding out' of that investment (Ashton 1948; Williamson 1984; Heims and Mirowski 1987; also Mokyr 1987).¹

Whatever one may think of the 'crowding out' argument, there can be no doubt of the relative superiority of Britain's financial position at the end of the eighteenth century. Its strength can be illuminated by comparison with another great-power contender of the times, France. Britain's

financial revolution, according to Charles Kindleberger (1984), put it, financially speaking, one hundred years ahead of France. Kindleberger emphasized the collapse of John Law's bank project, the Mississippi Bubble and the ensuing state bankruptcy of 1720, for this left France with a legacy of popular mistrust of banks and government debt which could only be overcome in the nineteenth century, roughly one hundred years later (Cameron 1967). It should be added, however, that French financial backwardness followed not from the collapse of 1720 alone, but from the continuing unreformed character of eighteenth-century French political institutions and the resultant weakness of public finance. The crisis of state finances, we recall, led directly to the Revolution, and in the Revolutionary and Napoleonic eras which followed public finances remained precarious (Marion 1914–33; White 1989; Weir 1989; Velde and Weir 1992). The role of the *assignats* illustrates that precariousness. In François Crouzet's chapter in this book we see that role, as well as the emergence of Napoleon's cautious if ill-fated financial policies, as a reaction to this legacy. The reaction may have included ultimately constructive measures, e.g. the founding of the Bank of France, but in any case it was one with powerful and long-lasting consequences for the French monetary and banking system. The proverbial propensity of the nineteenth-century French financial system to accumulate gold and silver – which braked, even if it did not prevent, French industrialization – thus derived from a series of short-term responses to the state's immediate financial needs at the century's beginning.

Anglo-French comparison would seem to support strongly the notion of 'financial revolution' as a major historical force in the shaping of modern financial systems. A broader comparative perspective, however, leads to a less unitary view and offers, in particular, two important qualifications. First, in a number of successful industrializers modernization of the system of public finance came in bits and stages, and not in the form of a one-shot, unidirectional shift in fiscal mechanisms; and in such cases it hardly seems to deserve the name 'financial revolution'. Second, the state did not respond to its financial problems and influence private systems of finance through fiscal and borrowing mechanisms alone; it frequently relied on administrative measures and regulation (and deregulation) as well. These qualifications are documented throughout the book. The first point can be well illustrated by a brief survey of German experience.

We begin with Prussia, the most important German state. Its 'financial revolution' could be said to have entered an initial phase during the Napoleonic Wars. This phase followed a long period covering virtually the entire eighteenth century in which Hohenzollern Prussia, in contrast to Western countries, adhered to an older, paternalist view of finance

based on the parsimonious principle of 'living within one's means', i.e. holding expenditures to the minimum essential to the state's survival, mainly in order to keep the monarchy independent of the provincial estates and to avoid surrendering some power over the state in exchange for additional powers to tax.² The decisive defeat of Prussia at Jena in 1806 shattered the Hohenzollern state and the internal balance of power between monarchy, landed aristocracy (Junker) and the largely agrarian population of peasant producers (the small urban bourgeoisie was not yet a significant factor). The response was to free the economy from corporatist, quasi-feudal restraints, e.g. by abolishing serfdom, and to centralize government administration, i.e. to strengthen the central government bureaucracy at the expense of the Junker (and to some extent at the expense of the absolutist monarchy). However, the financial measures adopted – new taxes and borrowing from private merchants and bankers – did not have much effect until after the war had been won (in 1815), and they produced, in any case, only promises of parliamentary controls over government finances and no concrete concessions. Moreover, the major loans of 1810, 1818 and 1820 were actually mobilized along traditional lines, contracted through foreign bankers (the Rothschilds), and were not part of a new strategy to tap the financial resources of an indigenous class of capitalist investors.³ Indeed, secrecy remained a hallmark of Prussian finances in these years. For neither the king nor bureaucracy welcomed the guarantee of public credit which a parliament of property owners could have granted. Thus, in the subsequent period the Prussian government's policy stance was highly restrictive, marked by monetary and fiscal restraint, a return to the older Prussian 'Hausvater' tradition of parsimony, even down to considerable reliance on non-tax revenues which had a low political profile.⁴

This changed in the 1840s, when railway building attained high priority in government policy; but the unresolved question of the power to tax and borrow became a major issue. It was one of the problems which led to the Revolution of 1848–9; and one of the most significant results of the Revolution was the second phase of Prussia's financial revolution. For with the adoption of a constitution came the creation of a parliament of property owners with the right to review the government's budget and to control its power to tax and spend. And it is interesting to note the strong increase in government borrowing and related state spending on infrastructure which was registered at this time.⁵

Prussia was important, but Germany's financial modernization transcended Prussian history. Two developments are relevant here. First, the south German states of Bavaria, Baden and Württemberg modernized their systems of public finance earlier and more thoroughly than Prussia.

By the late 1820s they had established accountable systems of government debt administration with taxing and spending powers limited – and legitimated – by parliamentary controls; and these seem to have had financial pay-off in the better borrowing terms which these states enjoyed *vis-à-vis* Prussia from around 1820 to the 1840s (Homer and Sylla 1996; Borchard 1968: 25–9; Ullmann 1986). These states, however, did not go as far as Prussia with respect to deregulation of their economies, e.g. the liberalization of trade, occupational entry or reform of land tenure, so their relative advantage in public finance was offset by Prussia's lead in other policy areas.

Second, for political reasons, Prussia pursued the goal of a German-wide customs union in these years, the realization of which had important financial implications. It turned out that the net revenues generated by the Zollverein were the latter's most attractive argument for many of the states, at least initially; and the distribution of those revenues led to an agreement on fixed exchange rates between the south German Gulden and north German Thaler areas, and eventually even to restraints on the issue of state paper money by the individual member governments (Dumke 1984; Holtfrerich 1989). Customs revenues outweighed seignorage potential, and thus unification of monetary standards and a built-in commitment to price stability and strict controls over the money supply developed out of the Zollverein as an instrument of public finance.⁶ These institutional changes, then, born of the need to respond to short-term problems of public finance, powerfully shaped the subsequent development of the German banking system.

British financial history, though it represents the classic case of 'financial revolution', nevertheless supplies a good illustration of our second point, which stresses the ongoing and general importance of the state as regulator of the private financial system. As noted above, one of the legacies of the English 'financial revolution' of the eighteenth century was the privileged position of the Bank of England and related limitations placed on the development of private, joint-stock banks (through the Bubble Act of 1720). The chapter by Cottrell and Newton in this volume demonstrates the importance of this legal arrangement by showing how rapidly joint-stock banks grew in the 1830s after the law was modified by Acts passed in 1826 and 1833. Their argument is reinforced, moreover, by reference to the slowdown in bank growth which followed another important piece of legislation – Peel's Act of 1844 – which regulated not just the Bank of England but entry into banking generally. Public concern for the status of the Bank of England, an early element of the country's 'financial revolution', thus continued to be an important determinant of its financial development.

That chapter, however, also helps identify a more subtle point about British financial development. For Cottrell and Newton note that the loosening of the Bank of England's monopoly only led to an increase in the number of new joint-stock banks after restrictions on their participation in the London market for small and liquid bills of exchange had been lifted in 1833. This improved their competitive position *vis-à-vis* private bankers but it did so by permitting them to operate in the well-organized London money market. Legislation, that is, encouraged them to do, on a somewhat larger scale, what their predecessors, the country banks, had already been doing, and therefore strengthened the 'market-orientated' elements of the British financial system.

This is worth stressing since, by a species of dialectic, these strong market elements also shaped the further development of British financial institutions.⁷ In Forrest Capie's chapter on central banking, it becomes clear that when the Bank of England began to try to assume lender-of-last-resort responsibilities (e.g. in the 1870s) it defined these in terms of anonymous relationships (sometimes termed 'arms-length' relationships), and was concerned with 'keeping in touch with the market', infusing liquidity, but not with monitoring the individual institutions involved and keeping watch for bad risks. Thus Britain's central bank – whose behaviour pattern proved not to be a model for Continental Europe – had to respond to a market development which was, in turn, at least in part a response to the Bank of England's own history.

The case of the United States offers yet another relevant chapter of historical experience, for in that country decentralization of political power was even more pronounced than in the German case. The institutions which determined public finance reflected that decentralization. Yet it is worth remembering that centralization of power is, and always has been, a part of the American experience. Conflicts between decentralizing and centralizing forces were always present, but for the most part they were accommodated into a framework of stable politics by the country's ingenious federal system that, under the Constitution of 1787, divided up sovereignty between federal and state governments. Sylla's chapter explores, within the federal-system framework, how the fiscal needs of governments at several key times in US history gave lasting shape to the country's financial system. Thus, however 'exceptional' the United States may have been in some respects, in terms of the thesis of this volume it was not at all exceptional.

Sylla's first example antedates US independence. Fiat paper money appeared for the first time anywhere in the Western world in colonial Massachusetts as a solution to a pressing short-term problem of public finance. But it quickly became a solution to the problem of providing the

means of exchange to accommodate long-term economic expansion throughout the American colonies, and in time throughout the world.

The historical concept of ‘financial revolution’ has already been raised here in connection with England and the Netherlands. It applies as well, Sylla argues, to the United States, where the Federalists of the 1790s, led by an able finance minister, Treasury Secretary Alexander Hamilton, engineered a sharp break with America’s previous financial history by introducing, in just a few years, a modern financial system with specie-based currency and public debt, corporate banks issuing convertible notes, a central bank and active securities markets. This financial system became a key underpinning of the country’s early start on the road to economic modernization.

Public finance considerations also figured prominently in the proliferation of American banks under the auspices of state charters. The states saw that their bank charters had value and learned to appropriate some of that value for public purposes. The lessons learned early by the states were instrumental in the development of the federal government’s national banking system, which came in during the Civil War of 1861–5 to aid in the government’s wartime bond sales. The occasion was also used to introduce for the first time a uniform national paper currency backed by the credit of the federal government.

Mira Wilkins’ chapter in a sense provides a sequel to Sylla’s. The United States, in no small measure because it possessed a dynamic, modern financial system from its first years as a nation, grew over the course of the nineteenth century into the world’s largest economy. Until the First World War, however, the country remained an importer of capital as well as the world’s largest debtor nation. The war changed all that. When it ended the United States had become the largest creditor nation. By the 1920s, New York City had become the hub of international finance. This came about, Wilkins says, ‘not because of any action or lack of actions of the US government, but because the United States was where the capital and the capital markets were’. The suddenness of the change in America’s international position, coupled with the lack of governmental financial involvement and leadership in the 1920s, led to some of the abuses that became painfully evident at the decade’s end. Wilkins notes that the ensuing crisis of the 1930s brought new governmental regulatory structures in finance that once again reshaped the US financial system. These changes, however, lie beyond the purview of this volume.⁸

The history of the other industrializing countries offers many variations on the same general theme. In the case of Belgium, as explained in the chapter by Herman Van der Wee, fiscal problems in the aftermath of

the Napoleonic Wars were behind the unwillingness of the Dutch parliament to sanction the state-owned development bank proposed by King William for the southern Netherlands (later Belgium). That refusal led in 1822 to the chartering of a *private* institution which did not require parliamentary approval. Thus was born an institution which was to play a dynamic role in Belgian industrialization and which was eventually to become one of the world's most successful universal banks, the Société Générale de Belgique. What it became, however, went far beyond the initial mission, which was to alleviate the state's financial situation. Ironically, perhaps, it was the king himself who initially weakened the Société Générale's role as government fiscal agent. He did so by pushing that institution into its universal banking activities, on the one hand by enlisting its support for a number of infrastructure projects and on the other hand by encouraging it to build up a national network facilitating the use of bills of exchange as credit and payments instruments. Even before the Revolution of 1830 led to the creation of the kingdom of Belgium, the Société Générale had begun to assume its leading role as a universal bank which combined its support of heavy industry and transportation investments with successful commercial banking operations. The correlation between the business activity of this single institution and Belgian industrial growth is truly remarkable.

Germany's economic history supplies yet another case in which repeated, though infrequent, shifts in the policy stance of the state continued to shape the contours of private financial development. In chapter 6, Tilly documents two short-run responses to financial crises with long-run effects. First, in the 1840s, the Prussian state's answer to crisis was to establish a government-controlled bank of issue which soon acquired a dominant position in the country's system of payments and short-term credit, thus encouraging private institutions to concentrate their resources in riskier, longer-term activities. Second, the boom and bust of the 1870s reflected short-run political changes, but it eventually led to a reform of the German system of corporate finance which encouraged concentration among both banks and industrial enterprises. The long-run implications were thus of major importance.

The cases discussed up to now represent, so to speak, scenarios not only in which significant shifts in the conditions of public finance took place which had readily identifiable, if long-run, effects on the development of private financial institutions, but in which rapid industrialization and economic growth also came about, presumably in part as a result of the operations of such institutions. For there can be no question but that the histories of nineteenth-century Britain, Belgium, France, Germany and the United States are success stories from the perspective of long-run

economic growth. That is, the theme of ‘economic modernization’ is not an undeserved component of our book’s title. That warrants emphasis in this introduction, since neither economic growth nor the mechanisms which link it to financial development are explicitly investigated here.⁹

Of course, an historical generalization based on the early industrializers alone cries for extension – in time and place. The book supplies that extension by including within its purview some industrial ‘latecomers’. The Spanish case provides a different angle on the interrelationship between the state and the financial system, a case which also illustrates the ability of institutions to stimulate or arrest economic development, and provides an example of what one may call ‘Cameron-Gerschenkron’ modernization, when banks and the state largely replace the market in mobilizing funds for industrialization. In the early modern period, the profligacy of the Spanish state and its disregard of economic logic played havoc with the country’s financial institutions (Tortella 1997: esp. 230–2). It was the state’s financial predicament which favoured the foundation of Spain’s first modern bank (Banco de San Carlos, 1782) and its demise. A state-sponsored plan to stimulate growth of the banking system as a means of financing the railway network in the mid-nineteenth century also ended in partial fiasco. It was not until the twentieth century that the birth of a strong private banking system, the state’s decision to put its financial house in order after the 1898 *débâcle*, and the development of a special triangular relationship between the central bank (the Bank of Spain), the large private banks and the Ministry of Finance permitted the establishment of a surprisingly robust set of mixed banks, able to finance the development of heavy industry (metallurgy, chemicals, electricity) and public works without suffering – at least not with the same acuteness – the recurrent crises which affected other European ‘mixed’ systems. Undoubtedly, the fact that Spain was on a silver standard (which was *de facto* fiduciary) contributed to lend flexibility to this rather unique setup. In the Continental tradition, the capital market played a secondary role in Spain, and it was the large banks, with strong support from the central bank and the state, that took the lead in industrial finance.

Peter Hertner’s chapter considers the experience of yet another industrial latecomer – Italy. As its title suggests, the main theme concerns the links between central banking and private, commercial banks. The initial weakness of those links documented here is striking and raises two sets of questions pertinent to the general concerns of our book. First, to what extent did the underdeveloped character of central banking itself, as reflected in the plurality of banks of issue and the failure to maintain convertibility and exchange rate stability, derive from the political and financial weakness of the Italian state? Second, given that underdevelop-

ment and given the rapid growth of the activities of the two large mixed banks in the period, should we not conclude that successful 'industrial banking' owed little to effective central banking institutions?¹⁰ Hertner does not deal with the first issue directly, but his account suggests that the initial weakness of central banking was gradually overcome, partly because the Bank of Italy's position strengthened, partly because its chief, Stringher, began to redefine the bank's role in the country's financial system. There are thus some grounds for believing that the Italian mixed banks – and the Italian economy – would have done less well had central banking not strengthened over these years.

Our list of important 'industrial latecomers' includes Czarist Russia. Here, too, state financial priorities had consequences for the development of private financial institutions. Throughout the nineteenth century, the state faced the problem of reconciling its imperial, expansionist ambitions with a Russian economy that developed so slowly that it became more and more backward relative to the industrializing economies to its west in Europe. Russia's solution was autocratic: the state itself, meaning the Czar and his ministers, would exercise vastly greater control over the Russian economy and financial system than was the case elsewhere in Europe. In his chapter on Russia, Anan'ich gives a detailed account of how, during the century before 1917, the Russian state exercised nearly absolute control over the country's public and private financial arrangements through the Credit Office of the Ministry of Finance. During that period, the Credit Office centralized in one bureaucracy financial functions that were widely diffused in other countries. These included public debt negotiation (including foreign loans and state-guaranteed loans for railway building), debt management, the chartering and supervision of public (state-operated savings, mortgage and central) banks and most types of non-public (e.g. joint-stock land and commercial) banks, tax administration, coinage at the mint, foreign exchange dealings and stock exchange supervision.

In Czarist Russia, therefore, very few fiscal, monetary and credit institutions were beyond the ken and regulation of the Credit Office. Anan'ich's account provides a concrete example of what autocratic centralization of financial authority meant in practice. Autocratic rule in finance in Russia's case proved to be not inconsistent with industrial modernization, for by the 1890s the country embarked on an industrial upsurge. Russia's financial system, under the eye of the Credit Office, grew apace with this move towards modernization.

All of this happened, interestingly, without a 'financial revolution' in the Western European sense described earlier. In one respect, to be sure, Czarist Russia did adapt to Western bourgeois rules: in order to finance

its ambitious programme of economic modernization, it adapted to the demands of private financial institutions abroad, from the 1850s by reliably honouring its foreign debt commitments, then dramatically in the 1890s by adopting the gold standard. The related success story of capital inflow and economic growth is well known (e.g. Gregory 1994). This did not reduce the Czarist state's wish to control the financial system, however; and nor could it prevent the end of the *ancien régime* in 1918. A poignant element of Anan'ich's narrative is his account of how the finance minister during the last months of the Czarist regime was confronted by a seeming need to increase the regime's autocratic control over finance to cope with crises, and an opposed need to reduce such control – to deregulate a highly regulated system – in the interest of a stronger Russian economy. The Czar's regime was not given time to resolve this conflict.

Our comparative perspective necessarily widens as we move from our European centre to the periphery. That could be seen in the case of Czarist Russia. It is even more apparent if we consider the case of Argentina. With this example we take up a developing economy in which real economic development and its concomitant financial development were extremely dependent on foreign political and economic influences – on exports, on capital imports and also on immigration. Nevertheless, internal political conditions had great influence – more than is often thought (see Marichal 1989 on this). Cortés Conde shows how domestic political fragmentation encouraged the development of a weak banking system, in which governments founded banks to favour special interests but also to ease their own financial problems (by imposing, in effect, a seignorage tax). When fragmentation increased, for whatever reason, weak financial institutions proliferated, their growth potential magnified by European investors who were 'bullish' on Argentina. The episode known in European economic history as the 'Baring Crisis' of 1890 had its origins in an almost anarchic expansion of provincial state banks and their corresponding note circulation in the second half of the 1880s. This was facilitated by an attempt at 'free banking' regulation (law of 1887) reminiscent of the US. Only when the crisis had broken the banks and foreign creditors as well did thorough-going reform of the banking system come. And even at that it took nearly a decade, for the decisive legislation first came in 1899, in association, significantly, with Argentina's adoption of the gold standard.

It is time to draw together the strands of the foregoing comparative observations. Three, or possibly four, general themes stand out. They correspond to questions deserving further research attention and represent issues raised, directly and indirectly, in the chapters which follow.

The first theme is the great inter-country differences in the mix of public and private finance and in the way states influenced private financial development. The differences range from the increasingly market-orientated development of Great Britain to the continuing strong controls exercised by the state in Czarist Russia. They call for further attention since they bear on the general question of what and how well financial institutions contributed to economic modernization in the countries considered. If it is true, for example, as Sylla has argued for the US case, that major financial innovations came about largely in response to changes in the arrangements governing public finances, then great interest necessarily attaches to those changes. An important caveat calls for acknowledgement here, to be sure: the differences noted may result from fundamental differences in the nature of the politics of the countries, e.g. in the degree of political fragmentation (or decentralization), or as a result of a country's position in the international system of power politics. They certainly do *not* simply reflect different development strategies.¹¹ Still, the national differences in this respect do offer an intriguing possibility for understanding how and how well financial systems have developed.

Second, the way in which the state affected private financial development had much to do with its influence on the flow of information relevant to private financial decision-making. This is obvious in the case of public finance: the institution of such rules as parliamentary controls over state budgeting, for example, could serve as useful information about the future expected real rate of return on government debt instruments. Another obvious and quite general example can be seen in the adoption of gold standard rules by nineteenth-century governments: this represented a signal to investors at home and abroad. Less obvious, but important, were the regulation of business incorporation and the conditions under which private corporate debt and equity could be traded in organized markets. At one extreme, stringent government controls could prevent competitive financial markets from developing; and at the other, lax disclosure requirements could allow such nascent markets as might have emerged to atrophy.

A third issue, related to that just mentioned, concerns the relative effectiveness of 'market-orientated' as opposed to 'bank-orientated' financial systems of private finance as development mechanisms. The chapters which follow include historical success stories associated with both types of system and offer illustrations of both costs and benefits of the underlying institutional arrangements. Comparative assessment of these two 'ideal types' (Weber) is related to the relative merits of hierarchies in overcoming problems of information asymmetry between providers and

users of financial capital as weighed against the presumed disadvantages (or costs) of having less competition than under the alternative, market-orientated arrangements. Readers will have to judge for themselves how clearly our book resolves this issue. Nevertheless, it is worth noting here that financial problems currently faced by countries in the process of economic transformation and development have analogies in the historical experience discussed here.

Finally, short-run state policy responses to immediate problems, economic and non-economic in nature, could have long-run effects on a country's financial development and on its overall pattern of economic modernization as well. Put somewhat differently, a country's long-run financial development can be said to reflect the historical sequence of events experienced, i.e. it is path-dependent. The histories of all of the countries considered in this volume illustrate the point. War and revolution seem to have powerfully influenced the private financial structures which emerged for example in France, in Belgium, in the US, in Germany. What remains to be seen, to be sure, is not only whether the paths of development observed varied significantly across the countries studied, but whether – and the extent to which – their doing so reflected uniquely different sequences as opposed to uniquely different sets of purely economic forces, such as relative prices and quantities of factors of production.

NOTES

- 1 It should be noted here that not all of the changes associated with 'financial revolution' necessarily contributed to improvement of the private financial system. The Bubble Act of 1720, for instance, may well have served to keep English banking smaller scale and more fragmented for a longer period of time than the needs of industry would have dictated. See Cameron 1967.
- 2 On this point see the insightful comments by Braun (1975).
- 3 Although this class developed strongly over the period, as the considerable growth of financial activity (including the sale of foreign securities in Berlin's capital market) between 1815 and 1840 indicates. On this see Brockhage 1910 and Borchardt 1961. See also the essay by H. Schissler and the documents edited by her and H.-U. Wehler in *Preussische Finanzpolitik 1806–1810* (Kehr 1984).
- 4 This policy stance even included restraints on military spending. Prussian money stock growth in the 1820s and 1830s was low by comparison with France or England; and its borrowing per capita, the highest among the fifteen most important German states in 1815, was by 1815 the lowest of that same group. See Cameron 1967; Borchard 1968. Borchard shows how Prussia's investment was restrained by its self-imposed fiscal conservatism.
- 5 On this see, in addition to Borchard 1968, Tilly 1966.
- 6 Of course, the individual German states were able to charter and *did* charter

the private banks of issue, but since users of their notes were able to discriminate between the different issuers a general overissue did not take place, and the largest state bank of issue, the Bank of Prussia (with around two-thirds of total circulation), set the pace for the rest. See on this Thorwart 1883.

- 7 That implies that the older studies which stressed the importance of the London money market were on 'the right track' (see King 1936; Pressnell, 1956). From around the 1860s the inland bill declined in importance, but the growth of foreign bills more than offset the decline; and the London money market became, if anything, more important for British banks. See Nishimura 1971.
- 8 For a perspective on twentieth-century changes in US financial development and regulation, see Bordo and Sylla 1995.
- 9 This question has been at the heart of many publications, including some written by the editors and also by Rondo Cameron. Two further points may be worth making here, however. First, the histories discussed in this volume include evidence of a positive connection between financial and economic modernization. One might even go so far as to claim that swings of more rapid economic development were favoured by changes in financial institutions, for example by a contraction of government demands for savings after a prior expansion of such demands had whetted investors' appetites, so to speak, by demonstrating the advantages of supplying them. Second, economic modernization, associated with capital-intensive technologies on the one hand, and with rising incomes on the other, will also have had powerful effects on financial institutions. An obvious point, no doubt, but worth remembering.
- 10 One could even go a step further and suggest – thanks to available evidence on rapid industrial growth in the period – that banks were less crucial for Italian industrialization than has been often argued. On this see Federico and Toniolo 1991: esp. 202–6.
- 11 We also acknowledge the fact that financial innovations deriving from changes in state policies need not have been primarily benign in their effects on economic modernization potential. Many scholars have noted the dialectical relationship linking state regulations with innovations which did not more than offset some of the negative effects of the former.

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