



Book Reviews

Howard Bodenhorn, *A History of Banking in Antebellum America: Financial Markets and Economic Development in an Era of Nation-Building*. Cambridge: Cambridge University Press, 2000. Xxi + 260 pp. Hardback \$59.95, Paperback \$22.95.

Thank goodness, a book on antebellum American banking that is *not* primarily about banking *policy* (Jackson versus Biddle, state banking debates). Howard Bodenhorn instead explores topics that the textbooks have largely ignored: what kinds of *business* antebellum banks did, and how they contributed to economic growth and development. His monograph will be useful to anyone who teaches money and banking or the economic history of the United States. (I teach both, so I will find it doubly useful.) Readers of this journal should note that Bodenhorn favorably cites Schumpeter on economic development, but does not draw on Austrian monetary or capital theory. The book is largely an integrated compilation of the author's articles published over the last eight years.

Bodenhorn (p. 23) rightly emphasizes that “banks can affect economic development either by increasing the pool of savings available to potential investors or by directing capital into more efficient investments.” As he notes, Edward Shaw, Ronald McKinnon, and Hugh Patrick have emphasized the first channel; Raymond Goldsmith the second.

Adam Smith discussed both. As Smith argued, one important increase in the pool of savings arises from allowing money-holders to voluntarily replace the coins in their purses with fractionally backed banknotes (or bank deposits). The substitution of bank liabilities (which fund bank loans) for coin augments the economy's stock of loanable funds and provides the means for capital formation. Bodenhorn (7–8) writes: “In 1800 banks and thus bank-supplied currencies were relatively unknown in the hinterlands. By 1820 banks had extended their reach and were monetizing at least some parts of the rural economy.” Later (44) he similarly names monetization as one of chief benefits of banking. These statements suggest that the use of banknotes and checking deposits directly replaced barter; I suspect that instead they mostly replaced the use of coin. Thus I think it would be better to speak of the substitution of bank-issued money (what Mises called “fiduciary media”) for coin than to speak of “monetization.”

Bodenhorn may actually agree. When he proposes (45) a verbal model (or “parable”) to explain “the link between financial development and economic growth,” his starting point is not a barter economy but a purely metallic monetary system. He does not offer any evidence that barter widely prevailed in the hinterlands in 1800. Nor does he provide any argument supporting the conclusion that bank-issued money is better than coins for promoting monetization. There does is a strong argument to be made: in the relevant case of a monopoly government mint versus competitive private banks, the products produced under greater competition (which takes place primarily along the interest rate dimension in deposits, along nonprice dimensions in currency) provide consumers with greater benefits to using money.

If coin and not barter did in fact previously prevail, then the historical spread of banknote use could not have been due to lower inflation rates, contrary to Bodenhorn (8), because prices in coin shared the same inflation rates. It was due to the other main factor he cites, namely banks becoming better known and trusted.

Bodenhorn's explanation of the social savings from fiduciary media is imprecise. While fractional-reserve banknotes are on average less costly than precious metals, the cost of issuing and keeping a \$100 note in circulation is far greater than the cost of paper and ink that Bodenhorn cites (17). In a competitive equilibrium the last \$100 in notes is, like the last \$100 in coin, produced at an opportunity cost of \$100.

Bodenhorn (14) writes that governments "encouraged the establishment of financial intermediaries by granting them special privileges." He specifically names limited liability and grants of monopoly. Limited liability has of course become an option available to businesses generally, so it hardly counts as a special privilege any more. Grants of "local, regional, or even state-wide monopolies" were indeed privileges, but surely they restricted rather than fostered the establishment of banks. It was states like those in New England, with liberal chartering policies rather than monopolistic grants, that encouraged banking. Bodenhorn usefully surveys the structure of banking systems region by region.

To gauge the "macro" impact of antebellum banks on growth, Bodenhorn (63–64) offers a table of figures on bank-issued money (note-circulation plus deposits minus notes held by other banks) per capita by state at decade intervals, a similar table on bank credit (loans and holdings of commercial paper), four dozen bivariate cross-sectional regressions of growth on measures of financial depth, and two sets of Barro-type cross-sectional regressions of growth on a variety of right-hand-side variables. These exercises are informative but in some ways puzzling. Bodenhorn remarks (65) that "money supply and credit intermediation were so close in antebellum America," but in fact his tables show that the volume of bank credit was about triple the volume of bank-issued money. He does not tell us what mix of equity and other liabilities funded the remainder of bank assets, nor the percentage that credit occupied in total bank assets. The growth regressions try four different measures of financial depth, over subsamples of fast-, medium-, and slow-growth states as well as the sample of all states, for three separate decades ($4 \times 4 \times 3 = 48$ regressions). The motive for splitting up the sample by decades is presumably deeper than that of increasing the number of chances to achieve statistical significance, but Bodenhorn does not clearly motivate the splitting (or explain why he does not alternatively report results for all three decades taken together).

Bodenhorn (83) makes the important observation that states with "liberal chartering, free banking, or broad-based branch banking" had superior growth performance. But this remark is apparently based on a casual cross-state comparison. He does not try using banks (or bank offices) per capita as the financial-depth variable on the right-hand side of a growth regression.

To gauge the "micro" impact of antebellum banks on growth, Bodenhorn delves into the balance sheet records of four commercial banks, variously located in Watertown, NY; Petersburg, VA; Memphis, TN; Charleston, SC. A sample of four is admittedly small, but it certainly beats the sample of zero that informs most banking histories of the period. Bodenhorn finds that the largest share of loans went to merchant firms, the second- and third-largest to service and manufacturing firms; and that these shares roughly matched

the prevalence of such firms in the local economies (for the two towns where this can be evaluated). Some historians have imagined that antebellum banks failed to feed the economy's growth sectors, but no such failure is evident in the balance-sheet data.

To assess whether the antebellum banking system moved funds from lower-return to higher-return areas, Bodenhorn turns to the standard question of whether the regional pattern of interest rates shows the convergence implied by arbitrage. A number of historians have found that the postbellum period was marked by a lack of national capital-market integration. Bodenhorn (162) finds, somewhat surprisingly, that "regional interest rate differentials were generally smaller before 1860 than after 1900." The disintegrative effects of the Civil War—or perhaps of the National Banking regulations imposed during the War—were remarkably large and persistent.

Bodenhorn rightly questions the view that Nicholas Biddle personally brought about market integration through the policies he pursued as head of the Second Bank of the United States, a view common among historians who simply take Biddle's word for it. He argues that although the Second Bank was not irrelevant, the integration into a national capital market was largely accomplished by trading relationships among hundreds of banks and commercial paper brokers in different cities: "The antebellum commercial paper market consisted of a complex network of state-chartered banks, exchange brokers, private bankers and speculators."

In all, Howard Bodenhorn has provided economic historians with a useful and persuasive account of the contribution that banks made to America's early development.

Lawrence White

Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships by Mancur Olson. New York: Basic Books, 2000, 233 pages. ISBN 0-465-05195-2.

Mancur Olson, one of the most influential economists of the late twentieth century, died suddenly in 1998, leaving behind an almost completed manuscript of his third major work, subsequently published as *Power and Prosperity* (2000).

Throughout his career, Olson focused his research on the analysis of collective action, a field to which his book *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Mass.: Harvard University Press, 1965) made a seminal contribution. In that work, he argued that individuals have no economic incentive to participate in seeking large-group collective goods unless coerced or presented with other "selective incentives." Therefore, small groups have an advantage in organizing and lobbying for the provision of specific collective goods, gaining that provision at the expense of larger, unorganized groups such as taxpayers or consumers. Successful politicking corresponds with the now-familiar shibboleth of Public Choice theory, "concentrated benefits, dispersed costs."

In his second major work, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (New Haven: Yale University Press, 1982), Olson argued that with the passage of time a stable regime suffers increasingly from "sclerosis" as more and more small groups organize and lobby successfully for government actions that serve their