

Kenneth A. Snowden is an associate professor of economics at the University of North Carolina at Greensboro.

## Commentary

Kenneth A. Snowden

**W**e have learned a great deal over the past two decades about the principal components of the American financial system between 1790 and 1840—banks, nonbank intermediaries, and the market for corporate and government securities. In his paper, Richard Sylla assesses this literature and argues for a new interpretation of financial development during the early national period. Sylla is well qualified for the task because he, along with collaborators, has contributed much of what we know about the structure and performance of the U.S. securities market and the finances of state and local governments before 1840. Sylla integrates the histories of the banking system and the capital market to better explain the broad contours of early U.S. financial development and its impact on the nation's growth. In doing so, Sylla articulates an interpretation that informs, challenges, and stimulates both financial historians and students of economic growth.

Sylla's argument has three parts. First, he observes that modern scholars have focused too heavily on the early development of the U.S. banking system and examined this component of the financial system in isolation. The reality, he argues, is that banks and the securities market had close ties from early on in the United States and grew up together. Sylla's second point is that the Federalist financial policies provided the initial impetus for interrelated financial development in the 1790s and continued to support it through the early decades of the nineteenth century. As a result, the United States was blessed early on with a financial system that rivaled the best in Europe and surpassed all other New World competitors. This leads to Sylla's

third and most important point: Economic growth in the United States was financed before 1840.

Sylla's argument is modest in neither goal nor scope. He believes that U.S. financial-market development was rapid, pervasive, and growth-enhancing before 1840, and that government policy was instrumental to the process. This big picture should stimulate renewed interest in financial development during the early national period of U.S. history and will certainly shape that investigation. In this comment, I offer my thoughts concerning these future directions by considering the strengths and weaknesses of Sylla's three major themes.

### INTERRELATED FINANCIAL DEVELOPMENT

Sylla's central insight is that the development of the U.S. banking system and that of the securities market were closely linked and mutually reinforcing during the early nineteenth century. Like many important historical generalizations, the point seems obvious once made—after all, Hamilton, Gallatin, Girard, and others figure prominently in historiographical treatments of both banks and federal debt management policies for this period. Sylla looks beyond the accomplishments of great men and for the first time clearly focuses our attention on the functional connections between the markets in which they participated.

Sylla (1975) alerted us two decades ago to one element of the linkage between banks and the securities market that was still at work during the post-Civil War era. He argued then that the National Banking Act cemented correspondent relationships between country and city banks and effected a flow of reserves from rural areas to the New York City call loan market. He noted that the historical roots of this mechanism date back at least to the 1830s and represent one way in which the devel-

opment of the banking system supported the securities market.

Sylla (1998) is more concerned with the opposite direction of impact—how the development of the securities market stimulated bank growth. The point is made by connecting two previously separate bodies of evidence regarding financial development during the early national period. The first concerns the performance of the securities market between 1790 and 1810. Sylla, Wilson, and Wright (1997) have recently shown that the market for U.S. government securities quickly became modern in structure and efficient in performance. This result is important in its own right because it expands the existing literature on historical securities-market performance. We already know, for example, that American stocks were priced efficiently by the 1870s (Wilson and Jones 1987; Snowden 1987) and that they displayed “modern” patterns of returns and volatility as far back as 1802 (Schwert 1990). So the four results that Sylla (1998) cites appear to extend the “early security market efficiency thesis” even further back in time. More to the point for the argument of this paper is the fact that the market for government debt was already deep, broad, and sophisticated as early as the 1790s.

A second set of facts emerges from a re-examination of Festernmaker's data on U.S. banks. Sylla is careful to point out the warts in these numbers, as well as the difficulties that arise when one compares American and British bank capital for this period. Nonetheless, the results of his analysis are persuasive and startling: U.S. bank equity grew rapidly in the first few decades of the nineteenth century and by 1830 was probably twice as large as the banking capital of England and Wales.

Sylla draws these two generalizations together by asking which types of financial assets, other than federal debt, were traded in the precocious American securities market. Most important, we learn, was bank stock—most prominently, shares of the First Bank of the United States (BUS) and the equity of large, state-chartered urban

banks. Remarkably, these securities were traded in all major regional exchanges by 1811, even though the nation's commercial banking sector was still in its infancy. From this evidence, Sylla concludes that the development of the securities market and banks were intertwined and mutually reinforcing from 1790 to at least 1830. Early in the period, the stocks of the federal government and the federally chartered Bank of the United States dominated, while the securities market became deep, broad-based, and efficient. State-chartered, incorporated commercial banks then used the market to grow rapidly.

I hope and expect that Sylla and others will continue to refine our understanding of the bank/securities market nexus. Two potential lines of inquiry strike me as particularly intriguing. First, it is important to assemble at least rough estimates of the growth in banking services (loans, discounts, and note issues) to complement Sylla's estimates of the growth in bank capital. U.S. banks tended to operate at relatively high, and potentially variable, capital ratios during this period, and we will ultimately want to focus on variations in the output of American banks across space and time. Additional data like these will be hard to come by and, in my opinion, are unlikely to substantially change the estimates of aggregate bank growth that Sylla (1998) presents. These data would, however, provide a clearer picture of how widely and deeply the benefits of bank development were distributed across the economy.

A more exhaustive analysis of bank stock transactions would also provide better focus on how bank development benefits were distributed across the economy. The evidence presented in his Table 3 successfully establishes Sylla's basic point: An active market in bank stocks was operating between 1800 and 1820. But this picture is both more and less compelling than Sylla's discussion indicates. On the plus side, the bank stocks that were listed and quoted in 1811 for the Baltimore, Boston, New York City, and Philadelphia markets include every bank that had been chartered by 1810 in these four cities (Perkins 1994, p. 274). But

in these same markets not one stock was listed from the group of 80 banks operating outside the major money centers by this date. Their absence offers little support for Sylla's claim that the equity transactions involving large urban banks represent only a "tip of the iceberg" that extended to smaller banks in smaller cities. I doubt, moreover, that further analysis of the financial pages of big city papers will change the picture very much because the two later dates (1811 and 1817) represented in his Table 3 were both years of very rapid bank growth as the industry adjusted to the disappearance of the First Bank of the United States and then to the establishment of its successor (Walsh 1940, p. 123).

To be fair, Sylla cautions us to expect that dealings in the equity of smaller banks would have been more infrequent and less publicized than those of their big-city counterparts. But we will need more evidence to establish that the bank/securities market connection was pervasive and not narrowly confined to major Eastern trade centers. Perhaps one could identify wider impacts that resulted from the securities market dealings of the largest banks: Did owners of smaller institutions use these markets to diversify their bank-related investments? Did large banks raise funds to subsidize the development of their correspondents? Alternatively, one could undertake the painstaking task of culling through the histories of smaller bank enterprises in different regions to construct a systematic picture of how their equity was initially raised and how often that equity was then traded.

These suggestions for future work are not intended to detract from Sylla's accomplishment. To the contrary, they reflect my belief that Sylla has refocused and enlivened the debate on financial-market development during the early national period by clearly exposing the connection between banks and the securities market.

## THE FEDERALIST FINANCIAL REVOLUTION

Government policy plays a key role in Sylla's analysis and conclusions. He argues

that modern, private financial arrangements emerge only if the public sector provides an infrastructure of sound government debt and solid monetary arrangements. There can be no substantial disagreement with this general historical observation. But financial development is ultimately driven by the private sector's real demand for intermediation and the legal and informational constraints that determine the types of financial contracts that can be written and enforced. I would have liked to have seen much more about these influences in Sylla's paper. But Sylla takes the view that the monetary and fiscal arrangements chosen by the public sector determined the pace and character of early American financial development. He also asserts that the Federalist Revolution represented the critical watershed in the process.

I cannot disagree that government policy deserves a place at center stage. In 1770, the colonists were still prohibited from organizing banks and forced to seek mercantile credit from British agents. The American Revolution swept this structure aside but created financial exigencies that drove government fiscal and monetary policies for at least a decade. And then, only five years after the cessation of hostilities, a constitutional convention began rewriting the laws of the land. These laws included the most basic fiscal and monetary rules of the game. A settlement committee began to apportion the overhanging war debt among the state and federal governments. By 1790, the American financial system had endured two decades of continuous turmoil and uncertainty in the basic public policies that condition the private sector's ability to develop and implement its own financial innovations.

From this perspective, an obvious achievement of the Federalist program was a sorely needed measure of institutional stability. But Sylla seems to argue that Hamilton's revolution was not simply permissive in character: Federalist policies provided a particular direction for private-sector financial development and were designed to accelerate the process. I

am ambivalent about Sylla's position on this last point because I have trouble following this part of his argument. When he cites Beard at some length, for example, he endorses the idea that Hamilton and his allies resolved a fundamental controversy over alternative models of financial structure in favor of the "financial, commercial and industrial classes" who opposed "state parochialism." But even though Beard clearly believed that Hamilton was responding to specific "interested demands" rather than general political theories, Sylla chooses not to identify the particular private financial arrangements or interest groups that he believes Hamilton had in mind.

At times in the discussion, in fact, it appears that the Federalist program was imposed on an environment in which no coherent private financial interests had emerged. Commercial banks had appeared in the 1780s, but "these were isolated, local" institutions. And even though private investors held and traded large amounts of risky state and federal debt during that decade, "there was no organized capital market." These characterizations may be historically accurate, but they provide little information about the forces that drove financial innovation and development in the private sector prior to the Federalist Revolution, however modest the gains may have been.

I found Sylla's discussion of the eventual impacts of the Federalist program to be much clearer. The reason, I believe, is that policy is directly connected here to the bank/securities market connection discussed earlier. Under Hamilton's program, the federal government funded \$77 million of securities in 1790 and 1791, or a debt equal to 40 percent of gross domestic product. The taxing power of the new constitutional government secured these bonds, which were made even more attractive by the provision that \$6 million of the debt could be used to subscribe to the stock of the BUS. Together, these policies created a much deeper and more active securities market than would have emerged in their absence.

## FINANCE-LED ECONOMIC GROWTH

Sylla concludes his paper with a discussion of the most important implication of his analysis: American economic growth was finance-led. The argument is appealingly simple. He notes that attempts to explain the onset of growth by identifying a specific "leading sector" have been tried and have generally failed. This leads to the possibility that all of the "real" candidates—cotton, factories, canals, and railroads—were stimulated by the rapid pace of financial development after 1790.

Financial historians, and I am one, are predisposed to conclusions in which financial markets matter. But we know, and I am sure Sylla is aware, that it will take much more to make the case for finance-led growth than simply proposing it as the best, new candidate for the role of a leading sector. He provides no specific guidance to those who will take up this challenge, nor will I. For now it is enough to observe that Sylla has identified the bank/securities market connection as the driving force of early American financial development, has characterized the pace at which this mechanism worked, and has explained how it was enhanced by government policy. He has given us much to think about and left us with much work to do.

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MAY/JUNE 1998

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