Integration of Financial Markets:

the British and French Experience

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INTEGRATION OF FINANCIAL MARKETS: THE BRITISH AND FRENCH EXPERIENCE

By

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I am honored to be asked to Karachi to celebrate the life and work of a distinguished statesman, educator, planner, and central banker, Mr. Zahid Husain, Minister of Finance in the Government of the Nizam of Hyderabad before partition, Chancellor of Aligrah University, Member of the Commission distributing assets between Pakistan and India in 1947, first chairman of the Pakistan Planning Commission, first Governor of the State Bank of Pakistan. I am honored but at the same time I am considerably embarrassed. It is hard to know what if anything I can contribute to the edification or interest of a central-banking audience in a developing country in this part of the world when my recent research has been almost entirely confined to the economic history of Western Europe. The subject of economic development is one that I had a brush with in the 1960s, but it has become too subtle, complex and ramified for me to keep up with. I have become aware, however, of the interest in the development literature in financial institutions, and in particular in the research of McKinnon on financial repression,[1] and of Shaw on financial deepening.[2] While I fear I know nothing of the past, present, or future state of financial institutions and their structure in Pakistan, it occurred to me that it might be of interest to you to offer a contrast of the experience of financial integration in the eighteenth and nineteenth centuries of England on the one hand and France on the other. To give the comparison somewhat greater generality, I propose to add a highly compressed account of the issue in the United States from which I come.

Financial repression in McKinnon's phrase consists in setting a price for external finance (the interest rate) below the equilibrium level, and discriminating in favor of the government, firms engaged in foreign trade, and perhaps a few others, at the expense of other would-be borrowers who are either excluded from the market altogether and made to depend on internal finance, limited to high-priced credits from money lenders, or unable to find any capital with which to grow. The position can be illustrated in the following diagram from Maxwell Fry's discussion of financial repression.[3] Given the initial schedules of savings and investment, the equilibrium interest rate should be r_1, but has been set by the government or central bank at r_0, limiting investment to I_0. At that interest rate the excess demand for savings is $I_d - I_0$. With no discriminiation and savings limited to I_0, the interest rate would tend to r_2 and the rectangle $O - I_0 \times r_0 - r_2$ would be either the profits of a monopolized banking system or a sum spent by competing banks in building branches to attract deposits. In the usual McKinnon case of discrimination, there is strong rationing and some $O - I_d$ favored borrowers will get bank loans at rates at or below what they would be willing to pay. Many others will be frustrated.

My interest is slightly different—in the fragmented or compartmentalized market that requires a somewhat different but equally simple diagram. McKinnon and Fry sometimes call repressed markets "fragmented," meaning that the demand for savings is divided by discrimination. Interested especially in regional discrimination, I prefer to use the "back-to-back" partial-equilibrium diagram of international trade in a single commodity, where barriers of some sort—high transport costs, tariffs, lack of knowledge, or forceful discrimination by traders or government—keep markets apart. In Figure 2, investment demand and savings supply in the provinces run from left to right in the normal fashion on the right hand side of the diagram, but oppositely in the financial center on the left. With an impenetrable barrier between center and periphery, the rate of interest would be r_p in the provincess and r_c in the center. If the barrier were completely removed, the rate

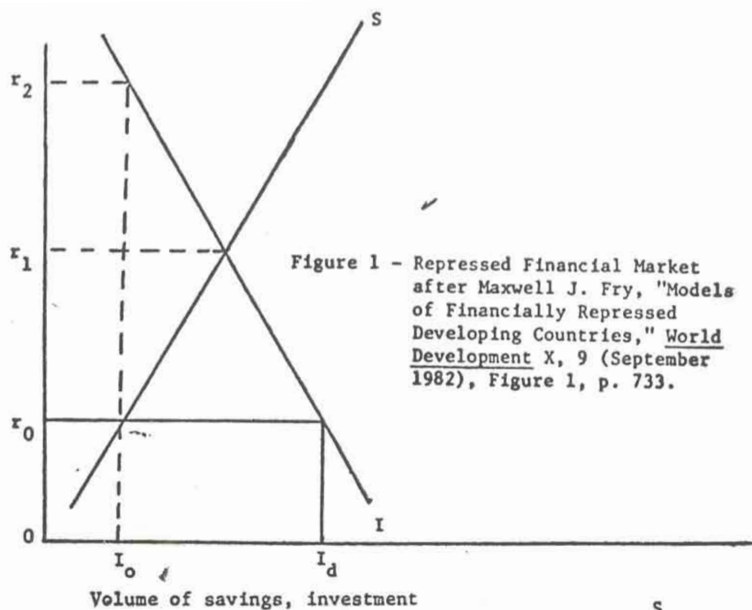

Figure 1 - Repressed Financial Market after Maxwell J. Fry, "Models of Financially Repressed Developing Countries," <u>World Development</u> X, 9 (September 1982), Figure 1, p. 733.

S_p

r_p

S_c

r_n

r_c

I_c

I_p

Volume of savings, investment
Financial Center

Volume of savings, investment
Provinces

Figure 3

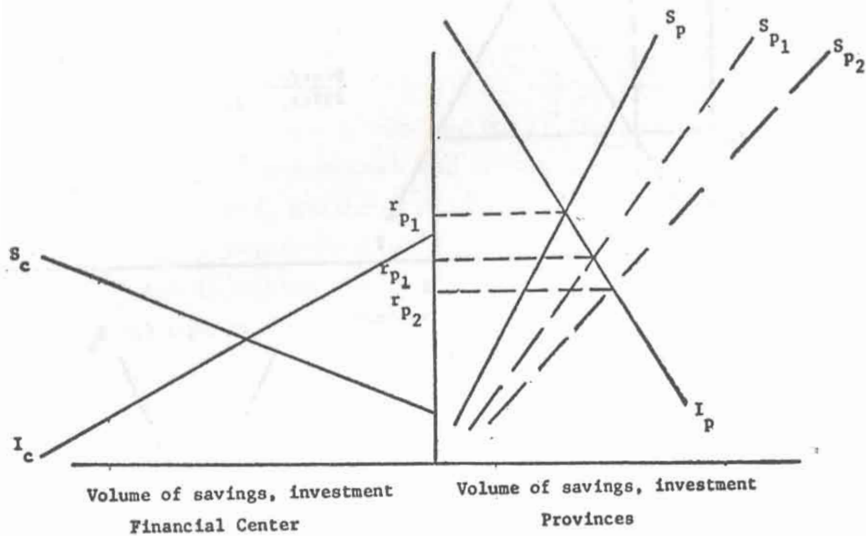

Figure 3

Fragmented Market with Credit Creation in Provinces

of interest would rise in the center, fall in the periphery to a new national level r_n. McKinnon focusses on the removal of repression and the rise in interest rates from r_c to r_n. In the historical literature especially in France, however, more attention is paid to the possibility of credit creation— called by Schumpeter "the essential part of the capitalist engine"[4] – which is diagrammed in Figure 3. This is done by the introduction of new curves for savings on the provinces' portion of the diagram as a result of the establishment of new banks or the issuance of newly-created banknotes in the countryside. I leave open for the most part whether new country or provincial banks add to the total supply of money and credit, or somewhat reduce that available for the financial center because of the need to transfer reserves from London and Paris, the centers I shall be largely talking about, to the rest of the country.

So much for simple geometric analysis. But I am not through with the appetizers or ready for the main course. A bright young British economic historian, Charless Jones, has stated that there are four ways to write financial history, or possibly four different kinds of such history: the "orthodox", the "heroic," the "populist," and the "statist."[5] The orthodox suggests that the problem through time is to curb the tendency of banks in the system to overissue banknotes, to lend to excess. The task, that is, is for the central authority, usually the central bank, to get potential wildcat banking under control by monopolizing the issue of banknotes and by developing central-bank techniques for assuring stability such as manipulating the discount rate, undertaking open-market operations, and the like. The heroic view focuses on major innovations such as the **Credit mobilier** of the Pereire brothers in France, which in 1852 altered the character of the French banking system by a quantum jump in lending for public works. The Populist position is the antithesis of the orthodox insofar as it resists the control of the authorities over independent and sometimes wildcat banking outside the major financial centers. It is especially illustrated in the history of banking in the United States, as succinctly described below, with Populists in the South and West of the United States warring against Philadel-

phia, Boston, and New York, the financial centers that allegedly limited their access to money and credit. Finally the statist explanation holds that banks were created to serve the needs of government. Jones stated that this applied to Argentina, Australian, and Canadian central banks. It also clearly explains the origins of central banking in England, when the Bank of England was granted a charter in 1694 to help finance the Nine Years' war against France, and in France where the Bank of France was created in 1800 to regularize Napoleonic finances in the war against England. After statist beginnings, however, the financial histories of England and France diverged. That in Britain became largely orthodox after the middle of the eighteenth century as the Bank of England and the City tried to bring the ebullient country banks to heel. There were orthodox elements in French financial history, too, as the Bank of France tried to limit the spread of independent note-issuing banks in the provinces. At the same time there was continuous pressure from a group of Paris intellectuals, among them bankers, who thought it was vital for French economic growth to extend banking and credit in various forms beyond the confines of the capital. A small amount of Populism existed in the provinces themselves, but the main source of agitation in this direction came from the Saint-Simonien opposition to the financial establishment on largely theoretical grounds rather than a strongly felt demand for external finance.

The fragmentation of financial markets I shall be talking about is largely geographical, with ports, and to a lesser extent market towns, lying between the principal financial center and the remoter countryside. In Britain, fragmentation calls for analysis of the City of London, of ports, the agricultural counties of the South and East, and the industrial agglomerations of the Midlands and North. Distinctions in France run along lines that have been noted time and again. Edward Whiting Fox wrote of two Frances, divided between the major centers, including ports, and the rest[6], and Fernand Braudel, with an eye to finance, of three, one using gold and banknotes, centered on Paris, one in the market towns with silver coin, and the material life of the countryside where little

money at all was seen, and that mostly copper.[7] Eugen Weber notes that it took seventy years for the monetary vocabulary adopted by Paris in 1800 to reach the peasantry.[8] French provinces outside the major inland centers and ports, moreover, should probably be divided into the agricultural departments of the west and south and the industrial departments of the North and East. The manufacturing towns especially differed from the market cities in their credit needs.

But the breakdown was by no means exclusively geographic. It was also functional. Finance may be dominated by government and by foreign trade, the sectors regarded by McKinnon as favored enclaves, but there are also public works—canals, turnpikes, and railroads,—agriculture, sometimes divisible into small holdings and large estates, the mortgage market, large industry, small industry, shipping, etc. Within industry financial requirements and therefore institutions differed as between for example, iron and steel on the one hand and textiles on the other. Financial markets at the informal level may be fragmented by social class: the intermediation of banks is necessary to allow aristocrats to lend to middle-class entrepreneurs or borrow from middle-class savers, operations of great difficulty if conducted face to face.[9] Further fragmentation runs along lines determined by risk, affecting the term structure of loans on the one hand and such distinctions as debt vs equity or domestic against foreign lending on the other. The famous Macmillian gap was by size of firm, with large firms having access to the formal capital market of London, and small firms acquiring capital informally in provincial towns, but great difficulty for a middle-size class of firms between.[10]

II

The differences between English and French experiences are striking. In England "country banks" sprang up in the middle of the eighteenth century, after 1750, and especially during the industrial revolution. Over the first century of its existance, the Bank of England operated almost exclusively in the City of London, and was referred

to from time to time, in a Populist way, as the "Bank of London."[11] Outside London, Bank of England notes were rare, but the needs of trade and industry found a more or less spontaneous response. Business men issued their own tokens and coins, sometimes even guinea notes. In Lancashire bills of exchange of all sorts of denominations including odd amounts passed from hand to hand as money. But as the demand for circulating media grew, the major response was a rise in country banks. These were partnerships with no more than six partners, and unlimited liability. From 12 in 1750, numbers doubled to 1770 and reached 400 by 1800.[12] There were widespread bankruptcies in financial crises, new upsurges in subsequent booms. Some like Smith's of Nottingham went in for branching, including the establishment of an office in London. Most country banks had correspondents among the private banks in London, and the role of the London private banks gradually grew into that of clearing country-bank transactions. J.H. Plumb states that the industrial revolution was initially held back by lack of transport and lack of finance.[13] The construction of canals and turnpikes, and after 1830, of railroads, took care of transport. The working-capital needs of industry were largely met by the country banks.

In the eighteenth century, the London securities market was limited to government debt and a few equities, notably the stock of the Bank of England, the South Sea Company and the East India Company. Bank of England notes which circulated in London were initially available only in large denominations, which gradually declined during the century down to the Napoleonic wars. Not everyone was satisfied with the system, and people found especially trying the propensity of the country banks to fail in crisis. One reformer, Thomas Joplin, a Newcastle timber merchant, agitated for permitting joint-stock, i.e. incorporated, banks on the Scottish model in England. The Act of 1826 responding to this pressure and to the rash of failures in the crisis of 1825 authorized the establishment of joint-stock banks beyond 65 miles from London, but within that distance preserved a monopoly of joint-stock

banking and note issue for the Bank of England. Joplin came from Newcastle, a city notorious for its appetite for capital for the coal industry. As coal mining grew, its capital requirements mounted beyond the ability of informal markets and sleeping partnerships to satisfy. All this time, however, there were the beginnings of a regular national flow of savings from the agricultural counties of the South and East to the North through the country banks and their London correspondents. The distance of 65 miles was presumably drawn so as to include some towns of financial significance and exclude others. It may be observed, however, as of interest to the geography of finance, the cost of money in 1734 was much higher "outside 60 to 70 miles of London" than in that city, and that "two-thirds of the Nation's Cash are the property of those who reside in and about the City."[14]

The Act of 1826 further provided for the branching of the Bank of England into the countryside to spread the use of its notes in competition with those of the country banks in an orthodox attempt to centralize Control. Banknotes continued to replace coin. The £1 and £2 pound notes issued during the Suspension of convertibility from 1797 to 1819 were withdrawn during the process of Resumption but reissued again in the financial crisis of 1825.

Among the joint-stock banks created under the 1826 Act was the National Provincial which combined existing and newly-created banks in nine cities beyond the 65-mile limit into a single institution. The cities were Gloucester, Exeter, Stockton, Darlington, Kingsbridge, Manchester, Ramsgate, Newcastle, and Emlyn. To create a sprawling organization of this sort is said to have required courage in an era of slow communication.[15] It marked a striking innovation in financial integration. The bank maintained an office for administration in London, but performed no banking operations there until the 1860s when it gave up the right of note issue. An analagous much earlier proposal for a series of banks—actually more nearly pawnshops—in a series of English cities had been put forward a century and a half earlier

in 1571 at a time when there was little if any banking in England but many proposals to emulate those of the Continent. This called for seven principal "banks" in London, York, Norwich, Coventry, West Chester, Bristol, and Exeter—all cathedral towns it may be noted. The capital of each of these banks was to be provided by people leaving their best garments to be sold by church wardens in the bank's area.[16]

A loophole had been found in the banking legislation of 1826 and 1833 under which joint-stock banks could be established within 65 miles of London provided that they did not issue banknotes and thus challenge the Bank of England geographical monopoly. The first such bank was the London and Westminister of 1836 combining offices in the City of London with another in Westminister or Mayfair where the aristocracy maintained its London residences. This social group did some borrowing, typically on mortgages for consumption or construction, but also moved rents from the provinces to London twice a year in May and November, and invested its savings in government stock, equities, and in due course foreign bonds.

Markets outside London were highly fragmented until about 1830, by borrowers, by lenders and by institutions. There had been demands for land banks in the seventeenth century, but these had not come to fruitation. Schumpeter has remarked that landed gentlemen in the House of Commons, no more than other agrarians, were unable to "see why they should not borrow as cheaply as traders or financiers, and they did not take kindly to arguments about the difference between a bill and a mortgage."[17] The provincial mortgage market was largely in the hands of scriveners whose services were needed in the conveyance of property. Finance of ships was carried out in highly informal markets in the ports where shipowners, captains, merchants, families, and friends and neighbors dealt in shares of ships on a binary basis, down as a rule to 64ths. This system lasted until about 1840 when the coming of the steamship and the iron-clad vessel raised the size of the capital needed, which outgrew the confines of the primitive arrangements.

Most industrial equity capital was also dealt in on an informal basis with family acquaintances. It is now recognized that the early emphasis of Thomas Ashton, W.W. Rostow, and W.A. Lewis on the capital needs of the industrial revolution was misplaced.[17] The requirements for fixed capital in Lancashire and the Midlands were small: buildings were rented, machinery bought with mercantile credit. Working capital was obtained by buying for credit and selling for cash to the extent possible, and beyond that from short-term bank finance. Growth was financed through plowed-back profits. Banks furnished some long-term capital, for the most part involuntarily through successive renewals of short-term credits.

The major exception was the iron industry with its large capital requirements, initially financed by London merchants and then by the sale of securities. With the passage of time and the increase in firm size, the shift from informal provincial markets to London continued, in ships as already noted, and beginning about 1870 even in such an industry as cotton textiles for those firms building plants of 70,000 spindles.

The London market was of course needed for government stock, for the great chartered companies, and gradually for public works such as railroads. London was also the gateway for international lending, toward Britain in the eighteenth century, almost entirely from Amsterdam and Geneva, and from London to the Continent from the Baring loan to finance the French indemnity after the Napoleonic War in 1817 to the revolution of 1848. That episode frightened British investors who turned their attention the Empire, the United States, and Latin America.

The coming of the railroad gave rise as well to the establishment of provincial stock exchanges. These got their start in such cities as Manchester and Liverpool in auctioning off securities accumulated in estates, and gradually developed into organized exchanges for continuous trading.[19]

The culmination of orthodox efforts to get the country banks and their note circulation under control was the Bank Act of 1844. From the 1850s the joint-stock banks spread into national networks, partly by absorbing country banks, partly by the establishment of new branches. Banks outside the metropolis set up head offices in London; those in London filled out the gaps whether north or south. Lloyds Bank of Birmingham for a time maintained one deposit rate outside the City, another in London that tracked the Bank of England discount rate. With the passage of time it found it less and less possible to do so as depositors would move funds back and forth in search of the higher rate.[20] At this stage the money and capital market could be said to be virtually integrated. There were flaws in that integration: the Macmillan gap for firms of an awkward size, and perhaps the tendency of the City to favor foreign investment in government bonds and railroad securities over domestic industrial enterprise. The history of the English money and capital market, however, was less one of eliminating repression than of the "orthodox" task of getting widespread spontaneous financial forces under discipline and control.

III

In France the drawn-out history of financial integration was intimately linked to the continuous running battle between two schools of thought in finance which may be called, with some license, Keynesians and monetarists.[21] The Keynesians were expansionists who wanted to establish more banks, use credit to stimulate industry and agriculture, as well as commerce, and especially to spread banking and the use of banknotes from the financial capital—Paris in the period of our interest, though Lyons was the larger financial center prior to 1700,—to the provinces. The monetarists were orthodox, fearful that note-issuing banks in the countryside would get out of hand in speculative excess. That there was some merit to their fears is illustrated not only by the sporadic financial crises in England, but even today by experience in Latin American where the end of repression has led to financial excess and caused McKinnon to back away from the strong implication of his

initial analysis, that banking should be freed of regulation, to a second-best position that calls for ending repression with great circumspection.[22]

The list of Keynesians in French financial history in our period starts with John Law, Turgot, and Necker in the eighteenth century, and continues with Napoleon, Jacques Laffitte, and the Saint-Simonists, especially Michel Chevalier and the Pereire brothers in the nineteenth. The monetarists, on the other hand, consisted in the **Anti-Systeme,** opposed to the System of John Law, and the **officiers and financiers** of the royal court who defeated the financial reforms of Turgot and Necker; of Francois Mollien, who argued against Napoleon's Keynesianism, the Bank of France, the Rothschilds, and indeed the monetary and banking Establishment of the Parisian **hautes banques.** Time does not permit more than the sketchiest account of the action over 200 years.

John Law's **Banque generale** and successor **Bank royale** which blew up spectacularly in 1720 in the Mississippi bubble were both interested in extending the use of their banknotes into the countryside. To Law and to other thinkers going back a century or two, money and credit were compared with blood, which needed to circulate throughout the body economic.[23] Hamilton observes that the **Banque generale** lowered interest rates first in Paris in 1716 to which its operations were initially confined, but then achieved a national circulation far more quickly than did any other public bank before the ninetheenth century.[22] A decree of April 1717 providing that **Banque generale** notes be accepted in payment of local taxes was said by Levasseur to make finance bureaus throughout the country into branches of the **Banque.** "Money stayed in the provinces. The notes, flowing through thousands of canals, inundated France with its benefaction."[24] The receivers of taxes in the provinces resisted law's changes because they lost the profits on bills of exchange used to remit taxes to Paris.[25]

After the collapse of the Banque royale, the issue of financial integration took fiscal form. It could hardly operate through money

and banking since there were no major banks. The subsistance peasant economy contributed through the corvee, or taxes in labor, largely building roads, which Turgot tried to reform into money payments; the economy of the ports paid through taxes and the purchase of **offices** by means of payment to the court. The state is said to have skimmed off money from the economy on the coast, the rivers that served each other, the colonies and foreign nation.[26] Turgot and Necker both warred against the centralization of royal finances at Paris and Versailles and lost out. The task remained to be accomplished by the French revolution.[27]

With the establishment of the Bank of France in 1800, and later with Napoleon as Emperor, the financial integration of the country could once more proceed by the spread of money and credit to the provinces. The road was a rocky one. There were two principal means: creation of branches of the Bank of France in the provinces and the founding of independent local note-issuing banks. Under Napoleon, the Bank of France started three branches at Rouen, Lyons, and Lille. Napoleon wanted a much wider program of branching but met resistance from the Bank of France itself, and especially from Mollien, his Minister of the Public Treasury, on whom he relied for financial advice. Napoleon would write Mollien letters asking whether it was not wise to do this and that, especially push for a program of branches of the Bank of France, as he was under pressure from delegates from various cities, asking for branches for the purpose of bringing down the local rate of interest. Mollien opposed him with a variety of arguments: if Bank of France notes were to circulate through France and be redeemable at many branches, one would have to have the equivalent of the Bank's reserve at each such branch to assure convertibility of banknotes into specie.[29] In addition, each branch should have its own capital and be able to earn its way by an adequate annual volume of discounts. Mollien urged Napoleon to turn away delegations of petitioners seeking branches by asking them to furnish lists of potential stockholders and of merchants able and willing to discount several million francs annually

in bills of exchange.[30] But Mollien's real objection was monetarist. Banks produce artifical money, not supported by real values. Stockholders sometimes forget their obligations to the holders of their notes.[31] Napoleon, he complained, took no notice of abuses of discounting.[32] In trying to persuade Napoleon against the establishment of branches in the industrial towns of Amiens, Cambrai, Saint-Quentin, and Valenciennes, Mollien offered to draft a statute changing the name of the Bank of France to the Bank of Paris.[34] When Napoleon fell, a force for expanding credit in the countryside was lost, and the Bank of France closed down the existing branches.

With the Restoration of the monarchy in 1815, initiative shifted to the provinces. No bank could be created in France without the approval of the Paris government's Conseil d'Etat, which in its turn sought the advice of the Bank of France. When the expansionist Jacques Laffitte became governor in the postwar period, new note-issuing banks were approved for Rouen, Nantes, and Bordeaux. With Laffitte's resignation in 1819, there was a relapse. After the July monarchy of 1830, however Laffitte came back into favor briefly. There began the formation of a series of provincial banks, admirably studied by Bertrand Gille in a series of papers, describing the credit conditions in which the banks were each sought, the negotiations with Paris to gain, or in the case of Dijon not to gain, permission, and the terms on which permission was granted. Gille describes provincial credit in the 1830s as a vacuum, rudimentary and primitive, in contrast to Paris, some centers well provided, especially the ports and several manufacturing cities, but for the rest large sections blank or almot blank.[35] The fragmentation of the national capital market is illustrated by citing interest rates: 9 to 10 percent for Dijon as contrasted with 4 percent for Paris and 3 percent for Lyons on either side of it.[36] In the same decade a partisan Saint-Simonien, Michel Chevalier, described fragmentation by the interest rates available to different borrowers. The treasury could borrow at 4 or even 3 percent when it did not need to, and so could privileged merchants in their prosperous moments. Landlords almost

everywhere pay 6 per cent. Little proprietors and little industrialists pay 8, 9 and 12 percent. "As one descends the social scale, the interest rate mounts. For the worker in the city in his retail purchases for household needs, it is 50 and even 100 percent. For the peasant in his relations with the bailiff, the publican, and the merchant of the village, 100 per per cent a month."[37] This statement of course takes no account of the costs and risks of lending to different groups.

In the space of a few more years to 1836, six more departmental note issuing banks were formed, making nine in all, in Rouen, Lyons, Lille, Marseilles, Le Havre, Toulouse, Orleans, Bordeaux, and Nantes, all ports or entrepot towns except Lille in manufacturing and Orleans and Toulouse as major market towns. At that stage the Bank of France turned to acquire control over the note issue through a monopoly rather than through negotiated conditions. It set out deliberately to create its own branches, to resist further independent banks, and to stand ready to take over the existing ones. The opportunity presented itself in the financial crisis of 1847 when the departmental banks got into trouble but were not rescued by the Bank in a lender-of-last-resort capacity. On the contrary it absorbed them and achieved a monopoly of the note issue. The problem, however, did not go away. In the late 1840s, there was more information on discount rates and the variation remained wide. The Bank of France discount rate was maintained at 5 per cent in those days and never varied. The position in the provinces, states Gille, was "infinitely worse" (sic), with interest rates varying between 3 and 3½ per cent in Lyons and 18 to 30 per cent in Eure et Loir. Between the extremes were found Chateauroux at 6 to 8 per cent according to some, 7 to 12 for others; Grenoble 8½ per cent, Besancon more than 6, Mulhouse 5 to 6, Angouleme 6 to 8, Nimes 8, Agen 6, Caen 6 to 10.[38]

Larger firms had access to credit in Paris, no matter wherever in the country they were located, usually as a result of close association with a private bank. The Anzin coal company in the North was in fact owned

by the Perier bank in Paris which also owned a large machine shop at Chaillot. Schneider of the Schneider-Creusot steel company had worked for the Seillieres bank in Paris and maintained an association with it. Georges Dufaud of Fourchambault in the Nivernais to the south of Paris relied for capital expansion primarily on plowing back profits, but in 1829 raised $6\frac{1}{2}$ million francs from a Paris bank under the control of his partner Boigues, plus the help of a deposit of 4 millions from Boigues' relatives.[39] Thuillier observes that banks in the Nivernais played practically no role in developing local industry, maintained very high liquidity, and reserved their resources for agriculture and expansion and equipment of large estates.[40] What leadership there was in banking for industry was in Paris. In his account of Georges Dufaud, however, Thuillier mentions a failed forge which local banks tried to restart with 1 millions of capital, calling it "a rare example of direct intervention of local bankers in the life of a factory."[41] Finally in this brief catalogue may be mentioned the complex financial life of Les Fonderies et forges d'Alais, which raised its initial capital in the 1820s among two distinct groups, the local notables of the Gard deep in the countryside and financial interests in Paris. In the difficulties of 1837 it was obliged to sell 30 per cent of the firm to a Paris banker and managed to raise 1.2 million francs in the same year in Marseilles. In 1856 it put out a 2 million franc bond issue, subscribed to more than two-thirds in the Midi, but failed in an attempt to raise $1\frac{1}{2}$ millions through a bond issue in 1858. In 1866, it managed to borrow 600,000 francs from the Credit agricole in Paris (sic!). Talabot's Paris-Lyons-Marseilles railroad and its constituent elements had been Alais' largest customer, and Drouillard, Benoist d'Azy & Co. lent it their political weight in 1836 when Talabot borrowed 6 million francs from the French government on a bill that passed the Chamber of Deputies by but six votes.[43]

In renewing the Bank of France charter in 1857, the Chamber of Deupties required it to establish a branch in each of the 90 departments in France by 1867. At the beginning of the 1850s, the Bank had 24

such branches, of which 7 made losses and 17 profits,[44] a criterion of success adduced by Mollien with an implicit philosophy that appealed to many students of finance at the time but not to the Saint-Simoniens. The latter regarded bank branches that brought credit to the countryside as public goods, needed to stimulate commerce and industry, and akin to the branch lines of railroads that may be unprofitable in themselves but justified because of external economies.

In addition to this pressure from the legislature, the monopoly of the Bank was threatened when the Pereire brothers bought the Bank of Savoy in a province previously Italian which had become French when Savoy was ceded to France in 1860 to enlist the support of Louis Napoleon for Italy in its war against Austria. The Saint-Simoniens managed to organize a formal inquiry into money and banking, ostensibly to discuss the financial crisis of 1864, but in reality to deal with questions of the Bank of France monopoly of the note issue and the need for more banks and banking througout the country. These were the questions raised time and time again by Michel Chevalier who served on the Conseil Superieur conducting the Inquiry in his rather hostile cross-examination of the banking establishment. In his testimony, Emile Pereire said that no place should have a bank more than 20 or 30 leagues (60 or 90 miles) away, that the Bank of France should triple its note circulation, popularize the use of credit and bring the capital it could not employ in Paris to the provinces.[45] The first witness to testify was the English editor of **The Economist,** Walter Bagehot, who found the banking system of France inferior to that of England in transferring the nation's savings to industry. "In England each village has at least two banks. Thanks to them, no shilling of savings is lost."[46] In questioning de Waru of the Bank of France, Chevalier noted that the Bank had only 54 branches, well short of the 90 due by 1867 by law, but even that number far short of needs, put by Chevalier as not 200 or 300, but 1,000.[47]

It should be noted that in creating branches in the provinces, the Bank of France to a considerable extent was serving a clearing rather

than a credit function, by making it possible for merchants in the countryside to collect sums due to them by discounting bills drawn on buyers. In this effort, required because of the rudimentary development of payment by checks, the Bank of France was competitor of the commercial banks. The expansionists applauded the establishment of more branches; Georges Palladin who became governor in 1879 and stepped up the branching effort was hailed by one "Keynesian" as the greatest governor since Jacques Laffitte.[48] A twentieth-century monetarist observes somewhat disdainfully that by 1897 everyone in France had adequate discount service and that the important service of collecting drafts did not require the costly apparatus of Bank of France branches. The Bank of France would have developed from an operating bank into a bankers' bank, he thought, had it not been for the ignorance of Parliament on the one hand, and that of the authorities on the other.[49]

By the 1860s, French banking put on a substantial push. The last of the four great deposit banks was the Societe generale established in 1864 after the Credit lyonnais of 1863, the Credit industriel et commercial of 1859 and the Comptoir d' escompte. This last with a number of regional banks grew out of the comptoirs d' escompte established by the French monetary authorities in the crisis of 1848 to provide a third name for bills of exchange to make them eligible for discount at the Bank of France. The deposit banks spread rapidly, creating branches in what has been described as a logistic curve, from 170 bank offices ("guichets," literally "wickets") for the three largest to 1400 for the same three in 1927 and 1496 in 1939.[53] The Credit industriel et commercial acquired a network by buying 11 existing regional banks while the Credit lyonnais and the Societe generale struck out both to absorb local banks and to create new branches.[51] We have more detailed information on the Credit lyonnais than on any other. It particularly interested in acquiring deposits in the countryside for investment in Paris or abroad. When the railroad came to a town it would try to estimate whether the town, with a newly-established branch, would create deposits or demand loans, and tend to avoid it

in the latter instance. The head office gradually moved from Lyons to Paris. On occasion the bank called loans to local clients in order to be able to participate in foreign security operations.[52] McKinnon and Shaw make the point that more branches of banks may not be conclusive evidence of financial integration, as they may be built in cities or suburbs to gather deposits—the word in French is "drainage"—rather than to make credit available to borrowers.[53] The description well fits the history of the Credit lyonnais.

France has been a highly centralized society in many respects since at least the time of Louis XIV in the seventeenth century who drew the aristocracy to Versailles. Labasse at the end of the 1960s observes that the world presents three geographical models in finance: the "centralized," the "spread," and between these extremes, the "median." He illustrates these types with tables showing the percentages of total clearing that go through the financial capital. In the centralized case, Paris has 91.3 percent of the clearings of France, the nearest city being Lyons with 0.65 per cent. Canada furnishes an example of the spread model that applies particularly to federal states, with Toronto having 37.3 per cent of Canadian clearings, as compared with Monteral's 25.5 per cent and Vancouver's 6.5. Between them stands Japan, representing the median, with Tokyo having 51.2 per cent and Osaka in second place with 19.7.[54] Paris is not far different from London in this respect, however, because London has 87 per cent of British clearings, and again like Paris with highest percentage in the world, has 100 times the clearings of its nearest rival, Liverpool.[55]

Labasse's research unfortunately does not compare France and Britian and their financial centers in terms of deposits and credits. In France, Paris has 19 per cent of the French population, 42 per cent of total deposits and 46 per cent of credits. This profile, Labasse holds, illustrates the exceptional concentration of the French capital in the country's economic and social life, and reflects the fact that Paris has attracted to it the head offices of the country's most important companies. In the provinces one finds the opposite condition—of the sort

frequently encountered in the Third World at the beginning of their financial development, though not at the end,—with the percentage of population exceeding that of deposits which in turn exceeds that of credits.[56]

The disparity between the financial history of England where it was necessary to restrain the animal spirits of country banks and France where a significant intellectual movement sought to stimulate them is of course no accident and lies deep in the social matrixes formed by the two countries' respective histories and national characters. It is imprortant for economic theory to observe that comparative financial history teaches that the model and the policies deriving from it appropriate to one country may not have general applicability.

IV

A purer Populist experience than that of France is presented by the United States where the Eastern seaboard sought continuously to get money and credit under control and the South and West strained to break the bonds. One struggle in the East was for financial supremacy with the New York winning out over Philadelphia, Baltimore, and Boston. The East as a whole then tried to restrain the uninhibited expansion of wildcat banking in the rest of the country. Travelling in the country in the 1830s, Michel Chevalier remarked that newly-founded towns tended to establish a bank almost before the streets had been laid out and the stumps of felled trees had been uprooted.[57] The Second Bank of the United States was vetoed by the Populist president, Andrew Jackson, for fear that it would unduly limit bank expansion, this in the 1830s. In the 1850s, a number of states sought to prevent banks in their jurisdictions from holding their reserves in New York funds.

The National Bank Act of 1863 passed in the North during the Civil War had a statist aspect as it provided for the issuance of national-bank notes with Union bonds as collateral. It further provided, how-

ever, that required reserves of national banks could be held either in cash or in deposit claims on nine different cities, of which New York was only one, and banks in these cities had to a switch from holding deposits on New York to holding currency. The anti-New York provisions of this legislation were moderated the following year by allowing half the 25 per cent reserve of the reserve cities —the number being increased from nine to eighteen— to be held in New York funds. This in effect made New York a central reserve city.

The crisis of 1907 revealed that the banking system was far from stable. After a prolonged investigation by the National Monetary (Aldrich) Commission, the Federal Reserve Act was passed in 1913, providing not for one central bank, but for 12, one for each of 12 Federal Reserve districts. The purpose once again was to downgrade New York's financial position, through the creation of 11 other Federal Reserve banks and the coordination of all by a Board of Governors in Washington, the political capital at a distance from the money powers. The effort proved vain. The enormous requirements of government finance during the World War called for a single financial center with its economies of information and scale, so that New York emerged as the apex of the system. Some of the regional Federal Reserve banks have prominent roles to play, notable those of Chicago and San Francisco with their somewhat differentiated money markets.

The experience of the United States is thus contrary to the McKinnon model of repression, unless one thinks of the rest of the country trying unsuccessfully to repress New York, Populism is rather like today's **dependencia** theory in Latin America in which the periphery fears it is being throttled by the center. The South and West struggled against the money interests not only in banking but in trying to sustain bimetallism, to gain free coinage for silver, special agricultural price supports, and the like. The hierarchical structure of banking demonstrated its inherent efficiency by the fact it survived more than a century's continuous efforts to alter it.

V

This lecture has covered too much ground to lend itself to easy summary, and I must try at this late hour to be brief. What I think I have demonstrated is that there are no easy generalizations about financial repression, fragmentation, or integration that are good for all countries, times and places. Consistency, as Ralph Waldo Emerson remarked, is the hobgoblin of little minds. It was a mistake, McKinnon recognizes, to apply the lessons of repression from South Korea without modification to the banking systems of Latin America. Michel Chevalier deserves credit for having been a monetarist in his views on banking in the United States, while he was a Keynesian in the circumstance of France,[58] but he may be faulted for his cross-examination of witnesses in 1865-67 for having implied that the lessons of Scottish banking were applicable everywhere in the world.[62] Populist policies in the United States ran up against the hard fact that even in a federal system there is some residue of hierarchical ordering that is impervious to policy. Careful adjustment to shift systems to correct obvious excess in any direction is clearly desirable.

I wish I knew enough to apply the conclusions of this study to conditions in Pakistan, but I do not. In my ignorance I must state them in highly general terms, and allow you to see which, if any, fit:

1. The banking history of any country is not likely to fall consistently into one of Jones' categories as orthodox, heroic, Populist, or statist, but to swing among them from time to time, now one, then another in emphasis, but with different emphasis in different countries.

2. The history of the development of banking in a country is likely to be strongly affected by the nature of the commodities in which it has a comparative advantage, including the technology and scale. Comparative advantage, technology and scale, moreover, all change with the unfolding of history, so that the nature of banking remains in continous evolution.

3. There is no one pattern that all countries must follow in a series of stages. Much of the structure of money and banking at a given stage of economic development—if you will forgive the expression—depends upon such elusive considerations as the social matrix and national character. Strong individualism in Britain led to ebullient country banking—the same in the United States to wildcat banking, from which followed in both cases the orthodox necessity to get banking under control. The French predisposition to centripetal gathering of economic force at the capital in Paris gave rise to the opposite necessity—at least as seen by a series of outsiders and astute intellectuals—to spread the sources of initiative in financial questions to some considerable degree into the provinces.

4. In all societies there must be some balance—difficult to find and maintain—between the economies of scale from centralized finance and the gains in information from local knowledge that can be acquired—at the present stage of technology at least, and certainly in the past—from a local presence in the countryside.

5. All this leads me to great skepticism that there are any iron laws as to how the geography of finance should or must be ordered. At the same time I remain persuaded on general grounds based on Pareto-optimality—in favor of some degree—probably some considerable degree—of national, and yes, international financial integration.

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