Financial History Review 9 (2002), pp. 253–262. Printed in the United Kingdom

BOOK REVIEWS

Howard Bodenhorn, **A History of Banking in Antebellum America: Financial Markets and Development in an Era of Nation-Building** (Cambridge: Cambridge University Press, 2000. 282 pp. £15.95)

The early antebellum period in the United States has always been something of a 'dark age' for the financial historian. This is due not to a lack of primary data sources but, rather, because organising the volumes of individual bank and securities-market transactions dispersed throughout the country is a task beyond the capabilities of a single individual. In his recent book, Howard Bodenhorn offers a coherent view of the challenges ahead, and sounds a call to arms for economists and historians seeking to understand more completely the linkages between financial development and long-run growth in the United States. Given the recent rediscovery of the early American experience as, arguably, history's most successful emerging market, Professor Bodenhorn's analysis is a timely one.

The book's strength lies not so much in answering the broad questions that it poses, such as quantifying the macroeconomic impact of antebellum banks or the extent of their discounting and exchange operations, but in showing the reader how they will ultimately be answered. To this end, Bodenhorn surveys the traditional literature on the links between financial factors and economic growth. This body of theory, which derives largely from the development and macroeconomics literatures, describes formally how the financial sector can promote growth by reducing informational asymmetries between borrowers and lenders, facilitating risk-sharing arrangements, allocating capital to its most productive uses and helping to overcome indivisibilities in investments. The survey is a good introduction to the topic for historians less familiar with Ronald I. McKinnon's path-breaking paradigm of the 'fragmented' economy, and places the more descriptive case studies, which have always been the realm of economic historians, into a broader context. This is important because case studies, informed by theory, appear to be the area where our understanding of the finance-growth nexus is most likely to be advanced.

Following the earlier empirical analyses of Robert G. King, Ross Levine and others, Bodenhorn presents a preliminary analysis of the correlation between finance and growth across the antebellum states. The results, though less than conclusive, are consistent with the interpretation that finance played a leading role in American growth. The relative weakness of the findings compared to those obtained with more recent data in a cross-country setting may be a result of insufficient identifying variation and more error in the data for the states at this time. This would appear to underscore the potential of time-series analysis for establishing the direction of causation more convincingly, but this angle remains undeveloped.

The book presents several new facts about antebellum banks. One striking fact is that they did not appear to discriminate against industrial entrepreneurs in favour of merchants and agrarian interests, even in the South. Manufacturers received loans roughly in proportion with their share of the business population. Since the growth of the modern sector after 1815 is a strong contender for explaining the gradual 'take-off' of the American economy between then and 1840, this fact, even if derived from a sample of only four banks, suggests that banks may have played a more central role in promoting early growth than has been heretofore believed. It also lends some support to the view that it was the agricultural focus of entrepreneurs rather than banks that caused the development of the South to lag behind that of the more industrial North-East. Bodenhorn also assembles evidence that points to the existence of a large and active commercial paper market by the 1820s – a market that had already achieved a national scope. This contrasts sharply with the standard view that the commercial paper market emerged on a large scale only after the Civil War.

Professor Bodenhorn's sketch of an already financially developed economy in the antebellum United States is bolstered by a summary and extension of his earlier and influential work on capital market integration. Again, using a relatively small but substantial sample of banks and regions, he uncovers a pattern of convergence in regional interest rates prior to the Civil War. This suggests that the early part of the nineteenth century should not be viewed as a backward extrapolation of the convergence pattern that Lance Davis discovered nearly four decades ago for the postbellum United States. In fact, one cannot dismiss the possibility that regional capital markets were more integrated in 1835 than they were in 1900! The broader implication is that the American capital market may have been 'sufficiently' integrated since the days that Alexander Hamilton served as the nation's first Secretary of the Treasury. The story also places the domestic exchange activities of Nicolas Biddle, President of the ill-fated Second Bank of the United States, at centre stage in the integrative process. At the same time, Bodenhorn stresses that the capital market would have developed less readily had it not been for changes in the legal environment between 1820 and 1840 that clearly established the rights and obligations of creditors and debtors. This view is consistent with recent studies in empirical macroeconomics that emphasise the importance of property rights as a precondition for financial development.

A History of Banking in Antebellum America is a provocative book which presents a hypothesis of capital market integration that, while possibly a bit hyperbolic, deserves further attention among economic historians. It shows how records of antebellum American banks can be obtained and usefully analysed by those energetic enough to make a contribution, and offers a taste of the high returns promised by this endeavour. As such, it is a 'must read' for students of the period that will fuel doctoral dissertations for decades to come.

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W. A. Thomas, **Western Capitalism in China: A History of the Shanghai Stock Exchange** (Aldershot: Ashgate, 2001. xii + 328 pp. $74.95) and *Grace Loh, Goh Chor Boon and Tan Teng Lang*, **Building Bridges, Carving Niches. An Enduring Legacy** (Oxford: Oxford University Press, 2001. 320 pp. $35.00)

The financial history of Asia raises the issue of the extent to which financial intermediation has primarily been driven by universal economic principles and the degree to which cultural and institutional features peculiar to specific regions have also come into play. This tension is evident in both of these volumes, which, respectively, address the cases of Shanghai and Singapore.

Thomas's study is a careful, quite detailed study of the development of the securities market in Shanghai from the mid-nineteenth century to the present. The more or less continuous narrative account provided allows Thomas to provide insight into the shifting balance of local and global forces at work on the Shanghai stock market. The underlying message is one of a market that has been in the process of emerging for a century and a half.

Thomas begins with a more general account of early British commercial activity in Shanghai and Hong Kong during the first half of the nineteenth century. He then proceeds to a detailed account of the establishment of international settlements in Shanghai and the legal/institutional basis for these settlements in particular. This provides a foundation for his examination of the nature of the securities issued from these settlements and traded on the Shanghai stock exchange when it developed. The option of setting up companies on a limited liability basis, especially via registration in Hong Kong, was pursued by only a few Shanghai enterprises at the mid-nineteenth century. This discussion also emphasises the importance of the comprador, the native Chinese agent, for providing the enterprises established at European initiative with both language skills and local contacts required.

Thomas then turns to a blow-by-blow account of the development of securities markets in Shanghai. He surveys the various types of enterprises issuing securities. During the 1860s, when securities trading became evident, banks and other commercial, insurance and shipping enterprises dominated. By the end of the nineteenth century, industrial enterprises had more of a presence and then in the early twentieth century plantations, especially rubber plantations, came to dominate securities listings on the Shanghai stock exchange. What emerges are some of the particular activities that receive funding and the mix of local, government and international enterprises involved. In fixed-interest securities, the presence of the Imperial government was evident. In many cases, trends in Shanghai moved differently from the world in general. While the Shanghai market was certainly influenced by international trends, it was also heavily affected by both local and regional supplies of securities and local and regional demanders/investors. Thomas argues that, in contrast to a common international tendency for stock markets to have their origins in markets for government debt, in the case of Shanghai, the demand for securities seems to have been based on a desire to pursue speculative ventures. Thus, much of the story of the Shanghai securities market in the early twentieth century deals with the fortunes and flow of resources into regional rubber plantations.

Thomas takes the story up through the Communist Revolution and then resumes the story in the 1980s, when capitalist forces in China were resurgent. In this recent period, Chinese securities markets have been heavily regulated by the central Chinese government authorities. Shanghai and Shenzen, the Special Economic Zone bordering on Hong Kong, were at first the only two areas allowed by the central government to develop securities markets. And what enterprises would be allowed to offer shares or bonds for sale and in what quantities were decisions made by the centralised authorities rather than by enterprises themselves. Thomas notes the pronounced volatility in share prices in the Shanghai and Shenzen markets during this period.

Thomas's study is meticulously documented. In the absence of any original records of the Shanghai Stock Exchange, established in 1904, or its predecessor, the Shanghai Sharebrokers' Association, set up in 1898, Thomas relies heavily on the weekly share lists and reports published in Shanghai settlement's English language newspaper, *The North China Herald*. The first share lists were published in 1866. Thomas uses the reports of company meetings and those who attended, reported in the same source, to examine who held shares in the companies traded on the exchange. Although the study is firmly grounded in primary sources, the level of detail provided without clear relation to general issues or trends is a bit mind-numbing. Facts and trends regarding particular securities issues are described, one following on another such that overall patterns and trends become difficult to isolate.

Loh, Boon and Lang's volume is nominally a history of the Overseas Chinese Banking Corporation, based in Singapore. However, it becomes quite evident early on in the work that it is really a biography of the long-time director of the bank, Tan Chin Tuan. The book provides insights into Tuan's vision of banking in Singapore and into the balance of local and international forces to which he tried to respond in running the bank. The account of how Tuan and the bank adapted during the Second World War and managed to hide and protect the bank's assets from the Japanese is of particular interest. The argument is made throughout that Tan Chin Tuan was adept at cultivating useful contacts and networks, while still demanding competence and performance from those whose acquaintance he developed. However, it is never made completely clear why this did not lapse into mere cronyism. The book also provides insights into the shifting mix of financial institutions involved in the Singapore economy over the twentieth century. Nevertheless, the volume is primarily a celebratory encomium of Tan Chin Tuan. Matters, such as the selection and negotiation to have I. M. Pei be the architect of the bank's new building and various recognition and retirement dinners, dominate the book. Indeed, it is frankly a bit surprising that such an established publisher as Oxford would be willing to sponsor what is essentially a vanity, puff piece.

Despite the limitations of each of these volumes, they both illustrate, albeit in quite different ways, the mix of regional and international forces that have influenced the process of financial intermediation in Asia over the last century and a half.

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Michael Palairet, **The Four Ends of the Greek Hyperinflation of 1941–1946** (Copenhagen: Museum Tusculanum Press, University of Copenhagen, 2000. 172pp. Dkr. 198)

Palairet dates the onset of the hyperinflation in Greece to May, or June, 1941 and its termination to January 1946, making it, with around 56 months, probably the longest hyperinflationary experience ever recorded. Greece was occupied by the Axis powers for nearly 42 months out of the total inflationary period. (Occupation in Greece began in April 1941 and the country was liberated in October 1944.) In severity, this hyperinflation ranks third after the Yugoslav experience of the 1990s and the Hungarian hyperinflation of the 1940s.

This book is structured around the four stabilisation attempts that occurred between 1941 and 1946. The four 'ends' of the Greek hyperinflation also provide the title of this book, which echoes work on hyperinflations that occurred during the 1920s. None of these stabilisations brought about fundamental change, they were short-term measures (p. 22). The first stabilisation of October 1942 was devised and implemented by Hermann Neubacher, a Nazi official of Austrian descent. By mid-November 1942, inflation rates had been curbed and remained low for nine months. The second stabilisation attempt, 'Waley's Stabilisation' as the author calls it, was announced early in November 1944, approximately a month after Athens was liberated. The cornerstone of this plan was fiscal austerity involving a substantial reduction in public expenditure on wages. A new drachma, worth 50 billion of the old, was also introduced. Varvaressos' reform followed in June 1945, introducing new taxation on entrepreneurs as well as price and wage controls. The fourth and final stabilisation attempt consisted of an Anglo-Greek agreement, signed in January 1946, that provided Greece with a loan. In return, the Greek government established a Currency Control Committee with one British and one American member who could veto measures related to monetary policy in the country. In addition, three times during the period discussed in this book the authorities in Greece sold gold as a means to control hyperinflation. The first sale of sovereigns and gold francs was pioneered by Neubacher, and took place between November 1943 and October 1944. The second and third sales were pursued in support of the stabilisation efforts of November 1944 and January 1946. Both the stabilisations and sales of sovereigns tended to cause inventory releases, easing merchandise supply, raising mass purchasing power and decelerating inflation. Palairet argues that these measures also sustained confidence in the drachma and enabled the authorities in Greece and the Axis powers to extract a steady flow of seigniorage over this long period without the drachma being repudiated as a means of exchange. According to the author, civil service wage levels, in particular after liberation, were the main destabilising factor in the efforts to achieve fiscal stability.

Acute shortages of supplies, in particular foodstuffs, during spring 1941 probably gave the initial stimulus to hyperinflation. Resort to the printing press, however, to cover huge budget deficits sustained and fuelled soaring prices until January 1946. The main argument, which appears to flow from the analysis throughout the book, is that the Greek governments could indeed have implemented fiscal reforms. Instead, they chose to use inflation tax to finance public expenditure. Palairet argues that the source of fiscal instability during the Axis occupation was the shrinkage in fiscal revenue caused by taxation reforms that the Greek government introduced. As a result, the government 'unwittingly stripped itself of real fiscal revenues' during the occupation (p. 28). The author remains unconvinced by the argument that these 'reforms' introduced by the Greek authorities represented some kind of passive resistance against the occupying powers. He proposes that the lack of fiscal rectitude during the occupation period can only be understood if it is 'taken in conjunction with the analogous behaviour of its post-liberation successors' (p. 28). According to Palairet, 'Greece was to use the inflation machine as a political ploy' to obtain foreign financial assistance (p. 108).

Information on the political and economic conditions in Greece is gleaned from a variety of archival sources, primarily British, and an array of secondary literature. Historians, however, will be troubled by the manner in which archival material is employed, as evidence as well as background information to the analysis. Palairet's description of the Greek authorities in Samos, after the Italian occupiers left the island in September 1943, is also used to describe Greek governments after liberation (pp. 52 and 55). The narrative that follows a statement by Varvaressos (p. 103) is, likewise, an example of this fundamental weakness of the book. By contrast, the use of already available quantitative evidence to describe the course of the Greek hyperinflation proves more successful. Palairet has modified the available cost-of-living index for the area of Athens and Piraeus to exclude the house-rent component. This readjustment helps him to redefine the period of hyperinflation in Greece within Cagan's broader theoretical framework.

It is difficult to believe that many readers will be persuaded by the book's core argument that fiscal adjustment to end hyperinflation was feasible either within occupied Greece or subsequently under the liberated regime. Neither may they accept that the historical narrative is thorough and presents an objective and well-documented picture of the political and economic conditions that prevailed during hyperinflation. It is a serious shortcoming of the book that Palairet does not examine the nature, political power and credibility of successive Greek governments during the period under examination. 'Greek authorities' is used throughout the book to refer to what were after all very different governments in power between 1941 and 1946.

Literature that perceives delays in stabilisation as a by-product of a war of attrition can offer valuable insights into the political economy surrounding the Greek hyperinflation. Hindsight can also be useful in understanding the history of the period in question. At the time, the war of attrition in Greece was not confined to the various interest groups that would bear the burden of reconstruction after the end of the Second World War. Neither was it simply a distributional struggle as to how the cost of reconstruction would be spread over time. A fully-fledged civil war continued to devastate the country until the end of the 1940s. The outcome of this civil war determined the politico-economic regime in Greece and its position in the world system.

All in all, this book offers interesting insights into the course of hyperinflation in Greece in the 1940s. It fails, however, to present a balanced and objective assessment both of the political and economic framework in Greece during the period in question. Readers may find *The Four Ends of the Greek Hyperinflation* unconvincing but, if that unease engenders a desire for further research, then the value of this book will increase.

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Gordon de Brouwer, **Hedge Funds in Emerging Markets** (Cambridge: Cambridge University Press, 2001. xii + 228 pp. $45.00) and *Reuven Glick, Ramon Moreno and Mark Spiegel* (eds), **Financial Crisis in Emerging Markets** (Cambridge: Cambridge University Press, 2001. xi + 467 pp. $80.00)

Was the recent Asian crisis caused by market panic induced by irresponsible speculators, or weak macroeconomic fundamentals in the Asian economies? This is a basic question in writing the history of the recent sudden turnabout in economic fortune in east and south-east Asia. It is also crucial for the choice of economic policies needed for recovery. A panic does not require reform afterwards but weak financial institutions do. Both these publications address this question, albeit from different perspectives. Gordon de Brouwer is a leading Australian expert on finance and draws in his monograph on first-hand experience as a participant in an international study group for coordination of hedge funds. The other book forms the proceedings of a conference held in September 1999 at the Federal Reserve Bank of San Francisco and all its three editors are staff members of that bank. Both are highly interesting for anyone wishing to understand the financial crisis in Asia but neither is especially accessible for the average economic historian. It takes a while to get accustomed to the specialist terminology used but it is worth the effort.

De Brouwer first gives an excellent exposition of what hedge funds are, i.e. private investment vehicles not widely available to the general public, often with a high entrance threshold of $1m. or more. Significantly, nobody even knows the exact number of such funds in existence. Following a recapitulation of the project in which he had participated, he offers a systematic analysis of case studies of several financial markets in the region, also including Australia and New Zealand, during the crisis years 1997 and 1998. He describes aggressive tactics and double play in Hong Kong, near-collapse in Jakarta, speculative waves and political pressure in Kuala Lumpur, resilience in Singapore and concentrations of market positions in Sydney and Wellington. His conclusion does contain the nuance that he promised to give at the outset. Hedge funds did not cause the crisis but made it worse by destabilising financial markets (impairing market integrity in financial jargon). Proposals for reform, formulated at the end, logically include a greater transparency and a code of conduct for main players.

This is where de Brouwer's main story ends. Basic concepts are clarified, the empirical evidence is by and large convincing and policy implications sound reasonable. Yet he continues to offer two more chapters thereby expanding the book by another 45 pages. The first is about models of how financial markets operate. It is worth noting that the three editors of the other book discuss the merits of the same models in their introduction, i.e. before the empirical evidence is presented. The second addition to de Brouwer's main argument is a critical examination of the method of inferring hedge fund positions from published returns. This seems to be part of an in-crowd discussion among specialists rather than addressing the book's wider issues.

A few minor points of criticism need to be mentioned with regard to de Brouwer's very well-informed study. In discussing the economic crisis in Indonesia, it is surprising that he uses none of the literature provided by country specialists, including some of his current colleagues at the Australian National University. It is also amusing to observe that Mahathir's charge that Soros and his like caused the crisis is quoted twice (p. 3, n. 2 and p. 110). Not all economists would agree that a correlation coefficient of -0.48, here between interest rates and stock prices in Hong Kong, is statistically significant. Similarly, in the regression analysis of onshore on offshore interests rates in order to examine effects of capital controls in Singapore, the R^2 is not given at all although the parameters of the regression equation are found to be statistically significant.

The San Francisco volume on financial crises and emerging markets consists of 11 specific contributions, i.e. apart from the thorough introduction by its three editors. Most authors are from American banks or universities and both the World Bank and the IMF are represented. Only two come from Asia (South Korea and Hong Kong). The 11 papers, supplemented by brief notes from the discussion at the conference, are distributed over four broad areas of attention: theory, capital flows, institutions and policies. They vary greatly in length with the longest one, an exploration of how financial crises are transmitted internationally, extending to more than 50 pages. The authors do not always agree with one another. One example is the case of a possible systematic relationship between interest rates and exchange rates in crisis-hit countries. One team – Robert Dekle, Cheng Hsiao and Siyan Wang – presents a positive correlation between rising interest rates and appreciating currencies in South Korea, Malaysia and Thailand, whereas two other authors, David Gould and Steven Kamin, find no such evidence when looking at the same countries plus Indonesia and Mexico. This shows us that the controversy among economists about the most appropriate monetary policy in a crisis situation – tightening versus money expansion – has not yet been resolved.

Several contributions in the San Francisco volume point in the direction of the Asian crisis being caused primarily by a too rapid financial liberalisation. A strong linkage between bank crises and currency crises may be expected in emerging markets in general; investor confidence can drop abruptly even if macroeconomic fundamentals remain good; crisis contagion may work through several channels simultaneously; credit supply at home may decline if uncertainties abound about debt repayment; and government bailout guarantees may postpone the outbreak of a combined financial and currency crisis but not for ever. Still, the editors remain cautious when addressing the basic question of panic versus fundamentals. Weak fundamentals enhance vulnerability to a liquidity or speculative crisis, but a crisis caused by weak fundamentals may also be accelerated by panic in financial markets. This sounds all very plausible but a careful differentiation by country and point in time would have been very helpful at this stage.

Standard procedure in the San Francisco volume is to present a theoretical model and to apply econometric methods in testing the predictions. This is done, amongst others, for banking and currency crises worldwide in the period 1975–97 (Reuven Glick and Michael Hutchinson), selected emerging markets since 1988 (Paul Masson), the accumulation of external debt in Thailand and South Korea in the 1990s (Joshua Aizenman and Nancy Marion), lending activities in east and south-east Asia since the early 1980s (Menzie Chinn and Kenneth Kletzer), lending under government guarantee by Korean banks and the effectiveness of capital controls in Thailand and Malaysia. The two studies on monetary and currency policy mentioned above also fit into this category, and so do two studies using a large database of internationally active private firms in order to assess either the situation on the eve of the Asian and Russian crises (Kristin Forbes) or corporate risk-taking behaviour in the years immediately preceding the crises (Stijn Claessens, Simeon Djankov and Tatiana Nenova). The most theoretical exercise of them all, containing numerical simulations rather testing of empirical data, is devoted to the provocative question of whether it was really desirable that foreign direct investment survived the crisis in Asia as well as it appears to have done (Assaf Razin, Efraim Sadka and Chia-Wa Yuen). A more down-to-earth approach would have fitted the underlying question, originally formulated by Paul Krugman, whether crisis-induced transfers of assets also meant a transfer to efficient owners. The highly technical approach in almost all contributions implies that there is little room for less quantifiable variables such as those relating to politics. One small example may suffice. It is assumed that the Indonesian rupiah collapsed 'primarily for political reasons' (p. 388). Yet no further explanation is offered, even apart from the question of whether the argument holds equally true in late 1997, when the position of the Suharto government appeared strong, as in early 1998 when its downfall was drawing near.

It is one of the strengths of the San Francisco volume that it incorporates evidence on other crises than the Asian one, notably the *tequila* crisis in Mexico in 1994/95 and the crises in Russia and Brazil in 1998/99. Yet a genuinely systematic comparison, spelling out similarities and differences between the various crises, would have been helpful. It is also clearly a book written by economists for economists. A longer historical perspective than one or two decades is scarcely, if ever, present and no reference is made to the Wall Street crash or the depression of the 1930s. This is one weakness, however, which both books under review here have in common with most of the literature on the Asian crisis.

Emerging markets is about the risks of rapid growth and it is not coincidental that the term appears in the titles of both books. Even if arguments easily become highly technical, especially in the San Francisco volume with all its econometrics, both these books fit into a growing tradition in the vast Asian crisis literature in which the Asian crisis and the preceding Asian miracle are seen as two sides of the same coin.

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