

Evolving Financial Markets and International Capital Flows: Britain, the Americas, and Australia, 1865–1914. By *Lance E. Davis and Robert Gallman*. Cambridge and New York: Cambridge University Press, 2001. vii + 986 pp. Tables, bibliography, notes, index. Cloth, \$100.00. ISBN 0-521-55352-0.

Reviewed by Randal C. Michie

I considered it a privilege to be asked to review *Evolving Financial Markets and International Capital Flows*, as I have long admired the work of both authors, Lance E. Davis and Robert Gallman. However, on receipt of the book I changed my mind, not through any disappointment with what I found but because the sheer size of the task I had taken on—almost 1,000 pages of continuous text, interrupted only by numerous tables and supported by extensive footnotes—was somewhat intimidating. This was no light reflection from two aging academics, but a serious and detailed work that aimed to bring together the distilled expertise of two distinguished careers on a subject of mutual interest, namely, the role played by international capital flows in the process and pattern of national economic growth through their effects on financial systems. Both in scope and scale this is an ambitious book. It relates to important themes developed over the years by many eminent economists and historians, such as Douglass North on the role of institutions and Rondo Cameron on the importance of financial intermediaries. It covers five major countries—Britain, the United States, Canada, Australia, and Argentina—in three different continents while making passing reference to many others, such as Japan and Mexico. It covers the period from 1865 to 1914 in depth and also surveys the entire twentieth century. Although concerned with the past, it also relates historical experience to the present and the future. Consequently, this book should appeal to many different readers and is written in a way that allows its individual sections to be read separately while still constituting a coherent whole. Do not be put off by its length!

The structure of the book is fairly simple, though there is no introduction explaining the authors' goals, possibly because, unfortunately, Robert Gallman died in 1998. The opening chapter does, however, provide a brief overview of the subject matter and theories that are to be examined, particularly the implications of the relation between

Britain, as the source of international capital, and the other countries as destinations. The next series of chapters covers each country individually, beginning with Britain and then moving on to the United States, Canada, Australia, and Argentina. The chapter format is uniform: a general account of each country's economic performance is followed by a detailed description of its evolving financial system and the conclusion summarizes how the handling and absorption of imported capital affected the particular economic performance of that nation. These five chapters provide excellent overviews of the financial history of each country, paying due regard to both their domestic economies and the international environment. The authors' ability to manipulate so much material and produce a coherent account is impressive. However, these chapters are but a means to determine the significance of capital flows for economic development, not through the traditional focus on amount and type of investment, but by scrutinizing the institutions created and used to handle its export and import for the countries involved. The authors conclude that Britain benefited from overseas investment and that the institutions and markets of the City of London provided the increasingly sophisticated investing public with the range of opportunities they were seeking at home and abroad. Consequently, whatever was lacking in Britain's pre-1914 economic performance was not attributable to the financial system to any significant degree. In their treatment of the United States, Davis and Gallman elucidate the importance of the New York investment banks in financing the railways and large industrial firms. These investment banks owed their origins to the role they played in facilitating the flow of capital from Europe, especially Britain, to the United States. With their London connections, these banks were able to coordinate the mobilization of capital in the United States, which was especially important given the fragmented nature of the American commercial banking system. However, it is clear that capital imported from Britain was significant only in the financing of railway construction and the development of a few firms like General Electric, rather than in the growth of the U.S. economy as a whole.

Imported capital was more important to Canada than it was to the United States, especially after the 1890s and the rapid construction of Canadian railway lines to the west. This vast flow of funds to Canada was largely handled through Canadian companies and Canadian banks, resulting in the development of an indigenous financial

structure. The rise of the Canadian bond house was a particularly important innovation. In contrast, though the flow of British capital to Australia was equally critical to that country, especially before the 1890s, it had less positive consequences. Much of the flow to Australia went through the state government, which was largely responsible for railway and related developments, and the government dealt directly with financial intermediaries in London. As a result, there was no equivalent of a New York investment bank or a Canadian bond house in Australia. The one Australia innovation was its banks' direct solicitation of British deposits, but this activity largely ended in the early 1890s when property values collapsed in Australia, leading to the bankruptcy of a number of banks. The flow of British capital to Australia did not provide it with the financial institutions that could mobilize large amounts of capital domestically, and this had consequences for the country's long-term economic growth.

A similar situation existed in Argentina, where the railway system was financed by British-owned companies and British-owned banks dominated the country's external financial relations. Argentine banks were initially willing to provide long-term funds for development from their short-term deposits. However, after the inevitable liquidity crisis, when banks found themselves unable to repay short-term depositors because their money was tied up in long-term loans, and the subsequent banking collapse in the early 1890s, this practice stopped, leaving control of long-term capital in the hands of the British. From these detailed case studies, Davis and Gallman conclude that the way imported capital arrives in a country is of major importance. Given the opportunity, capital flows have the ability to foster financial intermediaries that in turn contribute much to the mobilization and use of domestic savings in recipient countries. In turn, there is a dynamic process of adoption, adaptation, invention, and modification, enabling each country to acquire the financial system that best suits its needs. However, if imported capital is channeled through the government, as in Australia, or is totally controlled by the lender and not the borrower, as in Argentina, then, the authors maintain, local financial development is hindered. This contention is tested in a chapter that looks at financial developments since 1914 and ranges more widely than their chapters on individual countries. This chapter traces first the collapse of the international financial system from the First World War onward and then its re-creation, in a somewhat different form, after

1960. Davis and Gallman contend in their final chapter that there is a role for government intervention in both international financial flows and domestic financial systems but that ultimate success will only come about if markets are allowed to test the success or failure of government creations.

This book is a major contribution to its subject and a fitting tribute to a lifetime of achievement. It confirms that financial systems play a very important role in the process of economic growth and suggests that these financial systems are shaped by both external and internal forces. Beyond this, however, it indicates that nothing is inevitable in the process of economic growth and that much depends on the nature of these financial systems and the way that they have evolved to meet particular circumstances. Furthermore, the most successful financial systems are those that are closest to the needs of either lenders or borrowers and rely on the operation of the market to distribute funds, though there is a limited role for government to assist in the process.

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