Financial History Review, vol. 8, part 2, October 2001. Printed in the United Kingdom © 2001 Cambridge University Press.

Charters, corporations and codes: entry restriction in modern banking law[1]

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Governments have long played an important – and varied – role in shaping banking systems. From defining the specie content of the monetary unit to the establishment of government-sponsored (i.e. central) banks and setting the rules and regulations under which private financial firms operate, governments have influenced the shape of the financial landscape for centuries. Nor has their influence waned in recent years: governments and regulatory authorities in the industrialised, not to mention the industrialising, world are hard at work building up, altering and tearing down various facets of regulation for what is already one of the world's most heavily regulated activities.[2]

The impetus to regulate – or deregulate – comes from a variety of sources, which can be separated into: (1) traditional, purely economic motives, and (2) political-economic motives. Purely economic reasoning has long guided economists in their study of regulation and has led to the conclusion that, in the presence of market imperfections such as monopolies or imperfect information, government regulation can result in superior (i.e. more efficient) outcomes.[3] Thus regulation is merely a response by the authorities to an imperfect world. In the case of banking, purely economic motives for regulation centre on promoting *stability* and *efficiency*. Because of banks' unique role in money creation, in the form of transactions deposits (banknotes in earlier periods), bank regulation may also be motivated by the government's desire to exert *monetary control*.

An alternative literature focuses on the *political-economic* motives for regulation. This literature concentrates on the incentives faced by, and political power of, different political and economic actors, and views the evolution of regulation as the outcome of the interplay between different interest groups.[4] Groups with greater

[1] This paper is part of a larger project on the evolution of banking in the industrialised world. I thank the National Science Foundation for financial support.

[2] W. Möschel, *Public Law of Banking* (Boston, 1991), p. 3.

[3] F. M. Scherer, *Industrial Market Structure and Economic Performance* (Chicago, 1980).

[4] G. Stigler, 'The economic theory of regulation', *Bell Journal of Economics and Management Science*, 2 (1971); S. Peltzman, 'Towards a more general theory of regulation', *Journal of Law and Economics*, 19 (1976); G. Becker, 'A theory of competition among pressure groups for political influence', *Quarterly Journal of Economics*, 97 (1983); and R. S. Kroszner, Is the financial system independent? Perspectives

https://doi.org/10.1017/S096856500100021X Published online by Cambridge University Press

numbers, financial resources and cohesion will support regulations that are favourable to them and will have the advantage in the competition between different interest groups. This literature also considers politicians and regulators as interest groups that may be motivated by the desire for such non-economic goals as larger budgets and more staff or to advance a particular ideological agenda.

Although the reasons for regulation described above are distinct, in practice it is difficult to disentangle the multiple of motivations for a particular reform. For example, the National Banking Acts in the United States (1863–64), which established a new type of bank (national bank), a new regulatory authority (Comptroller of the Currency), and a bond-backed bank-issued currency (national banknotes), could have been passed on any of the grounds cited above. Since the National Banking Acts established uniform and relatively strict guidelines for granting bank charters, they could be viewed as stability enhancing. Since the laws also required publication of bank balance sheets, they could be viewed as ameliorating an information asymmetry and, therefore, be viewed as enhancing efficiency. Alternatively, since the Acts both established a new national currency and drove the notes issued by state banks out of circulation, they could be viewed as enhancing the government's monetary control. Finally, since banks chartered under the Acts were required to secure banknote issues with holdings of government bonds, the law could be viewed as serving the political-economic motive of providing a guaranteed source of demand for federal government bonds during the fiscally demanding Civil War. The difficulty of disentangling the motives for major legislation is not unique to the National Banking Acts as it could equally be applied to many banking reforms, including Belgium's Banking Decree of 1935, Japan's National Banking Decree of 1872, Sweden's Banking Code of 1846, and the United Kingdom's Joint Stock Bank Act of 1844.

Given the difficulties discussed above, together with the large number of major and minor banking reforms enacted by sovereigns, legislatures and regulatory authorities since the grant of the first modern bank charter, that of Sweden's Riksbank in 1668, it would be impossible to assess systematically the reasons for each and every reform. Consequently, the focus here is much less ambitious, to assess the motivation for one simple, fundamental form of regulation: entry into commercial banking. The objective is to gauge the motivation behind the different legal forms regulating entry into banking, and the evolution of these rules over time.

Entry into banking is typically achieved through the grant of a charter by some governmental authority.[5] During commercial banking's earliest stages, charters were issued (or denied) upon application by potential bankers to the sovereign or the

on the political economy of banking and financial regulation, mimeo (1999), which focuses specifically on banking and financial regulation.

[5] I exclude private, non-chartered, unincorporated banks from my analysis. Such banks existed in many countries and, typically, predated chartered banks. However, given that these banks typically existed without specific legislative sanction, an analysis of their legal foundation is beyond the scope of this paper.

https://doi.org/10.1017/S096856500100021X Published online by Cambridge University Press

legislature. In time, this procedure became less discretionary, and charters were available to any and all applicants that met certain requirements, such as the total capital available for the enterprise, securities held as a guarantee of notes issued, etc. These later charters were issued to institutions under general corporation law or via special banking codes.

Briefly, I conclude that the decision to move from charters granted at the government's discretion to those granted automatically resulted from a decline in charter values and, hence, the rents that issuing authorities could extract in exchange for them. The decision to switch to either corporation law or banking codes was motivated by the need to secure the means of payment. Countries in which the means of payment was provided by private banks typically enacted comprehensive banking codes earlier, whereas those where the money issue was concentrated in a central bank at an early stage tended to have looser banking regulations. The results suggest that control – or at least the security – of the money supply was of prime importance in regulating bank entry.

Section I of this paper reviews the rationale and theory of banking regulation. Section II outlines the beginnings of modern forms of regulation of entry. Section III presents some simple cross-country evidence. Conclusions follow in section IV.

I

There is no well-established branch of economics that addresses bank regulation. Rather, the economist's view of banking is characterised by 'various patches of economic theory which, more or less successfully, attempt to analyse certain aspects of banking regulation from the economic point of view'.[6] Nonetheless, four principal motivations for banking regulation can be discerned: (1) stability; (2) efficiency; (3) monetary control; and (4) political-economic goals.[7] Policy-makers have used entry restrictions to pursue each of these goals.

Banking stability can yield both political-economic and economic benefits. Since bank deposits are a common and, for some part of the electorate the major, form of wealth-holding, policies aimed at preventing banking instability can bring electoral benefits for politicians who enact such rules. In addition, there is a substantial literature on the macroeconomic costs of banking instability, highlighting the economic effects of banking stability.[8] Restricting attention to regulations on entry, of

[6] E. Baltensperger, *The Economic Theory of Banking Regulation*, Occasional Papers, Centre for the Study of the New Institutional Economics, Universität des Saarlandes, 2 (1990), p. 1.

[7] ibid.; and Möschel, *Public Law*.

[8] This literature emphasises a variety of channels (e.g. monetary channel, credit channel, payments mechanism) through which banking instability can exact a macroeconomic cost. See M. Friedman and A. J. Schwartz, *A Monetary History of the United States* (Princeton, 1993); C. P. Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises* (New York, 1978); H. Minsky, 'The financial instability hypothesis: capitalist processes and the behavior of the economy', in C. P. Kindleberger and J.-P. Laffargue (eds), *Financial Crises: Theory, History, and Policy* (Cambridge, 1982); B. S. Bernanke, 'Nonmonetary effects of the financial crisis in propagation of the Great Depression',

https://doi.org/10.1017/S096856500100021X Published online by Cambridge University Press

course, ignores many other potential stability-enhancing regulations, including supervision and regulation, minimum capital requirements, deposit insurance and the presence of a lender of last resort. However, entry regulations can have consequences for banking stability. For example, a system that limits the number of banks can reduce competition and increase profitability.[9] By preventing too much competition, regulators can lessen the likelihood of failure by encouraging the existence of large, profitable institutions.

Another important economic objective of regulation is efficiency. Efficiency arguments are made in connection with the regulation of many industries, and are widely discussed in the literature concerned with industrial organisation.[10] An efficiently functioning market is typically characterised by numerous buyers and sellers, where all the externalities are borne by producers, and consumers have relatively full information about firms. Violations of this ideal – market failure – can lead to outcomes that the government may have an interest in curbing.

The classic market failures are monopoly and oligopoly, where the number of producers is low. Monopolists and oligopolists are able to restrict output in order to charge higher prices,[11] so monopolised industries tend to produce lower output at higher prices than equivalent but competitive industries. Interestingly, in contrast with the stability-enhancing approach to entry, which might motivate regulators to stifle competition (i.e. restrict entry), a desire to promote a competitive (i.e. efficient) banking sector might encourage a free entry policy.

A third reason for regulating banking results from the importance of banking in the monetary system. Under fractional-reserve banking, banks issue money (notes or deposits) on the basis of their holdings of reserves. By setting the proportion of note issue that must be backed by reserves, the authorities can prevent an inflationary over-issue of money on the part of banks. Such over-issues resulted from the debasement of coins during the Middle Ages[12] and were cited in support of the National Banking Acts in the United States.[13] If banks are relatively unconstrained in their ability to issue notes and deposits, entry restrictions may preserve monetary stability.

Finally, there are a variety of other, less purely economic objectives that might

American Economic Review, 73 (1983); and R. S. Grossman, 'The macroeconomic consequences of bank failures under the national banking system', *Explorations in Economic History*, 30 (1993).

[9] R. S. Grossman, 'The shoe that didn't drop: explaining banking stability during the Great Depression', *Journal of Economic History*, 54 (1994).

[10] Scherer, *Industrial Market Structure*, p. 482ff.

[11] Either because of explicit collusion or because one of the few firms acts as a price leader, with others following. See R. Selten, 'A model of oligopolistic size structure and profitability', *European Economic Review*, 22 (1983); and J. Tirole, 'Noncooperative game theory: a user's manual', in J. Tirole (ed.), *The Theory of Industrial Organization* (Cambridge, 1988).

[12] N. Sussman, 'Debasements, royal revenues, and inflation in France during the Hundred Years' War, 1415–1422', *Journal of Economic History*, 53 (1993).

[13] H. Kroos, *Documentary History of Banking and Currency in the United States*, 3 (New York, 1969), p. 1355ff.

https://doi.org/10.1017/S096856500100021X Published online by Cambridge University Press

be met by means of regulation. If new banks are required to purchase bonds (as in the case of the National Banking Acts), it may be in the government's interest to expand entry. Alternatively, if governments realise returns by selling or auctioning off bank charters, it may be in the interest of the government to limit entry in order to maintain high charter values.

II

The earliest financial regulation was typically not banking regulation *per se*, but monetary regulation, the most common of which controlled the weight and fineness of coins.[14] Public interest in such regulation is clear enough since it is difficult for individuals to assess accurately the specie content of coins. Government certification reduced the need for individuals to assay coins and thus may have increased confidence in the circulating medium. On the other hand, control over the weight and fineness of coins allowed the government to increase its revenue by debasement (i.e. reducing the specie content).[15] As coins gave way to banknotes, the emphasis of government regulation moved in the same direction, ensuring the value of banknotes by either imposing unlimited liability on issuers or limiting note issues to amounts that could be secured with a mandated reserve.[16] In time, as bank deposits grew in importance, both as a store of value and as a means of payment, relative to bank notes, the focus of legislation and regulation shifted from note issue to the issue of bank deposits and, therefore, to the regulation of commercial banks.[17]

Among the most basic of regulatory functions are restrictions on entry. Entry restrictions in banking have typically taken one of three forms. The first and earliest was entry by charters granted on a case by case basis, through which permission was given by the government (legislature or sovereign) for an individual or a group of individuals to undertake banking business. These charters frequently provided the authorised banks with limited liability and set conditions under which they could conduct business, such as a required minimum share capital, the authority to conduct certain types of transactions, etc.

The first institutions to receive such charters were typically institutions that became central banks: Swedish Riksbank (1668) and Bank of England (1694). Subsequent Acts granted charters to the central banks of Austria-Hungary (1816), Belgium (1850), Denmark (1818), France (1800), Norway (1818), the Netherlands

[14] A. M. Allen, 'The principles of statutory regulation', in A. M. Allen, S. R. Cope, L. J. H. Dark and H. J. Witheridge (eds), *Commercial Banking Legislation and Control* (London, 1938), p. 3.

[15] Sussman, 'Debasements, royal revenues, and inflation'.

[16] For example, from 1709 to 1826 note issue in England was confined to unlimited liability partnerships of no more than six people and the Bank of England. Similarly, note issue in Sweden was confined to unlimited liability enskilda banks. Notes issues in Australia, Canada, Japan and the US at various times during the 19th century were limited by various balance sheet totals (e.g. paid-up capital).

[17] Allen, 'The principles of statutory regulation', p. 3.

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Table 1. *Establishment of central banks*

Country	*Year*	*Action*
Australia	1911/59	Commonwealth Bank of Australia (later Reserve Bank of Australia)
Austria	1816	Österreichische Nationalbank
Belgium	1850	Banque Nationale de Belgique
Canada	1934	Bank of Canada
Denmark	1818	Denmarks Nationalbank
Finland	1811	Suomen Pankki
France	1800	Banque de France
Germany	1876	Reichsbank
Italy	1893	Banca d'Italia
Japan	1882	Nippon Ginko
Netherlands	1814	De Nederlandsche Bank
Norway	1816	Norges Bank
Sweden	1668	Sveriges Riksbank
Switzerland	1907	Swiss National Bank
United Kingdom	1694	Bank of England
United States	1914	Federal Reserve System

Source: F. Capie, C. Goodhart, S. Fischer and N. Schnadt (eds), *The Future of Central Banking: The Tercentenary Symposium of the Bank of England* (Cambridge, 1994), Appendix B.

(1814) and other countries (Table 1). Although these banks were not the public sector non-profit maximising institutions associated with modern central banks, they were exceptional in that they were given rights, such as being the government's banker, and received certain privileges, frequently including a monopoly of the note issue (Table 2).[18] In many cases, it was not necessary to provide these institutions with exclusive banking privileges since they were often the only commercial bank in the country when founded.[19]

Although future central banks were usually the first chartered in a country, charters were subsequently granted to other commercial banks. An individually granted charter was the most common way of founding banks in British colonies. The British Parliament passed the Bank of Australia Act in May 1827, which served as the model for bank charters in New South Wales, South Australia and Tasmania until the colonial banking regulations made some adjustments during the 1840s. Similarly, the British Parliament chartered the first commercial banks in Canada,

[18] The modern notion of a central bank dates from the 19th century. See H. Thornton, *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain* (London, 1802, 1939) and W. Bagehot, *Lombard Street* (London, 1873, 1924). Not all central banks were granted a monopoly on note issue from their inception. See Table 2.

[19] F. Capie, C. Goodhart, S. Fischer and N. Schnadt (eds), *The Future of Central Banking: The Tercentenary Symposium of the Bank of England* (Cambridge, 1994), p. 4.

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Table 2. *Centralisation of note issue*

Country	*Year*	*Action*
Australia	1910	Federal Government authorised Treasury note issue and placed 10% tax on all other note issues.
Austria	1816	Priviligierte Oesterreichische Nationalbank established with exclusive rights to issue notes convertible into silver.
Belgium	1850	Banque Nationale de Belgique established after crisis of 1848 led to suspension of convertibility. The largest note-issuing banks 'were persuaded' to abandon note-issuance in favour of the new central bank.
Canada	1934	Bank of Canada given monopoly upon establishment, replacing notes of chartered banks and government-issued Dominion notes.
Denmark	1818	Predecessor Kurantbanken (established 1736), which had been sole note-issuer, folded. Subsequent Specie Bank failed 1813. Rigsbank (immediate predecessor to Denmarks Nationalbank) also given sole right to issue notes from establishment.
Finland	1886	Bank of Finland had been in existence since 1811, but Finland did not obtain its own currency until 1860. Bank given sole right to issue notes in 1886.
France	1848	Permission given for three note-issuing banks to be established in 1817–18, six more established by 1838. Following crisis of 1848, these became branches of Bank of France.
Germany	1876	Law limited currency of non-Reichsbank issuers to state within which they were issued.
Italy	1871	Law concentrated note issue in six public banks of issue.
Japan	1883	Bank of Japan regulations issued, centralising note issue.
Netherlands	1863	Bank Act (recharter act) of 1863 restricted the right of other institutions to issue notes.
Norway	1818	Granted a monopoly shortly after founding.
Sweden	1897	Note issue privilege of unlimited liability (enskilda) banks to lapse by 1904.
Switzerland	1910	Federal statute to allow a national bank with monopoly note issue passed in 1881, but national bank legislation not passed until 1905 and monopoly not established until 1910.
United Kingdom	1844	Bank Charter Act began process of centralising note issue in Bank of England by limiting franchise to those banks that held it at the time of the Act's passage and specifying that lapsed note issues (due to closures, amalgamations, etc.) should revert to the Bank of England.
United States	1914	Creation of Federal Reserve begins process of centralising note issue in Fed.

Sources: Capie et al., *The Future of Central Banking*, p. 6 and Appendix B; and H. Parker Willis and B. H. Beckhart, *Foreign Banking Systems* (New York, 1929).

https://doi.org/10.1017/S096856500100021X Published online by Cambridge University Press

including Bank of Montreal, Bank of New Brunswick and Bank of Upper Canada during the period 1820–22.

The first chartered bank in Belgium not only predated the central bank but also Belgium itself. Algemeene Nederlandsche Maatschappij ter Beunstiging van der Volksvliet (Société Générale pour favoriser l'industrie nationale) was granted a charter by William I of the Netherlands in 1822. Following Belgian independence in 1830, the Bank of Belgium was established by royal decree. Banks in the United States also operated under individually granted charters during the Republic's early years. With the exceptions of the proto-central First and Second Banks of the United States, neither of which outlived its initial 20-year charter, banks were chartered by special acts of incorporation passed by state legislatures. Prospective bankers had to lobby their state legislature in order to gain a charter; they might be successful if they were, in the view of the legislature, of good character and the legislature felt that the area needed another bank. A petition's success might also depend upon the ability of the potential banker (or the inability of existing banks opposing the petition) to persuade – or bribe – legislators.[20]

In time, most countries moved away from the model of individually granted charters to one of two less discretionary methods of charter-granting: (1) banking codes; or (2) general corporation law. Codes specified in detail the conditions under which new banks would be chartered, whereas general corporation law laid down the conditions under which corporations (whether banking or non-banking) could be established. Although legislators or regulators may have retained some residual authority over granting a charter, the establishment of banking codes and corporation law greatly reduced the discretion of chartering agencies, both to grant the charter and to alter its terms. In countries where specific banking codes were not passed, banks typically were established under general company law (Table 3).

The first banking codes were introduced in Britain (1844) and Sweden (1846).[21] These were relatively detailed, laying down conditions for entry, as well as form of charter, minimum capital requirements, publication of balance sheets, etc. The British code was not particularly long-lived: by 1857, the small number of banks chartered under the 1844 provisions led Parliament to replace the Act with the Joint Stock Banking Companies Act which essentially subjected banks to the provisions of the commercial code. The Swedish code was amended several times during the nineteenth century (in 1848, 1850–51, 1855), and was eventually repealed and replaced with a new act in 1864.

In the United States, Canada and Japan, the initial shift came in the form of free

[20] B. Hammond, 'Banking before the Civil War', in D. Carson (ed.), *Banking and Monetary Studies* (Homewood, 1963), p. 7ff.

[21] These were not the first commercial banking laws passed in either country. An 1826 law in Britain allowed the establishment of joint-stock banks 65 miles or more from London, although the legislation did not specify the details about how such banks were to be organised. A royal decree in Sweden in 1824 also authorised the establishment of private banks. This legislation also did not specify a detailed banking code.

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banking laws. Under free banking, introduced in Michigan in 1837 and in New York in 1838, rather than apply to the state legislature for a charter, individuals could obtain a charter by completing some paperwork and depositing a prescribed amount of specified bonds with the state authorities. By 1860, over one half of the states had enacted some type of free banking law.[22] In 1863–64, with the passage of the National Banking Acts, a version of free banking was established on a national scale. Similarly, the Canadian Free Banking Act, modelled on that of New York, was passed in 1850, although repealed and replaced with another comprehensive banking act in 1866. A Japanese National Bank Decree, based on the United States Acts, similarly regularised the charter-granting process in 1872.[23]

In other countries, no special banking laws were passed and, with the decline of individual chartering acts, new banks were established, explicitly or implicitly, under company law. Four Australian states passed laws allowing banks to be established under general company law between 1863–74.[24] However, in many countries specific banking laws were not passed until the twentieth century. Frequently, these were passed during the turbulent interwar period: Austria (1920s), Belgium (1935), Denmark (1919), Germany (1931–34), Italy (1926), Norway (1924) and Switzerland (1934). In France (1941) and the Netherlands (1952), explicit banking statutes were not enacted until even later.[25]

III

The evolution away from individually granted charters raises two questions. First, what caused the shift to a less discretionary means of charter issuance? Second, why did some countries enact banking codes, while others allowed banks to be formed under general corporation law?

The shift away from individual charters can be explained on several grounds. When governments bestowed bank charters, particularly central bank charters, they usually received some compensation in return, typically in the form of a loan.[26] For example, in return for its charter, which included limited liability and a monopoly of joint-stock banking in England and Wales, the Bank of England extended a long-term loan to the government. The terms of the loan agreement were adjusted at subsequent charter renewals. Thus the privilege of chartered banking was granted in return for some form of payment. In some countries, the demand for banks and

[22] H. Rockoff, *The Free Banking Era: A Reexamination* (New York, 1975).

[23] This was replaced with the Ordinary Bank Regulations of 1890.

[24] Queensland (1863), Victoria (1863), Tasmania (1869) and New South Wales (1874). South Australia consistently excluded banks from its company law. Western Australia was not self-governing until 1890.

[25] Note that no banking code was enacted between 1866 and 1919. This half-century-plus hiatus may indicate that the process of enacting codes was, in fact, over, and would not have continued in the absence of the turbulence following the First World War and the Great Depression.

[26] Capie et al., *The Future of Central Banking*, p. 7.

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Table 3. *Establishment of a comprehensive banking code*

Country	*Year*	*Description*
Australia	1863–74	Banks to be created under general companies law in Queensland (1863), Victoria (1863), Tasmania (1869), and New South Wales (1874). Many banks were British-based and created under British law. No comprehensive federal code as of the time of the Royal Commission (1937).
Austria	early 1920s	Law on liability of banks. The Vereinspatent (Association Code) of 1852, General Commercial Code of 1863, Vereinsrecht (Association Law) of 1867, Genossenschaftsgesetz (Cooperative Associations Law) of 1873 and the Aktienregulativ (Joint Stock Company Law) of 1899 all had an impact on banks but did not include specific restrictions over and above those of other corporations.
Belgium	1935	Prior to the Banking Decree (Decree 175) of 9 July 1935, there was no specific banking law.
Canada	1850	Free Banking Act. Previously banks had been primarily chartered by legislative acts.
Denmark	1919	First commercial bank legislation. Revised 1930.
Finland	1866	First banking law.
France	1941	Prior to 1867, banks founded by special charter, afterwards, under 1867 general incorporation law. No specific banking law as late as 1936. A Banking Control Commission was set up in 1941.
Germany	1931–34	Banking Commission established 1931, Bank Act of 1934 established rules and strict control by Banking Commissioner.
Italy	1926	Prior to 1926, the only laws governing commercial banking were those of the commercial code. Two decrees of 1926 established basics of banking code.
Japan	1872	National Bank Decree, based on US National Bank Acts. Replaced by Ordinary Bank Regulations of 1890.
Netherlands	1952	Preliminary Bank Act of 1952 (revised 1956).
Norway	1924	Prior to 1918, joint-stock company law applied to banks. Temporary law of 1918 regulated entry and changes of capital. Full banking code enacted 1924.
Sweden	1846	Preliminary law on private banks in 1824. Code enacted 1846.
Switzerland	1934	Banking Act and subsequent Executive Order established Federal Banking Commission and code.

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Table 3. *Continued*.

Country	*Year*	*Description*
United Kingdom	1844	Joint Stock Bank Act established procedure for establishment and operation of joint-stock banks. Repealed by act of 1857 that essentially put banks under the commercial code.
United States	1837–64	Free Banking laws enacted in over one half of the states between 1837 and 1860. National Banking Acts (1863–64).

Sources: Willis and Beckhart, *Foreign Banking Systems*; A. M. Allen, S. R. Cope, L. J. H. Dark and H. J. Witheridge (eds), *Commercial Banking Legislation and Control* (London, 1938); C. E. Freeman, *Joint Stock Enterprise in France, 1807–1867* (Chapel Hill, 1979); G. Enderle-Burcel, 'The failure of crisis management: banking laws in inter-war Austria', in A. Teichova, T. Gourvish and A. Pogány (eds), *Universal Banking in the Twentieth Century: Finance, Industry and the State in North and Central Europe* (London, 1994); S. J. Butlin, *Foundations of the Australian Monetary System, 1788–1851* (Carlton, 1953); N. Tamaki, *Japanese Banking: A History, 1859–1959* (Cambridge, 1995); A. Kuusterä, 'The Finnish banking system in broad outline from the 1860s to the mid-1980s', in M. Pohl (ed.), *Handbook on the History of European Banks* (Brookfield, VT, 1994); and Y. Cassis, 'Banks and banking in Switzerland in the nineteenth and twentieth centuries', in Pohl, *Handbook*.

banking services – and consequently the value of an individual charter – was low, so the chartering agency could not expect a substantial payment in return for the charter. For example, in the cases of Austria-Hungary, Denmark, Finland, the Netherlands, Norway and Sweden, at the time of the government chartering the central bank, the new institution was not only the central bank but was also the *only* bank.[27] The demand for chartered banking in Denmark was so minimal that, after the foundation of the Denmarks Nationalbank in 1818, a second chartered bank was not established for another 30 years. In the Netherlands, the presence of an active money market (*prolongatie*), private merchant houses and cashiers (*kassiers*), reduced the need for chartered banking.[28] In several countries, including Scandinavia and Italy, a variety of alternative financial intermediaries, such as savings banks, may have reduced the charter value of commercial banks.

In the United States, on the contrary, the demand for bank charters was robust and the development of alternative intermediaries was comparatively slow. Consequently, state legislatures maintained tight control over the bank chartering

[27] ibid., p. 4.

[28] J. Jonker, 'The alternative road to modernity: banking and currency, 1814–1914', in M. 't Hart, J. Jonker, and J. L. Van Zanden (eds), *A Financial History of the Netherlands* (Cambridge, 1997); and idem, *Merchants, Bankers, and Middlemen* (Amsterdam, 1996). One of the earliest entrants into the banking market in the Netherlands, Nederlandsche Handel-Maatschappij, had, in fact, been founded in 1824 as a trading company specialising in the Dutch East Indies.

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process until the beginnings of free banking in the 1830s, with more than a dozen state legislatures issuing charters individually as late as 1860. Why, in the case of the United States, did the shift occur in the 1837–63 period? Although an analysis of the passage of individual state free banking laws is beyond the scope of this article, there are two potential explanations. First, state legislatures' control of banking charters was seen as being responsible for concentrating the banking franchise in a well-heeled and well-financed elite, which ran against a populist grain.[29] Second, the gradual spread of free banking laws might indicate a decline in charter values across states. The passage of free banking on a national level in 1863–64 reflected both the views of the majority of states and the need for financing the Civil War. The shift in Canada and Japan appears to have been explicitly patterned on that in the United States.

In other countries, the evolution from individually granted charters resulted from competition between jurisdictions, or changes in corporation law, or from the prevailing economic ideology. In Australia, for example, states that included banks within general incorporation laws may have done so to encourage more banks to secure charters domestically rather than from the British Parliament. In France, a law of 1867 greatly simplified incorporation for both banks and other corporations by replacing charters granted by a central authority with simple registration. The French change can be traced, in part, to a desire to keep up with the liberal company law passed in Britain some years earlier.[30] In Germany, several attempts were made during the nineteenth century to enact specific banking laws but these were forestalled by clauses in the constitution and a prevailing ideology supporting a liberal economic environment.[31]

Why did some countries regulate banking with special banking codes while others allowed banks to be established under general corporation law? The first countries to establish central banks and centralise note issues within them were among the last countries to enact detailed banking codes. Countries that centralised their note issues relatively early, such as Austria, Belgium, Denmark, France, the Netherlands and Norway, each instituted banking laws relatively late – not until after the First World War and, at least in the case of the Netherlands, not until after the Second World War.

Other countries typically relied upon currency issued by private banks. Because of the dangers of over-issue of notes, these countries, including Australia, Canada, Finland, Japan, Sweden and the United States, soon enacted comprehensive banking codes. These codes usually imposed severe restrictions on note-issuing. In the United States, for example, national banks could issue currency equal to 90 per cent of the amount of bonds placed on deposit with the Comptroller of the Currency. Similar restrictions were placed on the free banks of Canada and Japan. Australian

[29] Hammond, 'Banking before the Civil War'.
[30] C. E. Freeman, *Joint Stock Enterprise in France, 1807–1867* (Chapel Hill, 1979).
[31] E. Honold, *Die Bankenaufsicht* (Mannheim, 1956).

https://doi.org/10.1017/S096856500100021X Published online by Cambridge University Press

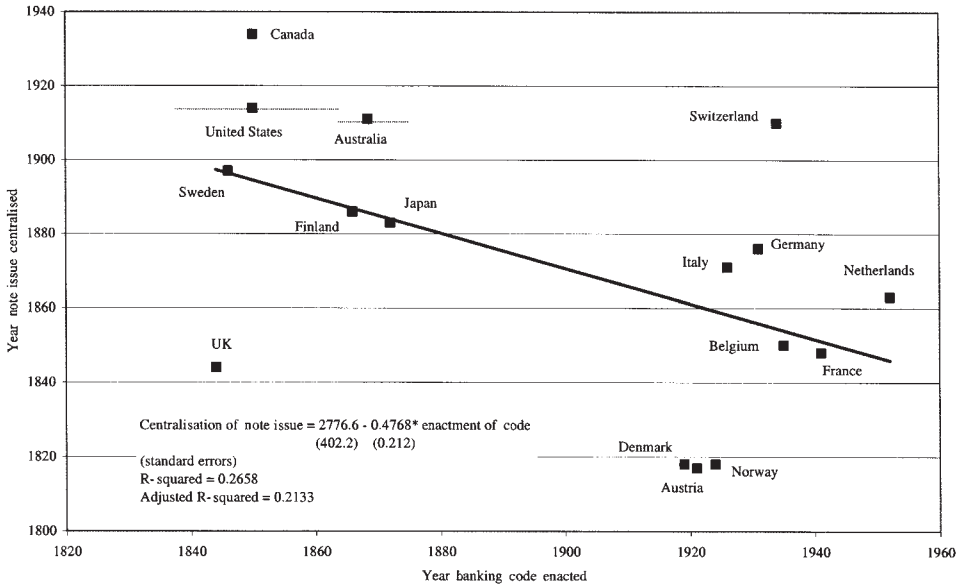


Figure 1. *Centralisation of note issue and enactment of banking code*
Source: Tables 2 and 3.

regulations predating the state acts mandated that any bank that did not maintain convertibility would lose its charter.

The relationship between the date of the centralisation of the note issue and the establishment of a banking code is illustrated in Figure 1. The regression line clearly indicates the negative (and statistically significant) relationship between the year in which the note issue was centralised and the year in which a banking code was enacted.

However, assigning precise dates to the enactment of a banking code and note centralisation is problematic in several cases. In the United States, the first banking codes, the free banking acts, were passed by different states between 1837 and 1860. Free banking on a national scale was only adopted with the National Banking Acts (1863–64). This is illustrated in Figure 1 by showing a range of dates (1837–63) at which banking codes were enacted, with the mid-point (1850) adopted, for purposes of the regression, as the year in which a code was adopted. Similarly, in Australia, where state-level corporation codes that included banks were enacted during the period 1863–74, the range is shown in the figure and the mid-point adopted for the regression analysis.

Despite the good fit suggested by the regression equation presented in Figure 1, the figure includes two obvious outliers: Switzerland and the United Kingdom. Given that the first Swiss banking code was not adopted until 1934, the centralisation of the country's note issue in the Swiss National Bank in 1910 occurred later than the model predicts. In fact, a federal law regulating note issue was enacted in

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1881, although the note issue was not centralised until 1910. Had the earlier date been adopted for the analysis, the point for Switzerland would have been quite close to that of Germany and the regression line in Figure 1.

For the United Kingdom, dating the enactment of both note centralisation and a banking code in 1844 is also problematic. The Joint Stock Banking Act of 1844 was repealed only 13 years later and, as late as 1938, it was noted that 'apart from a few special sections in the 1929 act, banking companies are subject to exactly the same regulations as other companies'.[32] Had a later date been adopted for the analysis, the point for the United Kingdom would have been near Belgium and France and close to the regression line.

The data presented in Figure 1 show that the sooner countries centralised their note issue, the longer their governments waited to adopt a detailed banking code. Despite difficulties in precisely dating the centralisation of note issues and adoption of banking codes, the pattern is quite robust. Although Switzerland and the United Kingdom seem to contradict the general pattern, the Swiss adoption of a note-issue law in 1881 and Britain's repeal of the Joint Stock Banking Act in 1857 suggest that they also fit the pattern illustrated in the figure.

IV

Banking legislation has gone through a number of changes since the first modern bank charter was issued to the Swedish Riksbank in 1668. Although a full analysis of each and every banking regulation adopted from 1668 to the present is a worthy goal, it is well beyond the scope of this article. Instead, I have examined only the most basic form of government regulation of banking: entry. Even this simple regulation has gone through a number of permutations over the last two centuries.

At first, bank charters were granted on an institution-by-institution basis. Initially, they were usually given to the promoters of central banks which supplied important public services, such as providing a currency and/or banking services, and which may have yielded the chartering governments rents in the form of low-interest loans. To the extent that charter values remained high, governments and legislators had an incentive to continue parcelling out charters on an individual basis. However, when charter values fell, or if corporation law changed or if public attitudes towards banking changed, the manner in which charters were issued was altered: typically the process was regularised, so that charters were issued in a less discretionary, more automatic fashion.

Once the decision was made to change the way in which charters were granted, two options were available: banking codes and general corporation law. For the most part, countries enacted banking codes when the means of issuing money was not concentrated in the central bank but rather was the responsibility of commercial banks. When the central bank was given a monopoly on money issue relatively

[32] A. M. Allen, 'Great Britain', in Allen et al., *Commercial Banking Legislation*.

https://doi.org/10.1017/S096856500100021X Published online by Cambridge University Press

early, the need for a detailed banking code was less and, in fact, regulation of banking entry was generally left to general corporation laws.

Of course, money issue was not the only factor affecting the legal structure of banking. There is a substantial literature on different legal traditions and their consequences for financial structure that may have had important influences on the establishment of banking law.[33] Furthermore, countries with federal systems, such as the United States, Australia and Switzerland, may have had additional forces driving state and national legislation. And, of course, a whole gamut of issues encountered in the course of economic development, such as industrialisation, war, inflation and could have had a profound impact upon the legal foundation of banking. Despite these many other potential influences on banking legislation, the regulation of entry appears to have been motivated primarily by monetary concerns.

[33] R. LaPorta, F. Lopez-de-Silane, A. Shleifer and R. W. Vishny, 'Legal determinants of external finance', *Journal of Finance*, 52 (1997).

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