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**Book's review: Mary O'Sullivan (2016), Dividends of Development – Securities Markets in the History of US Capitalism, 1866–1922, Oxford University Press**

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Mary A. O’SULLIVAN,  
*Dividends of Development—Securities Markets in the History of US Capitalism, 1866–1922*, Oxford, Oxford University Press, 2016, 384 p.

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*Book review by Laurent Le Maux*  
*Paris, March 2019*

On July 31, 1914, a few minutes before the usual market opening time, the Executive Board of the New York Stock Exchange took the decision to suspend trading until further notice. However, few market participants could then foresee that the United States would enter into the military conflict alongside France and Great Britain. At most, it was anticipated that some European investments would be liquidated in New York City.

In this dense and fascinating book on the securities market and capitalism in the United States in the late nineteenth and early twentieth centuries, Mary O’Sullivan shows that the decision of the Board of Directors of the New York Stock Exchange revealed a structural malfunction that had to do with the modest size and the narrowness of the private securities market. And this observation brings to light a paradox: during the Gilded Age, the banking and financial sphere was largely at a remove from industrial capitalism, even though the latter was expanding considerably.

To solve this paradox, the book links two themes that the literature generally treats separately: capital markets on the one hand and the workings of the banking system on the other. This link is based in particular on the concept of *financial banking* that Anna Yougman forged with some forethought on the eve of the 1907 crisis.\* In particular, the analysis concerns the practice of *call loans*, which were very-short term loans, repayable on demand, against the deposit of private securities. This growing practice throughout the period was very similar to repurchase agreement operations and made the financial market and the banking system highly dependent on one another.

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\* Anna YOUNGMAN, “The Growth of Financial Banking”, *Journal of Political Economy*, vol. 14, no. 7, pp. 435-443, 1906. A similar approach can be found in Margareth G. MYERS, *The New York Money Market*, New York, Columbia University Press, 1931. See also recent work by Jon R. MOEN and Ellis W. TALLMAN, “The Transmission of the Financial Crisis in 1907: An Empirical Investigation”, Federal Reserve Bank of Cleveland, Working Paper 14-09, 2014.

In addition to the banking and financial realm, the productive field is integrated into Mary O'Sullivan's demonstration, which enriches in passing the approach limited to examining the microstructure of financial markets. While, on the one side, the banking system was vulnerable to the vagaries of the private securities market, on the other, the private securities market depended on changes in the U.S. productive system. Therefore, the evolution of the corporate securities market, and in particular the industrial one, appears as erratic as it is laborious and, in fact, did not *a priori* constitute a solid and favourable basis for the rise of industrial capitalism during the Gilded Age.

The analytical interlacing of the productive, financial, and banking spheres allows the author to discuss several interpretations. One of them is based on the hypothesis that the development and maturity of financial markets make it possible to allocate resources efficiently and thus to finance investments adequately in a capitalist economy. However, "that is not what happened but, to understand why, we need to go beyond generalities to understand the specific mechanisms through which the country's economic development influenced the market for corporate securities" (page 6).

In addition, the book cautions against any retrospective interpretation. The new institutionalism holds that the transformation of political institutions contributes to the sustainable development of financial markets and, in turn, of economic improvement. Law and finance arguments emphasize the quality of legal protections and the guarantees that the common law provides to investors. Yet, "such claims seem curiously anachronistic when confronted with the concerns expressed by contemporary observers about the 'defect' of the US financial system in the late nineteenth and early twentieth centuries" (page 11).

Finally, if such interpretations of the roles of legal institutions in the development of finance are constructed at the expense of what the actors and observers of the time might have thought, the antidote based on contemporary discourses about financial institutions might in passing lose sight of economic analysis. The book avoids both of these pitfalls and proposes an accurate articulation between a financial history based on extensive and rich documentary sources on the one hand, and a solid and enlightening economic analysis on the other.

The first chapter presents with great clarity the main themes investigated, namely: the primary and secondary markets for corporate securities (shares and bonds) in terms of both supply and demand from banking and financial institutions; the long-term role of investment banks specializing in the creation, subscription, and distribution of private securities; the short-term behaviour of national banks and trust companies intervening massively on the call loan market. On several occasions, it is emphasized that, while the

market segment of railway company securities had reached maturity, those of industrial firm securities remained underdeveloped until the eve of the First World War. The remainder of the book examines these various themes in chronological order.

To illustrate the poor development of the industrial securities market, the literature commonly contrasts the “liberalism” of the London Stock Exchange (LSE) with the “conservatism” of the New York Stock Exchange (NYSE). Nonetheless, a comparison of the LSE’s rules related to the US corporate issues over the period 1888–1892 (Chapter 2) with the NYSE’s rules on industrial corporate issues over the period 1889–1897 (Chapter 3) reverses such an interpretation: the NYSE’s rules were rather lax—if not opaque. As a result, on the demand side of the securities market, investors had little appetite for industrial securities insofar as accounting rules did not appear rigorous and transparent to them. On the supply side, the various initiatives in Chicago and then New York were hampered by the instability of industrial activities: these initiatives ground to a halt with the 1893 crisis, not resuming until the turn of the century.

The development of the industrial securities market was intrinsically linked to the evolution of the productive system of Gilded Age capitalism, and price competition between firms partly explained the vulnerability of the quality of their issues. An initial strategy, that of cartelisation within certain industrial sectors, was not quite successful. A second strategy, that of mergers and acquisitions, had the notable consequence of generating an unprecedented wave of industrial securities issues during the period 1897–1901 (Chapter 4). Although these mergers and acquisitions as well as the notable increase in production and exports of industrial goods helped to improve investors’ confidence, the market segment for industrial securities was still limited, when the railway securities segment remained dominant.

Ultimately, the structural weakness of the market for securities issued by industrial firms and the lack of permanent investors subjected demand to a speculative dynamic that was particularly at work on the call loan market. The careful examination of the 1907 crisis (Chapter 5) shows that the use of industrial securities as collateral set in motion a dynamic of prices and short-term funding: suspicion arose not so much over the default of individual firms as over the market segment, in this case the industrial securities segment. What the 1907 crisis therefore reveals is that the problem of finance banking (in particular the call loan market) associated with shadow banking (in this case trust companies) was much more significant and dangerous than the mere problem of the supply of means of payment (the so-called currency inelasticity problem).

After investigating the financial and banking institutions in detail, Mary O’Sullivan insightfully approaches the state of the reflections on the period 1908–1913 (Chapter 6). In particular, she explains why Paul Warburg insisted on the need to introduce a discount system—of European design—that could replace the highly unstable call loan market. In the aftermath of the 1910 National Monetary Commission, Nelson Aldrich proposed the Republican project for central banking whose purpose was to put an end to the structural failure of the US banking and financial system. The Democratic majority in Congress from 1912 onwards, however, changed the political calendar.

The Pujo Report drafted in 1913 for the House of Representatives denounced the domination of investment banks (the “money trust”) in the market of subscription and distribution of corporate securities (here, at the level of the primary market). Chapter 7 goes beyond the mere observation expressed in the literature about the limits of data that can be found in the Pujo Report. By providing new data, it challenges the Pujo Report’s argument about the domination of money trusts: actually, the industrial securities segment was dependent on a large number of individual investors and financial institutions. On the other hand, the Pujo Report provided more salient information on, and deplored not without reason, the functioning of the call loan market (there, at the level of the secondary market).

From committees to parliamentary reports, a consensus had finally been forged on the need to end the banking system’s dependence on the call loan market and to keep it away from any speculative dynamic and instead to finance the productive system. This was one of the (quite optimistic) objectives of the 1913 Federal Reserve System Act.

Lastly, Chapter 8 looks at the dividends of the First World War and points out two features that were as unexpected as they were ambivalent for the observers and policy-makers of the time. On the one side, the market for industrial stocks had reached the maturity that had been long sought and had even overtaken the railroad securities market that was then in slight decline: between 1914 and 1919, the number and trading volumes of shares of industrial firms, including “war babies”, increased significantly. On the other side, the dependence of the banking system on the call loan market had grown: the creation of the Federal Reserve System notwithstanding, more liquidity was provided by New York banking and financial institutions on the call loan market in the early 1920s than in the early 1910s. Thus, Mary O’Sullivan’s book opens the way to further research with new and interesting perspectives.