The Nineteenth Century as the Cradle of Global Capital*

Julia Zinkina, Alexey Andreev, and Elizaveta Mosakova

In the nineteenth century some attempts were made to create an international financial regulatory system to internationally manage flows of innovations. One of the clearest manifestations of this aspiration was the emergence of various international monetary systems and unions. The most famous and popular among them was the international gold standard. Another major innovation of the nineteenth century was the creation of a truly global financial market of capital (the spread of the gold standard greatly contributed to this phenomenon). It should be noted that this system possessed a number of important differences from our contemporary global investment market. In this paper we will discuss the peculiarities of the nineteenth-century global capital movements in more detail.

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In the early nineteenth century the monetary systems of many countries allowed for simultaneous minting and circulation of both gold and silver coins – in other words, in those countries the bimetallic standard was used. In some countries, such as the German states, the Austro-Hungarian Empire, Scandinavian states, Russia and some Asian countries, the silver standard was used. Britain was the only country where the gold standard was used since the beginning of the nineteenth century, more precisely, since 1821.

In 1717 Sir Isaac Newton, Master of the Mint, set too low a silver price for gold guinea; thus, the price of 'money' silver turned out considerably lower than the market price for silver, which resulted in almost all silver money in the country disappearing from circulation (Andrei 2011: 146–147). During the Napoleonic Wars the increased expenses led to inflation and the suspension of the convertibility of banknotes. In 1819 the Parliament ordered the Bank of England to make its banknotes convertible into gold again at the market price of 1821. Thereafter, a new monetary order was established in the UK, namely the gold standard system. This system ensured that all issued currency could be at any time and at short notice exchanged for a corresponding amount of gold. The following mechanisms ensured the functioning of the gold standard: the Royal Mint was required to trade unlimited amounts of gold at a fixed price; the Bank of England and any other British bank was required to exchange banknotes into gold. Import and export of gold was unrestricted. Gold functioned as a reserve for the total volume of money in the country (Osterhammel 2014: 733).

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However, Great Britain remained the only country with such a system until the mid-nineteenth century. Continental Europe saw the foundation of the Latin Monetary Union in 1865. Within this Union France, Belgium, Italy and Sweden (and later on many other countries, including Spain, Greece, Romania, *etc*.), decided to bring their currency to the bimetallic standard with a fixed ratio between silver and gold. Silver was the real currency of the Union, as each country defined its own currency in relation to a fixed weight of silver.

In the second half of the nineteenth century bimetallic systems started to be abolished because of considerable fluctuations in silver prices and the emergence of England as the world trading and financial center. One after the other European governments shifted to the gold standard (which greatly facilitated obtaining international loans and trade with England). Germany was the first (in 1873) due to its close association with Britain in financial terms. Germany's transition to the gold standard (together with the discovery of new deposits of silver) contributed to a drop in the market price of silver and prompted other countries – Denmark, Sweden, Norway, the Netherlands and the countries of the Latin Monetary Union – to switch to the gold standard (Eichengreen 1996: 17–18). In 1879 the USA joined the gold standard, although the Congress officially recognized this fact only in 1900. Finally, in 1897, the gold standard system spread to Russia. Thus, by the early twentieth century all European countries had the same type of currency.

The scope of the gold standard system was not limited to Europe. Japan joined the system in 1898. It used the reparations paid by China after the defeat in the 1895 war for creating gold reserves in its central bank. Also in 1898 the British colonial administration of India (which for a long time had adhered to the silver standard) attached the rupee to the pound, that is to gold. In Latin America the convertibility of the national banknotes into gold was introduced by Argentina, Mexico, Peru, and Uruguay (Eichengreen 1996: 19). The adoption of the gold standard meant 'international respectability' of the country, its willingness to respect the Western rules of the game, as well as its hope for Western investment (Osterhammel 2014: 733).

> The gold standard, as a regulatory mechanism effective across the world from North America to Japan, was not simply the abstract apparatus presented in textbooks. …This institution required from participating governments an explicit or implicit willingness to do anything necessary to defend currency convertibility – hence a consonance at the level of economic policy. This meant, for example, that no one was supposed even to think of devaluation or revaluation, and that in a highly competitive international system, governments were ready to solve financial crises by mutual agreement and mutual assistance. This happened in the Baring crisis of 1890, for example, when a large British private bank declared itself insolvent and only prompt support from the French and Russian state banks maintained liquidity on the London market (Osterhammel 2014: 734; see also Eichengreen 1996: 34).

Nevertheless, we should not imagine that the world of the late nineteenth-century was uniformly covered by the gold standard, acting according to one and the same set of financial rules.

First, the gold standard did not encompass the whole world. China, a number of countries in Central America, and many colonies continued to adhere to 'archaic' silver.

Second, even in countries that adopted the gold standard, the 'rules of the game' differed – or, more exactly, the extent to which the countries followed these rules varied greatly. Thus, although many Latin American countries announced the adoption of the gold standard, they (until the 1920s) did not have a central bank or private banks which could provide a reliable guarantee against crises. Population hardly believed in the governments' guarantees of gold backing paper money. The convertibility of gold was often suspended in the interests of oligarchs or large landowners (commodity exporters interested in high inflation and weakness of national currency) (Osterhammel 2014: 735).

Only four countries, England, Germany, France and the United States, adhered to the 'pure' gold standard, with gold coins in circulation, and central banks containing enough gold to cover the paper money in circulation (Obstfeld and Taylor 2004: 20).

Even financially strong nations, such as Germany or France, provided their monetary authorities with tools to protect the gold reserves in case of a threat. In exceptional cases, the strict maintenance of the gold backing for paper money could be ceased (Obstfeld and Taylor 2004: 195).

Nevertheless, by the end of the nineteenth century, during the heyday of the gold standard, a truly international financial system based on this standard emerged. There is no doubt that such a wide spread of the gold standard system would have been impossible in its mature form without the discovery of significant gold deposits on three continents after 1848, due to which its global production increased by about ten times (Eichengreen 1996: 13; Osterhammel 2014: 736).

It is important to emphasize the role of the international gold standard system in shaping the network space of the global economy, particularly in the field of international investment. This issue will be discussed in detail below.

The emergence of a global network of capital flows should be considered to be the absolute innovation of the nineteenth century. Of course, the history of capital investment goes back to much earlier times. One of the first attempts to legislatively regulate the investments of private capital and the profit thereof was present in the Code of Hammurabi. In the following centuries and millennia the long-distance trade required the development of increasingly diverse financial instruments for the collection of initial capital when preparing distant trade expeditions, as well as securing financial guarantees for each participant. These processes could be observed in various regions of the Afro-Eurasian World System. However, despite the abundance of financial instruments enabling long-distance trade that existed and were actively used in the Middle Ages (such as credit, loans for various periods, investments, various forms of debt and participation in commercial partnerships [see Postan 1978]), it is clearly too early to talk about a global financial network at that time.

Conventional wisdom is that 'financial revolution' of the international level began in the Netherlands during the era of the greatest power of this country at the end of the sixteenth century. It was associated with the development of the bill market and a system of interacting commercial banks in Antwerp, London and Amsterdam, which provided for these bills. The first significant instrument to be regularly used in international financial transactions was the negotiable foreign bill of exchange created in Antwerp, one of the largest international trade and financial centers. There is evidence that in the major port cities the bill served as a form of currency exchange, in addition to local money (Neal 1990: 5–7; Obstfeld and Taylor 2004: 18).

An important milestone in the making of global capital was the opening of the first permanent stock exchange in Amsterdam. It transformed the city not only into the central warehouse of world trade, but also into the central market of money and capital for the European world-economy (Arrighi 1994). Excess capital from all over Europe flowed to the Amsterdam stock exchange and banking institutions that had been established in order to serve it.

However, the functioning of trade and financial instruments even in the era of the Amsterdam stock exchange (or, in the terminology of Giovanni Arrighi, in the era of the Dutch financial cycle) was regionally limited, *i.e.* being a matter of regional parts of the world-economy (*e.g.*, the Muslim one or the European one). 'The "cosmopolitanism" of the early modern period had been confined to Europe; no ruler and no private individual from Asia or Africa had thought of borrowing money in London or Paris, Amsterdam or Antwerp. This changed in the nineteenth century, especially during its second half' (Osterhammel 2014: 737).

Global export of capital was 'born' in the second half of the nineteenth century. In 1820 global investment was very small and mostly limited to the UK, the Netherlands, and France. However, after 1850 the necessary conditions and pre-requisites gradually evolved outside of Europe as well, including special financial institutions, both in the borrowing and the lending countries, the accumulation of savings within the new middle class, and a new awareness of the foreign investment opportunities.

The capital placed abroad most commonly took one of the following forms: 1) credits to foreign governments; 2) loans to private individuals; 3) corporate stock and bonds held by foreigners; and 4) direct investment by European firms in other countries, often through branches and subsidiaries (Osterhammel 2014: 737).

Table 1. The total amount of capital placed abroad, billions of current US dollars

	1825	1855	1870	1900	1914
Great Britain	0.5	0.7	4.9	12.1	19.5
France	0.1	n.d.	2.5	5.2	8.6
Germany	n.d.	n.d.	n.d.	4,8	6.7
The Netherlands	0,3	0.2	0.3	1.1	1.2
The USA	0	0	0	0.5	2.5
Canada	n.d.	n.d.	n.d.	0.1	0.2

Source: Woodruff 1967: 150–159. N.d. = no data.

The largest capital exporter of the late nineteenth and the early twentieth centuries was Great Britain, righteously called 'the world's banker' of that period. The peak value of the share of the British capital in the global capital exports was enormous – 80 per cent (for comparison, the share of the United States in global capital exports in 2000 was 25 per cent) (Obstfeld and Taylor 2004: 55). London's capital market mobilized the credit internationally and funded the business far beyond the British Empire, attracting funds from around the world and overseeing the issue of securities in many countries. 'British capital was present everywhere in the nineteenth century. It financed the Erie canal, the early railroads in Argentina and Japan, and conflicts such as the war of 1846 – 48 between the United States and Mexico' (Osterhammel 2014: 737).

The British capital placed abroad as of 1914 is estimated at the range from 4.1 to 6.6 billion pounds (20–33 billion dollars)[1] (see review of assessments in Twomey 2000: 42). Of this amount, foreign direct investment accounted for less than half; about 30 per

[1] Most estimates are closer to the lower limit of this range.

cent were loans to governments and municipalities, and about 35 per cent was made by the capital invested in railways (Twomey 2000: 42). A similar distribution was observed in the export of French capital, which ranked second in the world (but far behind the UK). More than a half of French capital abroad was allotted to state and municipal loans, about 15 per cent was destined for the construction of railways, and about a third (as in Britain) was made by other private enterprises. The largest market of the French capital was Russia, about a fifth of all French foreign investments was received by Latin America, and only a tenth of it went to the French colonies (Twomey 2000: 47).

On the eve of the First World War, when Britain had lost its absolute industrial supremacy, its 50 per cent share of total world capital invested abroad still made it the largest source of foreign investment. It was followed by France and Germany, though their shares in the global capital invested abroad was much more modest. The United States was the largest importer of capital and did not play a significant role in its global exports (Obstfeld and Taylor 2004: 55).

Overall, in 1870 the total capital placed abroad accounted for only 7 per cent of world GDP; but by 1900–1914, the zenith of the classical gold standard, this proportion rose to 20 per cent. This figure collapsed after World War I, and managed to regain this level only in the 1980s (Obstfeld and Taylor 2004: 55–56). Between 1900 and 1914 one can already trace quite clearly the structure of the emerging network of global capital flows:

> Though international finance developed in response to the needs of global trade ad communications, it would be misleading to think of the basic structure of capital flows as a fully articulated network. They did not have the reciprocity of trade relations: capital was not exchanged but transferred from core to periphery. The reverse flow from countries in receipt of the credits and investments consisted bit of loan capital but of profits, which disappeared into the pockets of the financiers. It was thus a typically imperial constellation, in which the asymmetry was plainly visible. The export of capital could be steered much better than trade flows, for there were only a few control centers. …Unlike trade, it presupposed the creation of modern institutions such as banks, insurance companies, and stock exchanges all around the world (Osterhammel 2014: 737–738).

Not only was the network asymmetric in terms of donor-recipient structure, but the distribution of capital among the recipients was also extremely uneven, and 'the institutional structures of domestic capital markets, however, ranged from primitive to modern' (Davis and Gallman 2001: 4). For example, in the UK in 1870–1914 the annual export of capital amounted to 4–5 per cent of GDP, reaching even 8–10 per cent in some years (Obstfeld and Taylor 2004: 60). About a third of all British savings was invested abroad – an enormous figure for the time (Davis and Gallman 2001: 5). However, about half of the entire British capital invested abroad was directed to only four countries – the United States, Argentina, Australia, and Canada (Davis and Gallman 2001: 5).

When considering foreign investment (including foreign direct investment), the following most significant recipients of such investment can be identified on a global scale: in the first place, the 'settler' countries of North America (the USA, Canada, to a lesser extent Mexico), Latin America (Argentina, Chile), Africa (Union of South Africa), and Oceania (Australia). In these countries the volume of foreign investments in 1913 ranged from US$ 100 to US$ 400 per capita. The second echelon of investment recipients (from 25 to 75 dollars per capita) involved different Latin American countries, such as Brazil, Mexico, Honduras, Peru, and Jamaica, as well as the large states (including the European colonies and protectorates) of the Middle East, such as Egypt, Algeria, Turkey, and Tunisia. Finally, the third echelon with less than US$ 25 (or in some cases less than US$10) of foreign investment per capita included mostly East Asia – India, Indochina, China, Thailand, Korea, *etc.* (see Table 2). It has to be seen that some countries from the third echelon, in particular India and China, were in reality very large recipients of investment, but ended up in this group because of their very large population, and not because of the lack of attention of investors. In particular, India ranked the first among the Third World countries in terms of the absolute volume of foreign investment on the verge of the First World War.

Table 2. Foreign investment per capita and direct foreign investment per capita in the recipients of the global capital, 1913–1914

Country	Foreign investment per capita, current US dollars	Direct foreign investment per capita, current US dollars
Canada 1913	385	73
Australia 1914	275	70
Argentina 1913	266	186
Union of South Africa 1913	202	140
Cuba 1913	175	147
Chile 1913	114	74
Egypt 1914	63	29
Brazil 1913	59	35
Malaysia 1914	58	45
Mexico 1910	54	46
Honduras 1913	50	13
Algeria 1914	48	15
Peru 1913	44	44
Turkey 1913	41	14
Jamaica 1913	31	13
Ghana 1911	29	24
Tunisia 1914	22	6
Venezuela 1913	17	10
Morocco 1914	13	4
Indonesia 1914	12	11
Colombia 1913	10	6
The Philippines 1914	10	9
Indochina	9	4
India 1911	7	2
Thailand 1914	6	2
China 1914	3	2
Korea 1914	2	1

Source: Twomey 2000.

When considering foreign investment relative to the economy, rather than the population of the country, the scenario is somewhat different (see Table 3), but, nevertheless, the first places remain occupied by settler economies.

Table 3. Foreign investment and direct foreign investment as % of GDP in the recipients of the global capital, 1913–1914

Country	Foreign investment, % of GDP	Foreign direct investment, % of GDP
Argentina 1913	248	173
Union of South Africa 1913	235	163
Chile 1913	197	127
Peru 1913	168	168
Honduras 1913	156	42
Malaysia 1914	148	115
Canada 1913	146	23
Cuba 1913	138	116
Mexico 1910	119	101
Egypt 1914	105	48
Algeria 1914	103	32
Turkey 1913	98	34
Australia 1914	80	20
Ghana 1911	75	60
Brazil 1913	65	34
Jamaica 1913	59	25
The Philippines 1914	53	47
Indonesia 1914	51	47
Venezuela 1913	49	29
Morocco 1914	44	18
Tunisia 1914	43	11
Thailand 1914	40	15
India 1911	35	10
Colombia 1913	25	16
China 1914	24	16
Korea 1914	14	6

Source: Twomey 2000.

As for the distribution of these investments, let us present two illustrative examples. In Argentina the bulk of the foreign investments were distributed almost equally between the public debt (about 30 per cent), construction of railways (35 per cent) owned exclusively by foreigners, and other sectors (about 35 per cent) with wide difference in investment volumes between various sectors (Twomey 2000: 154–157). Another typical example is Turkey, where the government loans exceeded all other types of use of foreign capital. As for foreign investments, about two-thirds of all funds invested went for the construction of railways (Twomey 2000: 150).

All in all, one can truly consider the late nineteenth century as the time of the emergence of global financial network.

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