

Chapter Eight

Puzzles from the First Globalization

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In the first globalization, 1870-1914, as in our own times, debates raged over the impact on domestic life of free movement across borders of goods, people, and capital.ⁱ Then as today in the hard times that have followed in the wake of financial crisis, many saw that open borders brought uncontrollable risks and vulnerabilities. Even a hundred years ago, without benefit of sophisticated statistical analysis, it was generally understood that cross-border capital flows greatly increased the potential for crisis as the troubles of other financial markets poured in unimpeded by national controls, and financial market distress turned into credit blockages to the real economy (Stevens 1894).ⁱⁱ As *The Economist* wrote about the 1907 New York banking crisis:

“ The fact seems to be that when a sudden collapse of speculation is accompanied by a banking panic, all the machinery of a great modern industrial society goes out of gear. Even in the vast territory of the United States, with all its diversities of soil, climate, industry, agriculture, and even law, the network of railways is so complete, and interchange of commodities and credit so intimate and complex, that every part seems to be dependent on some other part, while all are related more or less closely in a common dependence upon their great financial metropolis---New York” (The Economist, 1907).

These nineteenth century intuitions have been confirmed by recent research. In *This Time is Different*, Reinhart and Rogoff demonstrated that the greater the openness of borders to capital flows, the greater the likelihood of financial crises (Reinhart and Rogoff 2009, pp 155 ff). And as they show, financial crises usually lead to real economy crises with devastating and long-term impact. If today in the European Union the most pressing items on the agenda have to do with distributing the costs of the financial crisis and the sovereign debt crisis has followed in its wake, the long term issue is the sheer cost of openness. If today the problems are deciding who gets which leftovers from the Lehman Brothers bankruptcy or who compensates English and Dutch savers in Icelandic banks or who picks up the tab for German and French bank lending to Greece, Spain, and Portugal, the question that hovers within political sight is the legitimacy of open borders. French President Nicolas Sarkozy’s introduction in January 2012 of legislation to institute a “Tobin tax” on financial transactions is but the highest-placed of the proposals that aim at buffering the impact of the tides of capital that wash over national borders.

There are even greater shifts toward protectionist proposals from Sarkozy's rivals in the French Socialist Party. French Socialists played a major role in establishing freedom of trade and of capital movements as basic principles of the European Union (Abdelal 2007), so it is striking that today's Socialist leaders are calling for border-level controls (Parti Socialiste 2011; Montebourg 2011).

Thus far, these policy proposals have been limited and without major consequence. On balance, as Miles Kahler and others in their contributions to this volume convincingly argue, the dominant fact is how little effect the current crisis has had in stirring up opposition to the open institutional architecture of the global financial market. The puzzle that motivates this chapter is why—even in the wake of financial crises that wreaked great damage on the economy-- states did not raise barriers to capital flows. The current situation seems in this respect similar to that of the first globalization, where even as major battles were waged over tariffs, the free flow of capital across borders was contested, but remained largely unimpeded. In the social sciences, exploring things that did not happen is usually considered a futile pursuit. But this case of the “curious incident of the dog that did not bark in the night,” to borrow from Sherlock Holmes is fascinating because it turns on a contentious issue in political economy: how to conceptualize interests and their mobilization.

In a number of the contributions to this volume the explanation for the current quiescence of groups which might have risen up in reaction against goods, services and capital moving across borders is that today these groups themselves have far more complex, interwoven, and contradictory interests than in the past. As Peter Gourevitch (this volume, 408) summarizes, an orthodox Open Economy Politics perspective

conceives interests as springing out of the production profile of groups variously located in the international economy; these interests and their location in the economy directly determine policy preferences. As Helen Milner has expressed it: “Interests are the stable foundation on which actors’ preferences over policy shift as their situation and the policy area vary...Preferences are a variable; interests are not” (Milner 1997, p. 15). Even in the early nineteenth century crises he considered, Gourevitch found that interests did not directly determine policy outcomes; rather a variety of intermediating agents and institutions shaped or “packaged” these interests in different ways with different policy outcomes. About the later periods he analyzed, Gourevitch discovered (this volume, 409-10) that the “stripped-down interest group model of the first crisis seemed increasingly insufficient, albeit ever necessary” because ideology and institutions entered ever more directly into interest formulation.

This analytic move to identify a process of interest “complexification” over time with changes in the economy and in politics plays a major role in explanations of the current situation in which groups apparently adversely affected by capital and trade flows do not react as a simple OEP read-out of interests might predict. With the expansion of foreign direct investment into emerging economies and the fragmentation of national production systems and their reorganization into networked global supply chains, interests have become far more complicated. They have been redefined in ways that undermine the common ground under old protectionist coalitions. (Milner 1988; Kahler present volume, 4). Also, as Peter Hall (in this volume) emphasizes, divisions within the old class boundaries, for example, within the working class between “insiders” and “outsiders,” have made it ever more difficult to rally around common interests.

In all of these accounts of stability in the present, there is at least implicit comparison with a past in which interests with respect to international capital and trade flows were in some sense “pre-political” and more clearly and antagonistically defined than today. But is it really the case that interests in some past incarnation of an open world economy were simple and compelling, and that policy preferences could be read off the production profiles of different economic groups? When we return to the late-nineteenth-early twentieth century battles over capital flows and examine the positions of major political and economic actors in the wake of banking crises and in periods of high tension over sovereign borrowing (as, for example, during the 1905 Russian revolution), we do not find a past in which interests were prior to the politics that created them. It is not only that interests entered politics through the intermediation of leaders and political organization and through the transforming filters of different institutional constellations (although they did, *pace* Gourevitch). It is that interests as such emerged as the product of politics. Groups “discovered” their interests through a process of contention and coalition with others. For interest formation in the first globalization, it was politics all the way down.

<A>The Dangers of Open Borders

If the gold standard had become virtually inevitable for advanced economies by the last quarter of the nineteenth century, the openness of borders to portfolio and foreign direct investment had not. The gold standard involves a commitment to freely move gold across borders in response to demand. But how much and what other kinds of capital could be shifted across national borders and what kinds of regulations should apply to such flows remained open for debate. In Germany and France during the first globalization, there was political demand for regulating capital flows well after the adoption of the gold standard, and there were policy levers already in place that might have been used and enhanced. Given the vulnerabilities that borders open to capital flows created for domestic economies, why were there not stronger movements to close up or to regulate these flows? How was openness sustained against challenges? Who favored no regulation or less regulation? Who advocated regulations and/ or closure? How was capital mobility sustained during periods of contestation?

As the Bretton Woods accord showed, it is possible to design an international regime with a single monetary standard and a commitment to lowering barriers to trade and to couple these policies with national regulation and limitations on flows of capital across borders. In the nineteenth century an international consensus on capital controls was highly unlikely. But even short of such an international agreement, there were possible domestic, unilateral moves and at times the demands to make such moves were loud. Who supported such restrictions and why they ultimately failed to have significant impact will be discussed below. But to start, a few examples taken from German and French debates over capital control may serve as reminders that throughout the first globalization, regulating capital flows was seen as a plausible option and keeping the

borders open was a recurrent political challenge.

In Germany, after the 1907 banking crisis, a national commission was charged with examining the causes and consequences of the outflows of gold from Germany during the crisis and more generally, of German investment abroad and of foreign investment in Germany. The objective was to consider policies to reduce German vulnerability to future financial crises (German Bank Inquiry 1910). The participants debated at length whether lending abroad helped industry by winning foreign markets or penalized industry (and agriculture) by making money more expensive domestically. Did foreign investment in Germany add to Germany's strengths or was it a source of vulnerability, since foreigners could withdraw their capital in bad times? Should the Reichsbank intervene to limit the amount of German capital invested abroad? Should government regulate the flotation of foreign securities on German markets? A number of speakers berated the government for not intervening more forcefully to exercise its existing powers over capital flows. The Stock Exchange Law of 1896 had instituted a system of regulation over capital by prohibiting a foreign security from listing on a German exchange if it had been denied access in any German state. This gave Prussia and the German Chancellor a de facto veto over the listing of foreign securities (Laves 1927).

The Banking Inquiry considered more far-reaching controls. One proposal was for setting up a second "Juliusturm." The Juliusturm was gold, locked up in the Spandau fortress, that was to be used in the event of outbreak of war. The funds had been siphoned off from the huge indemnity paid by the French after the Franco-Prussian War. Some of the members of the Banking Commission demanded a "Juliusturm No. 2" to protect the economy against disruptions from capital flows. As one of the Krupp directors

on the Commission expressed it, “[J]ust as the Juliusturm forms a war reserve in the event of mobilization, this Juliusturm No. 2 would form a cash reserve. .. If we had such a reserve, it would open in a time of gold scarcity and stabilize the situation” (German Bank Inquiry 1910, vol II, pp. 649-50).

In France as well, the state had some leverage over capital flows through control over the listing of foreign securities on the Paris Bourse. (Ribi re 1913).ⁱⁱⁱ A para-public body, the *Chambre syndicale d’agents de change*, formally regulated listings on the Paris exchange, and for foreign offerings, authorization was required from the Ministry of Finance and the Ministry of Foreign Affairs. The government refused all listings of German securities; otherwise instances of rejection were rare. The tax system also provided a lever for public control of capital flows. In theory, taxes on all issues, domestic or foreign, were levied at the same rate, but the collection system was different, resulting in a lower rate on foreign investments. Over the years there were a number of legislative proposals to reform the collection system, including a Socialist proposal to encourage relatives to denounce family members who inherited foreign assets and failed to declare them at the time of an inheritance, with the incentive that the denouncing relative would be granted the foreign property as a bounty. This idea, like other less draconian ones proposed by successive Ministers of Finance, failed. But in moments of crisis, proposals for tightening up the controls always resurfaced.

Objections to the free movement of capital across national borders fell into four categories. First, some argued that letting domestic capital (or letting “too much” domestic capital) be invested abroad would starve the economy of resources needed to fund infrastructure, innovation, industries, and job creation. What might be profitable for

the individual investor might mean less housing, less investment in domestic industries, and less investment in innovation and development at home. As J. A. Hobson famously put it, “Although the new Imperialism has been bad business for the nation, it has been good business for certain classes and certain trades within the nation”(Hobson 1965 [1902,1905]). In France, the great debate over the impact on the domestic economy of the outflow of French capital played out around exchanges in the press between “Lysis” and “Testis,” the pseudonyms of a Left-wing journalist and of an economist close to banking circles.^{iv} Lysis claimed that bank-led export of capital was the principal cause of economic stagnation in France. Whether investment abroad weakened investment at home is still contested by economic historians.^v But at the time, many believed it, and the fact that academic controversy has continued so long suggests that contemporary policy makers might reasonably have regarded it as at least an open question.

Secondly, Left parties and unions argued that allowing capital to freely exit might block social reform, because capitalists could evade new burdens by shifting investment to less-exigent countries. In the nineteenth century as today, every new proposal for taxes or capital controls generated predictions about capital flight. A third class of objections to free capital mobility was nationalist. The French nationalist Right saw Germans as the illegitimate beneficiaries of French portfolio investment abroad (and it was true that significant French outward investment ended up in Germany). For the Left, the enemy was Tsarism, and during the 1905 revolution French Left parliamentarians demanded that the government deny access to French capital markets for new loans to Russia. In American political debates over the monetary standard and more generally, over the role of the state on the economic borders of the nation, there was also a strong nationalist

charge. William Jennings Bryant's speech on acceptance of the Democratic nomination and Coin's Financial School ---the 1894 best seller on the monetary standard-- show how powerful the idea of struggle against a hated English enemy was in these debates (Harvey 1983 [1894]).^{vi} Distant resentments may have been revived by the bitter disputes between the United States and England over the Venezuelan border in 1895. But above all, the British enemy was conceived to be the British banker—seen as a predator ready to grab American resources and a master eager to maintain subordination.

Finally, and perhaps closest to current anxieties about the dangers of open capital mobility, people grasped that a world of open borders was one in which misbehavior and failures in the financial market of some other country could rapidly be propagated through the multiple connections of the international economy into troubles and disaster at home. Responses to the 1907 financial crisis illustrate this vividly.^{vii} At the height of the crisis The Economist traced out the mechanisms of financial contagion. It reminded its readers that the crisis had roots deep in the international system, not just in the corrupt malfeasance of New York trust companies.^{viii} It identified the origins of the crisis in the vast devastation of capital in the Boer War and the Russo-Japanese war, and the issuance of large amounts of debt. Then abundant harvests led to an expansion of trade and inflation of credit. Together with increased production of gold, this led to price inflation. Then some “bubble companies” in Japan collapsed, followed by a fall in Japanese stock prices. There were troubles in Genoa and Egypt. Prices became unsteady on the American exchange, and rumors spread about weakness in the German and the U.S. economies. Then came “the sensational break in copper, and the failures in Amsterdam, Hamburg, Boston, and New York [which] provoked the final crisis that found theatrical

expression in the run on the Knickerbocker Trust.”

For some English, it might be a source both of profit and of pride to be so centrally located in the midst of these tangled webs of connections among economies around the world. As *The Economist* declared with satisfaction: “London, the capital of Free-trade and the great emporium of gold plays the lucrative but onerous part as the distributor and collector of credit, the clearinghouse of the world. We have no reason to be ashamed. The collapse of the American system has bought our supremacy into relief” (*The Economist* 1907, vol. LXV, no. 3357, p. 2286, December 28, 1907). But the more common effect of the 1907 crisis was to demonstrate how the interconnected capital markets of stocks, bonds, and direct investment made German shopkeepers, French peasants, and millions of other savers and small-scale borrowers vulnerable to the failure of the American regulatory system to constrain crooked American bankers. As observers noted, this crisis, in contrast to earlier ones, highlighted the dangers of capital mobility. Small wonder, then, that cries went up everywhere demanding buffers to protect and insulate national resources against the dangers of open capital markets. The question is why did these demands have so little effect?

Of the major advanced industrial countries, the case of France is, in many respects, the most puzzling. The willingness to let capital flow in and flow abroad virtually unimpeded was, understandably, strong in Britain and the United States. Most British overseas investment went into New World (United States, Canada, Australia) infrastructure projects and rather successful enterprises, and rates of return were higher for British foreign investors than for others. Even so, afterwards, there would be questioning of whether such high levels of foreign investment had been a good idea.

Keynes, writing in 1924, concluded: “[T]he nineteenth century, as in so many other respects, came to look on an arrangement as normal which was really most abnormal. To lend vast sums abroad for long periods of time without any possibility of legal redress, if things go wrong, is a crazy construction; especially in return for a trifling extra interest” (Keynes 1924, p. 585) But before the war, the challenges to heavy foreign investment were minimal in Britain. This was also the case in the United States---understandable since it was a net capital importer until immediately before World War I. In Germany, the issue of capital mobility was hotly debated, as the brief account above of the Banking Inquiry suggests, but the levels of capital invested abroad never came close to those of the British or the French.

The French stand out as exceptional both in the magnitude of the capital they sent abroad (second only to Britain) and (in contrast to Britain) for the disastrous outcome of this investment. Two-thirds of France’s outstanding foreign investments in 1914 were lost by the end of the war. At the war’s outbreak, about 40% of all private French wealth had been invested in securities of one or another kind (Michalet 1968, pp. 138-9). About a half to a third of those securities were foreign (Cameron 1961, p. 487.).^{ix} This meant that between one-quarter and one-third of total French wealth other than land and consumer capital was in foreign investments, by Cameron’s calculations.^x The French invested abroad sums equal to about 10 billion dollars at pre-World War I gold parity (50 billion gold francs). Only the British invested more, with foreign investments in 1907 amounting to about 40% of British savings (Cairncross 1953, p. 104).

Analyses of inheritances show a diffusion of these securities across urban and rural France. Surprisingly, small French savers seem to have bought foreign securities in

heavier proportions than the richest savers (Michalet 1968; Daumard 1977). French investors abroad initially bought government and railroad bonds, but in the decade before the war, increasingly funds flowed into foreign direct investment in enterprises. The ratio of foreign direct investment to portfolio capital on the eve of the war may have been considerably greater than generally recognized (Svedberg 1978). In contrast to Britain, which sent about 30% of its foreign investment to the Empire and 70% to politically independent countries like the United States, France sent very little to its colonies before World War One. In 1900, only 1.5 billion out of 28 billion francs of French-held foreign securities were in the colonies; by 1914, only 4 out of 45 billion in foreign holdings (Feis 1965 [1930], p. 51). The lion's share of French foreign investment went to Russia, the Near East, and Latin America. Russia was the largest single destination and absorbed about a quarter of all French foreign investment.

So France before the War is a promising case in which to examine more closely the political challenges to capital mobility, since the sums at stake were enormous and there were millions of lenders. Why did the French accept the investment of so large a proportion of domestic savings overseas? As I have suggested above, it was neither for lack of critics nor for lack of the means of control (however imperfect they might have proved). Nor do "interests" explain it, if we conceive interests as deriving from some more or less fixed and objective economic location of actors in the domestic and international economies. For many of the important social actors, "interests" regarding open borders for capital flows were indeterminate in two fundamental respects. First, no individual investor could calculate with any degree of certainty what his own "naked" interest might be, let alone which forms of collective action would advance it. Rates of

return on domestic and foreign securities varied too much from year to year—and the differences were usually too small—to make for clear conclusions. Secondly, “interests” in free capital flows were inextricably connected by politics to other highly salient and significant stakes, so that no actor could regard action on this issue as separable from outcomes on other high valence priorities. For this reason political actors could not reasonably hope to shift position on one part of a coalition’s policy package while leaving the other parts of the constellation intact.

<A>Calculating Interests in Foreign Investment

The consensus among mainstream economists then and now is that setting aside the realm of speculation and irrational expectations, there is no mystery about why people invest abroad instead of at home: they do it for higher returns.^{xi} France was in recession and stagnation from 1873-1897, and over these decades grew at a rate slower than other European economies. Between 1865 and 1895 Britain’s GDP doubled, Germany’s increased 3 1/3 fold, while French GNP grew only by a third (Broder 1997). French shares of world markets were shrinking. And the French population was growing at a slower rate than that of any other European country. In the view of liberal economists of the times, slow growth, demography, excess savings, and too few good opportunities for domestic investment explained why French investors chose to invest abroad. Brion in 1912 summed up these conclusions writing:

In France, as in other long-established societies, the resources of nature have already been exploited: there's nothing much left to create. There are no more railroads to build, no more cities to electrify or supply with tramways, no more natural resources to discover and extract. Germany, in contrast, whose economic birth is relatively recent, has still not fully developed its resources... (Brion 1912, pp. 82-83).

Paul Leroy-Beaulieu, a well-known political economist, advised first-time investors against investing in domestic industry as far too risky for anyone except experts and the very rich (Leroy-Beaulieu 1905, p. 50). The prudent investor should buy foreign securities, even though the rate of return on them might be only a little higher than on domestic securities: "It would be turning one's nose up at wealth to turn down an interest differential of $\frac{1}{2}\%$ " [i.e., between foreign and domestic securities](Leroy-Beaulieu 1905, pp. 107-8).

Calculating the rates of return on domestic and foreign investment in France before the war remains controversial, and the results vary greatly depending on time period and the methodology. Harry Dexter White, who calculated the 1899 yields of foreign and domestic securities at the price of issue found that the yield on domestic securities was higher relative to the issue price (4.28%) than on foreign securities (3.85%) though the rate at the price of February 1900 was lower (3.23%) than on foreign (3.84%) (White 1933, pp. 271-2). Others have reached opposite conclusions. Debate about the relative profitability of investment at home and abroad continues among economic historians analyzing British domestic and Imperial investment in the pre-War

period. Davis and Huttenback and Pollard showed there were many years in which domestic securities had higher returns than those abroad (Davis and Huttenback 1982). For Germany where a far larger share of savings were invested in domestic infrastructure and industry, Richard Tilly concluded that on the average over the forty years before the War, the annual rate of return on Prussian government issues (consols) was 4.3%; on domestic industrial shares was 9.35%; and on foreign securities traded on the Berlin Stock Exchange, 6.7 % (Tilly 1991, p. 95). But the basic fact, as the advice of Leroy-Beaulieu to the neophyte investor implied, was that the gap between the rates was usually not so great--in either direction-- that an individual could read his interest off a table of bond yields or stock market returns. It was impossible to calculate from year to year whether the best investments would be at home or abroad. Interests, even narrowly economically defined, were not obvious. How, then, did savers actually decide where their interests lay?

The Structures of French Capitalism

For politicians in Left and Right opposition parties and for the journalists who led the attack on the export of capital, the point was that it was a mistake to think of the world as one in which individuals face an array of rates and choose. Lysis ---the pseudonymous Left journalist who launched the great debate over the outflow of French capital ---argued it was the institutions of French capitalism that shaped the choices and responses of investors. “How can competent writers attribute the fall in French securities to spontaneous decisions of capitalists and make no reference at all to the formidable

organization of French financial markets or to its uncontested power?” Lysis claimed that it was the banks that channeled individual savings into foreign investment, and not a process in which individuals responded to different interest rates or were swept away by irrational “animal spirits.” Individual investors can only choose among the institutional options they find already in place. So the real factors shaping interest formation were the structure of French capitalism and the patterns of French commercial banking.

The banks attacked by Lysis and the deputies who rose to speak against foreign loans in the parliamentary debates over the export of capital were recently founded commercial banks that channeled the savings of millions of depositors. As critics pointed out, these banks earned large commissions on the sale of foreign securities and on manipulating the margins between the rates at which they negotiated the loans and the rates at which they sold them to their French customers. Between 1897 and 1903, the largest of these commercial banks, the Credit Lyonnais, made 30% of its profits in Russian affairs. The defenders of the banks responded that French banking laws and practices were not any different than those of other countries. It’s not the fault of the banks if economic growth in France is sluggish: the maturity of the economy, a stagnant demography, the lack of natural resources, a contentious workforce are simple facts, they reasoned (Testis 1907, 60-1).

<A>State-led Capital Exports

Political economists disputed whether capital exports represented rational individual responses to market signals or the institutional effects of the French variety of

capitalism, but others claimed that money flowed out of France because the government used capital exports as an instrument of state power. Foreign investment was a lever with which France could expand its influence in the international arena. Capital exports could be seen as a kind of substitute for French deficiencies: for a stagnant economy, for an inadequate military build-up, or as a vehicle of French influence in the world. As Brion wrote: “exporting our capital is in a way the ultimate form of our glory in the world” (Brion 1912, p. 219).

The strongest evidence for the case of state direction comes from the loans to Russia. French diplomacy since the 1870 war had been obsessed with breaking out of isolation. French diplomats considered the loans to Russia from 1888 on as instruments for prying the Russians out of their alliance with the Germans.^{xii} At first the loans were almost exclusively for government bonds to support government deficits and for infrastructure projects like railroads, bridges, and harbors (Girault 1973; Anan'ich and Bovykin 1991). But increasingly French funds flowed into foreign direct investment in Russian firms and into firms the French themselves established in Russia (Crisp 1960). The big sectors of French investment were metalworking, steel, iron, mines, infrastructure projects, and textiles and apparel. By 1910, five major French textile firms employed 10,000 workers in their own firms in Russian Poland. By the 1917 revolution, 44% of Russian banks were owned by foreigners (half of which was held by French investors.)

As loan followed loan, and as French governments began to have a better understanding of the state of Russian public finances, the French realized that, as a senior official in the Ministry of Finance put it in 1905, the ruin of the debtor would be a

disaster for the creditor (Girault 1973, p. 22). It became impossible to reverse course. The real test for this policy was the period 1904-6, when the Russo-Japanese war and the outbreak of revolutionary violence in Russia panicked foreign investors with evidence of the ramshackle state of Russian finances and the weakness of the Tsarist regime. Under considerable pressure from the government of Maurice Rouvier, the French banks kept lending to the Russians (Guilleminault and Guilleminault 1991). The loan of April 1906 was the biggest of them all.

Even if we recognize the French government's interest in pursuing a Russian alliance, though, the puzzle of large-scale private investment remains, for the state had no way of compelling or even incentivizing private investors to place their money in Russia. One factor was the interpenetration of governmental and financial elites with many of the most influential deputies and ministers sitting on the boards of banks, railroads, shipping companies, and industrial firms (Garrigues 1997). In ordinary times, the arrows of influence in these tight networks undoubtedly went from the world of business to the world of politicians. But in situations of high tension in international affairs as in 1906, the politicians could push businessmen and bankers, however reluctantly, to support state policy.

The second mechanism by which the government intervened to induce private savers to invest in ways that supported France's foreign policy objectives was colluding in the corruption of journalists who were paid by the Russians to report favorably on economic conditions in Russia. The archives of the Russian Ministries of Foreign Affairs and of Finance, opened after the Revolution, document the links between glowing articles in the French press about the prospects of investment in Russia and the money that the

Russians passed to journalists identified by the French government as the most influential (Raffalovitch 1931). One can roughly match up the recipients of the money and the newspapers with good news about Russia. For example, in 1909 the *Semaine financier* which received money wrote: “Political crises are no longer to be feared. The time for big loans is over. If Russia needs to borrow again, it will only be for extending the railroads.”(August 28, 1909). This was written at a time when Russia was borrowing simply to repay previous loans. Another journalist on the pay-off list wrote (*France économique et financière*, (March 12, 1913):

“In every domain, Russia appears to us as disposing of an almost inexhaustible mass of resources and forces and with a very large margin for expansion... The Russian state today—just considering its Treasury---is the richest in Europe. Since finances are the sinews of war, our readers can judge how fortunate France is to have its Russian alliance. »

These rosy visions were contested by other journalists who detailed the disastrous state of Russian finances and indebtedness and speculated about why the French were so willingly ignorant. After all, Saint Petersburg was only two days away from Paris, and anyone could see the true state of affairs. The information was there—but private investors mostly turned a blind eye.

<A>The Politics of Openness

Neither the evidence of clear self-interest nor that of state directives support any simple theories about why investors sent savings out of France into countries with dubious public finances and very risky infrastructural and industrial enterprises or why the politicians let them do so. The puzzle becomes even more challenging when one focuses on the support that Left parties and unions provided at all those political junctures—particularly after financial crises---when major steps to regulate capital mobility were proposed. Why should the Left and the working class movement, which might have expected to suffer from, and hence, to be opposed to, the mobility of capital, labor and goods across boundaries, have accepted the legitimacy of the internationalization of capital? Like many of the critics, the French Left understood that if the capital that was invested abroad had been invested in France, the rate of economic growth might have been higher; jobs more abundant; wages would have risen.

But the abundant evidence we have from Socialist and trade union congresses and publications and from the parliamentary debates over capital flows in the years before World War I shows the French Left as a consistent opponent of efforts to stop the investment of French capital abroad. In fact across the full range of political battles over border-level controls to stop the flow of goods, immigration, and capital, the French Left parties and unions, like the German Social Democrats and unions and the English were staunch opponents of protectionism. The Belgian Socialist leader Emile Vandervelde expressed the general point in arguing that nationalist autarchy was antithetical to the Socialist internationalist ideal of abolishing boundaries and assuring a decent life for workers all over the world. In debates over tariffs the positions of these parties and unions varied from a kind of neutrality justified on grounds that the issue was a

distraction from class struggle to a passionate defense of free trade for providing cheap food and basic commodities and thus raising the standard of living of workers. On internationalist grounds, the Socialists even refused to support legislation for limiting immigration, despite strong pressures from their base (Prato 1912).

On each of these issues—trade, immigration, capital mobility—the Left struggled with those in its own ranks who wanted some kind of protection, but perhaps on none of these questions was the “interest” of the Left in openness less evident—hence requiring of more interpretation and defense--- than on capital mobility. Yet in each of the great parliamentary debates over foreign loans before the war, the Socialists consistently supported the basic principle that capital should freely circulate among nations. French investors should be able to place their funds in developing countries, even if the result might be less investment in France, hence fewer new jobs at home. The Left’s support for open borders for capital faced even tougher challenges than hypothetical future growth rates and job loss in France. The debates in the Chamber of Deputies over the export of capital coincided in time with two other burning problems: French policy towards Russia during the 1905 Revolution and its aftermath and Minister of Finance Joseph Caillaux’s efforts to pass income tax legislation. When considered in conjunction with each of these two issues on which the Left had intense preferences, capital mobility seemed extremely dangerous, for it threatened to help out Russian reactionaries and, at home, it threatened to undermine the chances for progressive tax reforms.

On the first point, the Socialists strongly opposed authorizing new loans to Russia while Tsarist police were still shooting protesters and instigating pogroms. As Léon Remy wrote in *L’Humanité* (January 7, 1908): “We’re providing abominable Tsarism

with a knife to stab the revolution in the back, and we're providing the Tsar's supporters with easy rents. It's just a little sordid! Socialists should protest!" Socialists insisted that any further loans to the Russian government be approved by the newly-elected Duma. Centrist deputies also urged making the loans conditional on the Tsar's agreement to political concessions. Clemenceau wrote (*L'Aurore*, January 30, 1906):

We French are the ones who gave the Tsar the means to go to Manchuria and show the incompetence of his bureaucracy. After giving him all the financial resources he needed to be defeated by a foreign army, now we are supposed to give him the financial resources he needs to assure his victory over his very own subjects. ... If he can put together a government capable of real reforms, then he can receive support from the French Republic. But if it's to keep Barbarism going, let him get his loans from Kaiser Wilhelm.

In 1907 the Socialist leader Jean Jaurès developed the same themes, and argued that tyranny was the real cause of social and economic unrest in Russia: "in allowing new loans to go forward, you are giving arms to despotism against the people, and preparing the ruin of Russia's credit (Chamber of Deputies, *Journal Officiel*, Session of February 8, 1907, 339). But even in the case of Russia, Jaurès continued, he would not favor restricting French capital exports:

J. Jaurès: I am not opposed in principle to investment of French capital abroad. Yesterday, the Minister of Finance accused one of our Socialist colleagues

of economic nationalism. No, Mr. Minister. It's a question of degree and of prudence. It is impossible, and--- at a time when the whole world is in a phase of economic growth---it would undoubtedly not be a good idea to prevent French capital from participating.

J.Caillaux, Minister of Finance: But that runs contrary to all your doctrines.

J. Jaurès. It would be contrary, in a sense, though one should not confuse the internationalism which brings nations together with a false cosmopolitanism...But what I'm saying is that it's a matter of prudence and..moreover it's inevitable and in a sense positive that French savings participate abroad in human economic development. It's important that this expansion of French savings, of our national capital take place in a prudent fashion, while leaving a fair share to domestic industry and overseeing the securities that are allowed to be publicly listed...(Chamber of Deputies, Journal Officiel, Session of February 8, 1907, p. 338).

The Socialists' concerns about the export of capital focused not only on the political impact of these investments on foreign governments but on the impact of these monetary flows on French politics. For virtually all the reforms of the period—from the limitations of hours of work to income taxes-- Socialists had to battle against the Right's threat that social reform and the passage of an income tax would drive capital out of France. Jaurès used Lysis's arguments to drive home points about the extraordinary

monopoly of control over French savings in the hands of a few banks and to warn that if this power were used to subvert reform that the Socialists would mobilize to regulate the stock market as well as the commercial banks (Chamber of Deputies, Journal Officiel, Session of February 8, 1907, p. 338).

The concern that the banks' control over savings and bias towards foreign investments would undermine reform at home and the attack on French loans to repressive governments were themes throughout the debates of the first decade of the century. Sometimes the Socialists joined the majority in pressing governments to condition approval for foreign loans on the provision of contracts for French industries.^{xiii} But still, the Left of the first globalization always came around to support for open borders for capital, goods, and labor.

Why and how did the French Left come to conceive its interests as aligning with support for open borders---despite what might have been considered much evidence to the contrary? One possible approach to this question has been provided by Frank Trentmann's work analyzing the passionate support for free trade across broad and diverse sectors of English society over the period of the first globalization (Trentmann 1998; Trentmann 2008). Trentmann argues that the resilience of support for free trade, even as British interests in the international economy changed, derived from potent popular beliefs that associated freedom in trade with basic civil rights. He suggests we need to examine how interests are constructed out of the moral and political conceptions people bring to bear in interpreting the world. On this reading, it was the broadly-shared ethical assumptions of British political culture that allowed Conservatives, Liberals, and Labor --each with very different views about the international economy---to find common

cause in support of free trade. Its proponents were imbued with a sense of moral rightness, not only with an unshakeable conviction that prices of food would be lower under this trade regime than any other.

In France, there was nothing similar. No political symbols expressed as the “cheap loaf” did for the English the association between economic openness and the freedom and well-being of the public; there were no mass mobilizations over these issues. There was deep attachment on the Left to internationalism and a certain cognitive belief that different dimensions of internationalism were connected. But the commitment of the French Left to internationalism did not translate into passionate conviction in the virtues of free trade or, even less, in those of capital mobility.

Rather, as the passages quoted above from the French parliamentary debates over foreign loans suggest, the leaders of the Left were always weighing in the balance one set of possible gains and dangers against another. In the debates over Fashoda, the Moroccan crisis, the Turkish loan, Jaurès denounced the role of powerful interest groups in driving colonial policy and warned that the conflicts with the British and the Germans could spin out of control into war. He condemned “an internationalism of bombs and profits.” But still the Socialists saw the internationalization of the economy as creating a world in which democratic politics might gain. As Jaurès expressed it in 1905: “The world today is ambiguous and mixed. There’s no inevitability, no certainty. The working class is not strong enough to create the certainty of peace, but it is not so weak that war is inevitable. In this uncertainty of things and the unstable equilibrium of forces, human action can truly make a difference.” On the eve of the war, Jaurès saw the foreign investments of

capitalists and the web of interdependencies in the international economy as among the last possible bulwarks against the outbreak of conflict.

These political reflections suggest political leaders moving on to new and uncharted territory without a map. Working-class internationalism as an ideological grid did not provide good guidelines for dealing with capital flows. Rather the Left's support for open borders suggests a different mode through which groups may identify their interests. They search for familiar features of the political terrain---even when in new territory, and one feature in particular, helps to establish such landmarks. Where groups see their old enemies gathering, there be dragons, as medieval maps marked off blank spaces of unidentified lands and oceans. What helped the Left define and consolidate its positions on trade, immigration, and capital flows was that they could identify on the other side a familiar enemy in nationalism.

The pressures of economic changes in the first globalization, as today, come to bear on an already constituted set of political actors and alliances. The groups in contention did not emerge and mobilize in response to the forces of globalization. Rather these were actors already present, who had coalesced in the great political battles of democratic development: battles over the Republic, Church-State relations, and Socialism. In closest proximity to the great parliamentary debates over the export of capital was the near civil-war strife over the Dreyfus case and the separation of Church and State. The groups were ones whose politics had been forged in struggles over issues quite distant from the international economy. Their ideologies, constituencies, alliances, and connections to power were tied to old political cleavages. The actors tended to perceive and interpret the disruptions and opportunities of the new international economy

by reference to a set of benchmark political struggles in which they were already engaged. For example, during the 1906-7 parliamentary debates over authorizing new loans to Russia, different groups on the Left seized on the Republican stakes in the issue—despotism, arbitrary rule, the crippling of the Duma—rather than on the impact on employment or investment in France. There were indeed voices in the labor movement who found hope in the Russian events that “strike fever” in French-owned factories in Russia might spill over into France (*Voix du Peuple* CGT 1905). But the dominant chord was the reaffirmation of the Republican values at stake in supporting a repressive Russian regime with French savings. On these issues, Jaurès and the centrist Clemenceau could find common cause.

The internationalism of French working class organizations and the Left thus had two strong anchors that moored these groups, even when particular groups within the Left camp came under pressure from international competition. First, internationalism was anchored by the Marxist convictions of the Socialists, who understood socialism to mean that solidarity extended across national boundaries encompassing even Italian immigrant workers, who might drive down wages, even Russian workers, whose jobs in a French-owned factory in Russia replaced jobs the French firm might have created at home. Secondly, and perhaps most important, internationalism was anchored by the legacies of Republicanism and by a past in which Republican allies had been located in a free-trade camp aligned in opposition to reactionary foes in the protectionist camp. The battles of the turn of the century between Right-wing nationalists and the Republican camp worked to reinforce this identification of Republicanism and internationalism.

The anchors that attached French political coalitions to internationalism and Republicanism and served to define interests on free capital movements have long ago slipped their moorings. With the Bolshevik Revolution, internationalism became identified with subservience to Comintern directives. With the erosion of religious practice and a massive shift to the Left of many Catholic regions, the old Left-Right divisions and alliances were undermined. The result has been to unfreeze old definitions of interest and to open a new phase of interest identification and mobilization. Some groups within the Left have joined anti-globalization movements; others support open borders. As Marcos Ancelovici has shown in research on the shifts in French unions and parties on economic protection and openness, there is little direct connection between the socio-economic location of groups and their positions on globalization (Ancelovici 2002, Ancelovici 2009, Ancelovici forthcoming). Rather the dynamic of political competition among factions of the Left drives these positions.

To the question of how capital mobility survives politically in a world it makes more dangerous, the case of the French in the first globalization offers some interesting possible approaches. It suggests we need to widen our focus from the politics of those with clear and unconflicted material interests—as a first approximation: the bankers in our example—to a much broader field of actors who do not know and perhaps cannot know with any certainty where their interests lie with respect to the flow of capital across national borders. How these actors puzzle out their interests has much to do with the legacies of ideas, cultural norms, and cognitive maps they bring to the task. But to regard this as a process of cultural construction of interests suggests a tighter congruence

between the most deeply-held values of the actors and their positions on this issue than ever existed. Rather in this case, politics shaped interests from their very inception as the actors sought to figure out how this issue connected them to their allies and distinguished them from their enemies. Interests with respect to capital mobility emerged not as the first and most desired set of outcomes--- then at some later stage of the political process to be compromised and joined with others as strategic behavior. Politics entered from the first moments in the process of interest formation as a process of reasoning over how to conceive one's ends, not as a set of strategic calculations over how to achieve one's ends. As the French Socialists asked themselves what it meant to be on the left on an issue like capital mobility, they looked at their friends and allies and they looked across the way at their long standing opponents. In such a process, interests emerge not mainly as points that can be read off an ideological grid, but as extensions of political choices, compromises, and alliances made on quite unrelated prior issues. This accounts for the incompleteness of the "interests" that come to be affirmed in such a process, and for the continuous reworking and renegotiation characteristic of this phase of politics. Despite the evidence all around us of the same processes at work today in shaping choices over the regulation of financial flows within and across borders, this phase of interest formation remains a domain that we political scientists have barely begun to explore.

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ⁱ This chapter draws on arguments I developed in Berger (2003) and incorporates some text from that work. Translations from French texts are mine.

ⁱⁱ On the intellectual history of attribution of blame for crises to "international contagion," see Kindleberger (1978 [2005]).

ⁱⁱⁱ The classic study of government controls over foreign capital flows between 1870 and 1914 is Feis (1965 [1930]).

^{iv} “Lysis” was Eugene Letailleur, who published a number of articles in *La Revue* and *L’Humanité* and Lysis (1912). His ideas were attacked by Testis (pseudonym of Raphael-Georges Lévy) in Testis (1907).

^v In the British debate, among those who see such an effect, Cairncross (1953). For research suggesting the contrary, Edelstein (1982). For France, Lévy-Leboyer and Bourguignon (1985).

^{vi} The book sold around a million copies. On the anti-British sentiment in Coin, see Richard Hofstadter’s introduction (Harvey 1983 [1894]).

^{vii} On the crisis of 1907, see Bruner and Carr (2007) and Tallman and Moen (1990). Both emphasize the domestic sources of the crisis.

^{viii} A similar account by a contemporary American observer attacked domestic explanations of the crisis: (Noyes 1909).

^{ix} On the calculation of French foreign investment and returns, see also: White (1933), Lévy-Leboyer (1977B), and Lévy-Leboyer (1977A).

^x Cameron (1961, p. 64) and Michalet (1968) concludes for a lower figure: 14% of total private fortunes were in foreign securities.

^{xi} For recent contributions on how professional investors evaluated sovereign borrowers: Flandreau (2003) and Tomz (2007).

^{xii} See Kennan (1984) and Girault (1973).

^{xiii} Linking loans to guarantees of foreign contracts was a major demand of trade associations and a major source of contention between industrialists and the banks (Rust 1973).