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The international flow of finance: an overview

1. Introduction

Three-quarters of a century ago, the United States replaced Great Britain as the world's largest supplier of export capital. As early as the 1890s Americans had begun to invest heavily in Canada and Mexico; in the 1920s and 30s the American capital markets directed financial resources toward Central and South America; at the end of the Second World War both private and public monies helped rebuild war ravaged western Europe; and in the 60s and 70s the same partnership of board room and Oval room directed billions in American savings toward the underdeveloped countries of South America, Africa, and Asia, while continuing to expand the American financial presence in western Europe and the self governing portions of the British Commonwealth. The past decade, however, has seen a reversal of this nation's fortunes. Within that short time span, the world's largest creditor has become the planet's largest debtor.[1]

Over the last century, the United States was also the world's largest recipient of foreign investment, although, because of relatively high domestic savings, the figures did not present the economy with the same problems as the present half trillion debt. Unlike their great grandchildren, 19th century Americans displayed a high propensity to save. Although the evidence for the early years is sketchy, the share of net capital formation in net national product appears to have averaged about six and a half percent in the years between 1805 and 1840 and to have risen to almost twenty percent by the end of the century; and most of the resources that were diverted from consumption were domestic not foreign.[2]

Although the data are still somewhat speculative, it appears that net foreign investment accounted for just less than five percent of the almost $60 billion increase in the nation's capital stock that occurred between 1799 and 1900.[3] Thus, many modern economic historians appear to have accepted the conclusion that foreign capital played an insignificant role in American development. Simon Kuznets, for example, wrote, "Less widely recognized is the fact that neither the gross international indebtedness of this country nor the net . . . has been large, either in comparison with the total pool of international capital investments, or in comparison with the total capital in this country owned by its residents . . ."[4]

At first glance, it appears difficult to rationalize that conclusion with the emphasis that traditional economic historians have placed on the role of foreign capital; however, both Jeffrey Williamson, in his careful study of *American Growth and the Balance of Payments*, and Raymond Goldsmith, in his estimates of the growth of reproducible wealth in the United States, have provided a ready solution to the apparent dilemma.[5] Although, in the aggregate, the transfers do not loom large, for some periods the infusions represented a much larger share of total investment; and, during those crucial decades, they almost certainly played a critical role in shaping American development (see Table 1.1) In the years 1815 to 1840, foreign investment accounted for as much as twenty percent of new capital formation, in the Civil War decade, perhaps three-quarters of that amount, and, even in the 1880s, more than eight percent. As late as the years 1903 to 1914, years when long-term American capital exports totaled more than three-quarters of a billion dollars, long-term foreign investment in the United States exceeded $1.2 billion, or, according to Williamson's estimates, two and a half percent of net capital formation.[6]

Moreover, given the initially primitive and only gradually developing state of the American capital markets, foreign capital, directed by more mature markets, provided finance for projects that could not raise capital domestically. As Goldsmith concluded, "If the United States had been limited to domestic saving, the growth of wealth would certainly have been slower until near the end of the nineteenth century . . . because these imports were concentrated in crucial areas of growth, and particularly because without them the development of the American railroad system, probably the main economic achievement of the second half of the nineteenth century, would have been slowed down considerably".[7] In general, however, Goldsmith tends to agree with Kuznets' assessment, concluding that international trade and mass immigration made a greater contribution to the nation's economic development than foreign investment.

Because of its potentially important contribution at some times and in some industries – the 1830s and 1880s were decades of rapid industrial and spatial transformation for the American economy – the subject of foreign investment is important to any understanding of this nation's growth. Moreover, between 1890 and 1914 the United States became a major exporter of foreign capital particularly to Canada and Latin America, and it is in these turn-of-the-century decades that the still strident accusations of Yankee dollar imperialism have their roots.

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Table 1.1. *Relative importance of net capital imports in net capital formation, 1799–1900*

Years	Net foreign capital imports/net domestic capital formation (Gallman)	Net foreign capital imports/net national capital formation (Gallman)	Net foreign capital imports/net national capital formation (Williamson)
1799–1805	–.012	–.013	
1806–1815	.005	.005	
1816–1840	.220	.199	
1841–1850	–.008	–.009	
1851–1860	.027	.026	
1861–1870	.158	.136	
1871–1880	.055	.055	.045
1881–1890	.086	.082	.102
1891–1900	–.028	–.030	–.020
1799–1900	.049	.048	
1871–1900	.038	.036	.042

Source: for columns (1) and (2) new capital imports are from Historical Statistics Series U 18–25 and the capital stock series are from R. Gallman, *The United States Capital Stock in the Nineteenth Century* and R. Gallman, *American Economic Growth before the Civil War: The Testimony of the Capital Stock Estimates*. Column (3) is from J. Williamson, *American Growth*, p. 142.

This study attempts to describe the history of foreign investment in the United States and the beginnings of American capital exports in the period 1820–1914. Section 2 of Chapter 1 summarizes the net flows of capital. Section 1 of Chapter 2 provides quantitative estimates of the sources and of the industrial structure of foreign investment in the US; section 2 adduces additional qualitative material to flesh out that story, and section 3 narrows the focus to a detailed analysis of funds channeled through the London Stock Exchange between 1865 and 1914. Chapter 3 explores the response of both American and foreign investors to those capital transfers. Section 1 of Chapter 4 examines the American securities listed on the New York and London Stock Exchanges in some detail, and section 2 discusses the shortcomings in the American capital market that opened the doors to foreign, in particular British, capital infusions. Chapter 5 examines the export of American capital in the years before the outbreak of World War I, and finally, Chapter 6 reports some tentative conclusions.

There is one major caveat. There are no official estimates of international capital movements before 1919, and there are no estimates, official or otherwise, of gross capital movements before 1900. Prior to that latter date, the net movements are derived as a residual from estimates of the balance of payments, and, since the residual captures errors and omissions as well as capital flows, there is substantial room for error. For example, for the year 1900 when both the "residual based" and the "gross" estimates of the long term movements are available, there is a $78 million (thirty-seven percent) discrepancy between the two reported capital flow figures. While a part of that difference can be attributed to "errors and omissions" the largest part – probably more than four-fifths – reflects the absence of estimates of short term capital movements in the post 1900 series.[8] Although the new basic series on net capital flows represents a marked improvement over earlier estimates, there remains a substantial margin for potential error. The estimates of net flows employed here are the work of Douglass North for the years 1790 to 1860 and Matthew Simon for the years 1861 to 1900 as revised by the United States Office of Business Economics.[9] The gross estimates for the years 1900 to 1918 are based on the work of Paul D. Dickens, of C. J. Bullock, John H. Williams, and Rufus S. Tucker, and of the Department of Commerce's *Monthly Summary of Foreign Commerce* as revised by Raymond Goldsmith.[10] Both North and Simon recognize the potential sources of errors; and the editors of *Historical Statistics* warn that "the figures for 1790–1918 are from publications by private authors; therefore, they are unofficial figures."[11]

2. The net flows of capital

Since there are no direct estimates of international capital flows for the years before 1900, the aggregate data are indirect estimates obtained as a residual from the calculation of the balance of payments. Those estimates are reported in Table 1.2. There have been three major quantitative studies of the history of the American balance of payments; and, while their focus and conclusions are somewhat different, their reports on the timing and magnitude of net capital imports are similar.[12] All three agree that, between 1790 and 1813, net capital movements fluctuated around zero. The figures indicate that there were thirteen years of net capital imports and ten of net exports; and, taken together, they suggest a very modest net capital inflow of $125,000 a year.

That flow was, however, greatly magnified over the six years 1814 to 1819. All three studies agree that the foreign capital was primarily employed and was particularly important in financing the federal government, the Second Bank of the United States, and the nation's external trade. North goes on the say that, "the limited supply of savings and the

Table 1.2. *Net international capital movements, capital inflow into the US minus outflow* (Millions of Dollars)

Year	Net Inflow	Year	Net Inflow	Year	Net Inflow	Long Term Only
1790	1	1832	7	1874	82	
1791	8	1833	14	1875	87	
1792	8	1834	19	1876	2	
1793	–2	1835	30	1877	–57	
1794	–9	1836	59	1878	–162	
1795	13	1837	22	1879	–160	
1796	4	1838	3	1880	30	
1797	11	1839	49	1881	–41	
1798	2	1840	–31	1882	110	
1799	–15	1841	8	1883	51	
1800	2	1842	–6	1884	105	
1801	–2	1843	–22	1885	34	
1802	–7	1844	–4	1886	137	
1803	3	1845	–4	1887	231	
1804	–12	1846	–1	1888	287	
1805	10	1847	–19	1889	202	
1806	7	1848	2	1890	194	
1807	5	1849	–3	1891	136	
1808	17	1850	29	1892	41	
1809	–12	1851	6	1893	146	
1810	–7	1852	16	1894	–66	
1811	–35	1853	56	1895	137	
1812	21	1854	42	1896	40	
1813	–15	1855	15	1897	–23	
1814	9	1856	12	1898	–279	
1815	15	1857	17	1899	–229	
1816	58	1858	–23	1900a	–296	
1817	11	1859	26	1900b	–321	–218
1818	25	1860	–7	1901	–273	–245
1819	15	1861	103	1902	–82	–135
1820	–1	1862	0	1903	–154	–21
1821	–5	1863	13	1904	–117	10
1822	8	1864	111	1905	–94	–83
1823	–2	1865	59	1906	22	68
1824	–1	1866	95	1907	35	71
1825	–7	1867	145	1908	–187	–46
1826	3	1868	73	1909	143	59
1827	–10	1869	176	1910	229	255
1828	11	1870	100	1911	40	48
1829	–2	1871	101	1912	36	23
1830	–2	1872	242	1913	–142	87
1831	–8	1873	167	1914	–72	–72

Note: 1900a comparable to earlier years, 1900b comparable to later years.
Source: Historical Statistics, Series U 18–25.

primitive state of the capital market made the foreign contribution more important than the absolute figures might indicate." Important it may have been, but the following twelve years saw a return to the pattern established in the years before 1814 – small annual flows fluctuating around zero – but, in this instance, they resulted in an average net outflow of about $1.3 million per year.

As every American economic history textbook notes, the 1830's were a period of very substantial foreign investment in the United States. Between 1832 and 1839 the nation received, net, no less than $189 million in foreign capital – more than $12 for every man, woman, and child in the country. Williamson, for example, approvingly cites North's conclusion that "relative to the size of the economy it was probably the most significant inflow of capital during the nineteenth century". All three studies agree that the lion's share of the inflow was contracted by state and local government and directed toward the financing of commercial banks and, even more importantly, the expansion of the transportation sector.[13] Stimulated by the success of the Erie Canal, states and cities competed aggressively for funds that would permit them to link into the burgeoning "national" market. In the words of Bullock and his coauthors,

> "Although the United States by 1835 had completely paid off its public debt, the states had begun to finance banks and public improvements, and borrowed during the period $174,000,000, of which $147,835,000 was borrowed between 1830 and 1838. Part of this was simply a reinvestment of money previously invested in the federal debt; part was a reinvestment of interest on previous investment; part was owed to domestic creditors; but the greatest part was a fresh flow of capital from abroad, resulting in a large inflow of goods which were paid for only in obligations, some of which unfortunately were ultimately dishonored."[14]

Because of foreign reaction to those dishonored debts and to the delay in the payment of interest and principal on even those loans that were not ultimately dishonored, Americans encountered difficulties borrowing abroad.[15] In only two of the ten years 1840 through 1849 do the net figures show an inflow of capital, and, for the entire decade, capital exports exceeded imports by $60 million.

In the taxonomy of Bullock, Williams, and Tucker, the next episode in the history of the American balance of payments encompassed the years 1850 through 1873, although, from the point of view of capital transfers, the data suggest that they could have extended it through 1876. In twenty-five of those twenty-seven years the net capital flows were positive, in one year the flow was close to zero, and in only one year was there a measurable outflow of funds. Overall the net capital inflow probably exceeded $1.7 billion.

The inflow in the 1850s was about equal to what it had been two decades before, although, as both North and Williamson note, it must have represented a smaller fraction of total economic activity. It did, however, include a greater portion of portfolio transfers; and, within that portfolio, there appears to have been a greater proportion of private – mostly railroad – issues. In 1853 the Secretary of the Treasury estimated that foreign investments in the United States totaled $222.2 million, but that figure excluded commercial and bank debts as well as direct ownership of land and business enterprises. Three years later, the figure for bank loans and commercial credit was put at $155 million, and, on that basis, Cleona Lewis argues that the 1853 total for all indebtedness was probably about $375 million.[16] By 1860 the investments in securities alone were thought to have been about $400,000,000.[17]

If the 1850s had matched the 30s, the next decade saw net inflows of unprecedented proportions. Writing at the end of the decade, David Wells, the Special Commissioner of Revenue, reported that foreigners met the outbreak of the War with great suspicion; and that, as a result, about $200,000,000 of American securities were returned in 1861–63.[18] Wells may have been correct, but there is little reflection of the massive repatriation in the net flow figures. The figures for 1861 show capital imports of $103 million, those for 1862 reflect no significant movement, and those for 1863 display a net $13 million inflow.

Whatever the truth of the early years may be, the history of the rest of the decade is clear. Between 1860 and 1869 the net inflow amounted to $761 million, a figure that represents more than $21 per capita. Over that period, the federal government had incurred interest bearing debt of $2.4 billion and state and local indebtedness had increased by some $500 million. "By 1868, according to *Hunt's Merchant's Magazine*, $700,000,000 of United States bonds were held abroad, and they had not netted the American sellers more than 57 1/2 percent. Secretary McCulloch estimated the foreign investments, excluding railway stocks, at $850,000,000. Altogether the amount of American securities held abroad was estimated at $938,000,000."[19] Finally, in 1869, Wells, inventorying all foreign debt except commercial credit, placed the total foreign investment in the United States at $1.465 billion. Cleona Lewis adds some $75 to $80 million for the excluded items and estimates total US indebtedness at "a little above 1.5 billions."[20] Simon, writing some two decades later takes exception to this figure. He notes, "although sizable quantities of government bonds were sold at a discount in European markets, my estimates suggest that Wells' 1869 estimate is clearly extravagant", and he suggests an alternative figure of $1.2 billion – a figure that is close to the $1.216 billion reached by adding the balancing items in the OBE's revisions of the North and Simon series.[21]

Nor did 1869 see the end of the inflow. The net total for the years 1870 to 1873 was $610 million (Bullock, Williams and Tucker estimate the flow for the first eight months of 1873 alone at more than $100 million), and the years 1874 through 1876 brought an additional $171 million into the country. Thus, it appears that, over the twenty-seven year span, almost $1.8 billion was transferred from European savers to American business and government.

Bullock and his co-authors place the beginning of the next episode in 1874 and the end in 1895, while Williamson, with his emphasis on the "long swing", demarks it at 1879 and 1900.[22] A study focused on the net flows alone suggests that their single period may really have been two. The first, spanning the years 1877 through 1881, was marked by four years of capital outflow, and, as a result, a reduction of American net foreign liabilities of $390 million.[23]

The second "era" stretches from 1882 through 1896. In fourteen of those fifteen years, capital flowed into the country (the exception was 1894), and, in total, the inflows almost equaled the more than $1.7 billion transferred between 1860 and 1876 – in real terms, the transfer was substantially larger. Both Bullock and Williamson note the preponderance of railway securities in this total, but those years also saw foreign funds flowing into western mining, agriculture, and land development. Bullock and his co-authors argue that between 1890 and 1896 "the net security movement was heavily against the United States, the net annual withdrawal averaging $60,000,000, or a total of about $300,000,000."[24] While the net flow estimates do show a decline over the totals of the previous decade, with the exception of 1894, they suggest a continued capital importation of just less than $90 million a year. If, indeed, $300 million in portfolio investments were repatriated, those transfers must have been more than offset by increase in short-term capital or new long-term issues.

Like the brief period 1877–1881, the long-term increase of foreign investment was reversed in the nine years 1897–1905 – all years of substantial capital exports. Unfortunately, the period spans the shift in the series from the OBE revisions of North and Simon to the estimates for 1901 to 1918 prepared by Raymond Goldsmith; and, as a result, it is impossible to place an agreed value on the size of that outflow.[25] The net capital series indicate that, by Simon's calculations, the outflow totaled $827 million between the beginning of 1897 and the end of 1900 and, by Goldsmith's long term estimates, $712 million for the years 1900 through 1905.[26]

Despite the statistical problems, there can be no doubt that, for the first time, the United States had become a major capital exporter. The best estimates indicate that between 1897 and 1908 American direct investments abroad rose from $634.5 to $1,638.5 million (or more than two and a half times), portfolio investments increased from $50 to $886.3 million (almost eighteen fold), and, taken together, all foreign holdings rose from

$684.5 to $2,524.8 million (an increase of almost 270 percent).[27] As a result, the nation's net indebtedness declined from a peak of almost $3.3 billion in 1896 to between $2.5 and $2.6 billion in 1900 and, perhaps, to as little as $2.0 billion at the end of 1905.[28]

The last nine years before the outbreak of World War I, however, witnessed a return to the era of heavy American borrowing. In only two of those nine years was the nation a net exporter of capital, and in 1910 the import was a massive $255 million. Overall, despite a more than forty percent increase in American investment abroad, between January 1906 and December 1914, long term capital imports exceeded exports by $493 million.[29] By that latter date the country's net indebtedness once again almost certainly exceeded $2.5 billion.

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The sources and uses of foreign capital

1. The sources and the industrial disposition of foreign capital (1): the quantitative evidence

Although the data are derived from a number of uncoordinated and often incomplete individual studies, it is possible to glean a general approximation of the industrial distribution of the foreign capital imports at selected dates between 1803 and 1914 and to gain at least some feeling for the relative magnitude of the contribution of Great Britain from the 1860s and that of other European countries from the 1890s onward.

Table 2.1 *Industrial distribution of foreign investments in the United States*

(1) Years	(2) Total Gov.	(3) US Gov.	(4) State & Local Gov.	(5) Rail-roads	(6) Other Private Securities	(7) Direct Inv.	(8) Short Term Inv.	(9) Total Foreign Inv.
Panel A: Millions of Dollars								
1843	150	0	150	0	53	small	28	231
1853	159	27	132	52	8	5	150	374
1869	1108	1000	108	243	15	25	153	1544
1914	213	nd	nd	3934	1607	1210	450	7414
Panel B: Percentages								
1843	65	0	65	0	23	0	12	100
1853	43	7	36	14	2	1	40	100
1869	72	64	7	16	1	2	10	100
1914	3	nd	nd	53	22	16	6	100

Source: Cleona Lewis, *America's Stake*, pp. 519–557.
nd = no data.