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**ECONOMICS 303Y1**

**The Economic History of Modern Europe to 1914**

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**Lecture Topic No. 19:**

**IV. THE SPREAD OF MODERN INDUSTRIALIZATION IN THE 19TH CENTURY: THE 'SLOW INDUSTRIALIZATION' OF FRANCE, 1789-1914**

**E. FRANCE: Business Organization and Banking during the 18th and 19th Centuries (to World War I)**

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**1. Business Organization in 19th Century France**

a) **There were three main forms of companies or business organization:** one of which was, perhaps surprisingly, more advanced in many respects than those of Britain before the 1850s.

i) **société en nom collectif:**

(1) simple partnerships: with unlimited liability for all partners.

(2) This included as well many family firms (though not all were organized as partnerships).

ii) **société en commandite:** very different from any British business organization, and in many respects superior to British company organization before the coming of limited liability corporations in the 1850s

(1) a special form of partnership, with complete, unlimited liability for all the active, managing partners;

(2) *but* with limited liability for all other investing partners: the so-called sleeping partners, who merely invested funds into the company.

(3) this curious form of partnership dates from at least the later 17th century (about 1679),

- at least in formal legislation
- and probably much earlier, owing its origin to the medieval Italian *commenda* contracts;
- the medieval *commenda* contracts similarly provided limited liability to those ‘silent’ investors who supplied only capital but no enterprise: i.e., did not participate directly in the business venture.
- limited liability: the only liability risk was the actual loss of the capital investment, but without any other liabilities connected to the business enterprise

(4) it was incorporated into law by the Napoleonic Commercial Code, in 1804.<sup>1</sup>

(5) This business organization was never found in Britain;

(6) but it developed also in Germany; and elsewhere on the continent:

(7) and it provided a very superior means of raising capital

(8) It also avoided one pitfall of limited liability corporations: i.e., by not shifting so much of the risk to creditors (those holding bonds, debentures, or loan contracts).

(9) The ease of forming such limited partnerships, providing full protection for silent investors, probably impeded the full development of the modern corporation in 19th-century France (and Germany).

iii) **Société anonyme:**

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<sup>1</sup> Answers.com: French civil code enacted by Napoleon in 1804. It clarified and made uniform the private law of France and followed Roman law in being divided into three books: the law of persons, the law of things, and laws on acquiring ownership of things.

- (1) a joint-stock company, raising capital through the sale of shares of ownership to the general public.
- (2) As in Britain, rights of limited liability for shareholders – i.e., liability limited to amount paid for the shares -- was granted only by a special government charter of incorporation,
- (3) which, again, was very expensive and time consuming to obtain.

**(4) limited liability rights for investors:**

- In May 1863 (seven years after Britain's general limited liability legislation), the French government finally granted limited liability rights to joint-stock companies (*sociétés anonymes*)
- on similar simple conditions, without high incorporation fees.

**b) Structure of Business in 19th century France:**

i) **the vast majority of French business companies were family firms** and simple partnerships, though with a fair number of *sociétés en commandites*, as quasi corporations.

ii) **but very few genuine corporate *sociétés anonymes*, certainly not before the 1863 law:**

(1) in the business boom of the 1850s, when some 20,000 new companies were formed, only about 1% (221) were formed as *sociétés anonymes*.

(2) as I have already noted, and as I now repeat: with the ease of forming *sociétés en commandite*

- that provided adequate protection for silent investors,
- and thus there was much less of a need for limited liability joint-stock companies.

iii) **the predominance of family firms and partnerships in 19<sup>th</sup> century France is not really all that unusual:**

(1) Many economic historians point to this aspect of business organization -- the predominance of family firms -- as a fundamental weakness: especially David Landes, and Rondo Cameron.<sup>2</sup>

(1) BUT: the same could reasonably be said for most countries in this era, including Britain, Germany, and the US. [Think of Ford Motor Co in the U.S., for much of the 20<sup>th</sup> century]

(3) So: I am not convinced that this feature really distinguished France from her major competitors as any fundamental defect in markets and business organization.

**2. Banking: the 18th Century Disasters and their Conservative Heritage**

a) **19th century French banking is renowned for its ultra-conservatism:**

i) **An overly 'tight money policy': is the chief criticism that has been voiced:**

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<sup>2</sup> See in particular David Landes, 'French Entrepreneurship and Industrial Growth in the Nineteenth Century', *Journal of Economic History*, 9 (1949), 45-61.

(1) that the government's and central bank's very restrictive, tight monetary and credit policies threatened to impede economic expansion during the 19th and early 20<sup>th</sup> centuries.

(2) That is a very common view, whose most extreme exponent is the late Prof. Rondo Cameron;

(3) I shall return to criticize Cameron's views, later.<sup>3</sup>

**ii) First and foremost: this standard negative view does not fairly take account of the previous history of French banking, and thus of 'path dependency':**

(1) the character of general financial insecurity in early modern France;

(2) and then the traumatic effects of several 18th century disasters

(3) all of which necessitated, in my view, a subsequent conservatism in the 19th century to restore public confidence.

**iii) Therefore we shall look briefly at three 18th-century disasters:**

**b) John Law's Bank of 1716 - 1720:**

i) **John Law** (1671 - 1729):<sup>4</sup> was a Scottish economist, financier and promoter: in that very same era of speculation and fraud that produced, at this very same time, England's famous South Sea Bubble (1720).

**ii) John Law convinced the French King Louis XV to set up a national bank:**

(1) to establish a new royal bank

- to take over and manage the national debt and money supply
- in return for monopoly privileges in both overseas trade and banking.

(2) Naturally, John Law offered to manage this new royal bank.

**iii) To make a long story short:**

(1) John Law's bank collapsed in utter ruin in 1720 – i.e., at the very same time as did the South Sea Bubble in England.

(2) and it so disastrously bankrupted so many investors that the French public was long hostile thereafter to

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<sup>3</sup> See Rondo Cameron, 'Banking in France, 1800-1870', in Rondo Cameron, ed., *Banking in the Early Stages of Industrialization* (London, 1967), pp. 100-28.

<sup>4</sup> He is also the author of the famous 'Real Bills Doctrine' (referred to under British banking, in earlier lectures): From *Answers.com*: The Real Bills doctrine (RBD) is a theory of money creation that argues that issuing money in exchange for short term private credit is not inflationary. In this context a 'bill' is a promise to pay at a future date. An example would be a merchant buying goods for sale, with a promise to pay when the goods are sold. A 'real bill' would then be one where the goods are obviously in such demand, and the possibility of loss insured against it. Each time the bill is exchanged, the seller 'discounts' it by reducing the face value for the amount of time left before the bill is payable. In a RBD economy, banks would be allowed to issue notes, that is currency, based on real bills that they hold, in addition to specie. (See 'free banking').

any form of a national bank.

c) **Turgot and the Caisse d'Escompte of 1776:**

i) **Anne Robert Jacques Turgot, Baron de l'Aulne (1727-81):**

(1) Turgot was Louis XVI's minister of finance in the dying days of the *ancien régime*.

(2) His chief task: to restore public finances; and he desperately tried to stave off royal bankruptcy.

ii) **For this purpose, he set up a banking agency:**

(1) This bank operated under the ministry of finance as a new national bank.

(2) But this bank soon collapsed in ruin in trying to issue government annuities or *rentes* which found no market.

iii) **The negative consequences:** naturally this failure further convinced the French of the essential folly and indeed wickedness of national banks.

d) **The French Revolutionary Regime: Finances of the 1790s:**

i) **The Assignats:**

(1) To finance its government, the revolutionary regime issued a flood of paper money called 'assignats',

(2) supposedly backed by the value of confiscated lands (i.e., 'assigned' to them);

(3) but in fact, these notes had no backing in any form of real assets.

ii) **The result was a gross overissue of these bank notes and thus a ruinous inflation, which served only to intensify the hostility to government banking:** until Napoleon came to the rescue.

### 3. **The Bank of France and French Banking in the 19th Century**

a) **Napoleon established this bank in 1800:** it was the dominant banking and financial institution in 19th-century France:

i) **It was set up on the model of the Bank of England:** as a private joint-stock company bank that was to act as the governments' exclusive banker.

ii) **Its board of directors, or Council of Regents,** initially consisted of members of the leading merchant banks of Paris.

iii) **Unlike the Bank of England,** the new Bank of France from the outset did establish branches in the leading French cities.

iv) **But after the restoration of the monarchy in 1815 (Louis XVIII):**<sup>5</sup>

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<sup>5</sup> The 19<sup>th</sup> century French monarchs were: Louis XVIII (1814-24), Charles X (1824-30), and, finally, Louis Philippe (1830-48). That monarchy was ended by the 1848 Revolution and the establishment of the Second Republic (1848-52), under President Louis Napoleon; but he re-established the Empire, as Emperor

(1) these branch banks were abolished and replaced by rival government banks called departmental banks (in the various *départements*)

(2) they shared with the Bank of France the right to issue currency.

v) **From 1835**, the Bank of France resumed branch banking.

vi) **After 1848 Revolution, and the inception of the Second Republic, the rival departmental banks were abolished**, once again giving the Bank of France a complete monopoly on note issue.

b) **The monetary and banking policies of the Bank of France were highly conservative**: necessarily so, to restore public confidence in government banking.

i) **the money supply was made highly inelastic**:

(1) by having a very high proportion in gold coin -- about 70% in 1850s.

(2) by issuing banknotes only in very large denominations, with a minimum of 500 francs = £25 sterling = \$125 (1 franc = 25¢ US).

(3) For comparison note that annual per capita income was then about 300 francs.

(4) In the 1850s, 93% of French financial transactions were still conducted in specie (i.e., in gold and silver coins),

- compared to 35% in England,

- and just 10% in Scotland.

ii) **Secondly, the Bank of France maintained very high reserves for deposits**:

(1) While the law required 50% gold reserves, the Bank of France normally maintained 80% reserves (compared to 35% reserves for the Bank of England).

(2) French bullion reserves were about five times as those of the Bank of England.

iii) **Private bank cheques were not recognized as legal tender** before 1875:

(1) i.e., as instruments of payment: not legal or valid until 1875.

(2) For comparison, remember that in Britain,

- such cheque payments were legal from a much earlier date,

- and, a rapid increase in bank chequing provided the principal mechanism for circumventing the restrictive monetary policies of the 1844 Bank Charter Act.

d) **In dealings with the private commercial banks, the Bank of France was equally restrictive and**

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Napoleon III (1852-70), and then he was defeated in the Franco-Prussian War (1870-71), which resulted in the formation of the Third Republic (1871-1945). The post-World War II Fourth Republic lasted from 1945 to 1959, when Charles de Gaulle, elected President (the first elected since 1848), established the Fifth Republic, which continues to this day.

**conservative:**

i) **it forced other banks to keep reserves of 50% or more** for their deposits:

(1) thus potentially curtailing their ability to make loans, advance credit.

(2) Monetary expansion, or rather potential expansion, through bank lending, as the reciprocal of the reserve ratio, was thus only two- fold, compared to the ratio of three- fold or more in Britain.

ii) **Bank of France restricted its discounting privileges:**

(1) to just a very small, select clientele, who had to be personally approved by the Board of Regents (directors), on very limited conditions:

(2) only a very limited range of commercial paper was acceptable, with payment only in Paris.

(3) discounting for a limited period of only 90 days, at rates normally higher than current market rates (for rediscounting).

iii) **Bank of France generally refused to act as a Lender of Last Resort**

iv) **In general, therefore, the Bank of France was extremely reluctant to assist** the private commercial banks with lines of credit or other assistance.

d) **Rondo Cameron's criticisms of the Bank of France** (in his *Banking in Early Stages of Industrialization*, 1967):<sup>6</sup>

i) **he argued that Bank of France made the supply of both money and credit too inelastic and tight:**

(1) so that the French economy suffered a chronic shortage of working capital,

(2) and that shortage seriously constricted economic development during the 19th century:

(3) thus condemning the Bank of France as a major barrier to economic growth.

ii) **this view seems to be seriously overdrawn:**

(1) and it is doubtful that the Bank of France's policies can be blamed for creating such a severe shortage.

(2) or, if such was the case, we surely cannot lay the sole blame on the Bank of France.

iii) **Widespread public hoarding is a more central problem:**

(1) that reflects centuries of insecurity, which even the Bank of France could not counteract,

(2) especially the very widespread problem of peasant hoarding,

■ which severely restricted monetary circulation and

■ the volume of deposits in French banking system.

iv) **But even so, generally low interest rates were often as low as 3%**, as the following table indicates, and lower than those in Berlin (Germany) or St. Petersburg (Russia):

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<sup>6</sup> See n. 3 above.

**Official Rates of Rediscount in St. Petersburg, Berlin, and Paris, on 12-Month Notes, 1885 - 1912** (in percentages per annum):

| Years   | St. Petersburg (Russia) | Berlin (Germany) | Paris (France) |
|---------|-------------------------|------------------|----------------|
| 1885-90 | 6.10                    | 3.72             | 3.00           |
| 1890-95 | 5.95                    | 3.63             | 2.63           |
| 1895-00 | 7.80                    | 3.30             | 3.00           |
| 1900-05 | 5.90                    | 3.90             | 3.00           |
| 1908-12 | 5.10                    | 4.80             | 3.20           |

**Source:** Paul Gregory, *Before Command: An Economic History of Russia from Emancipation to the First Five Year Plan* (Princeton, 1994), pp. 74-6.

v) **Such low interest rates thus do not indicate that bank credit was tight in relation to demand:** and limited demand for bank loans is something that we shall consider later.

v) **Nobody has yet proved that high reserve ratios in fact severely curbed either the money supply or the supply of credit:** these views are speculative, based on ill-informed theory.

vi) **In any event, in my view, the Bank of France had no alternative** but to pursue very conservative monetary policies in the light of those 18th century disasters in French banking and the very natural public hostility to government banking.

vii) **The chief defence of the Bank of France is in achieving its one major goal:** namely, to ensure a sound, stable gold-backed money supply that would command the full confidence of the French public (and also of foreigners).

#### 4. Private Commercial Banks in France

a) **French Banking after 1815**, after the Napoleonic Wars, France in fact had a better developed banking system than most other European countries (excepting the Netherlands and Great Britain).

b) **But that French banking was very largely concentrated within Paris:**

i) **to a large extent consisted of small family merchant banks:**

(1) which dealt largely in government finance and in commercial discounting (especially for foreign trade),



(2) with almost no industrial financing.

ii) **Haute Banque**: literally the 'High Bank' (or 'Old' Bank): is the term applied to about a dozen of the leading Parisian merchant banks:

(1) almost all were Protestant and Jewish banks, based upon international financial and commercial connections that were family based.

(2) The Protestants were chiefly Calvinist Huguenots: i.e., descendants of the remaining few who had escaped the general expulsion of Huguenots by Louis XIV in 1685:

- The 'Expulsion of the Huguenots' had meant the Revocation of the Edict of Nantes, which had earlier, from 1598, provided religious toleration for Protestants:
- This was the edict that King Henry IV of France (1589-1610) had issued to protect his Calvinist co-religionists, even though he had to convert to Catholicism to gain the throne:
- compare this French situation with England's Toleration Act of 1689, under its new Calvinist king: William III or Orange (who had led the Dutch Republic, before becoming King of England, with his wife Mary II, daughter of the deposed James II).

(3) Many of the expelled French Huguenots had fled to the Netherlands, England, and Germany, while retaining close family connections with the few that survived and remained in France;

(4) Those few that did remain in France devoted themselves to commerce and finance for the same reasons as did the Jews [i.e., because all government, military, or Church occupations were closed to them, obviously] and the Dissenters in post 1660-England.<sup>7</sup>

(5) Indeed, in France, both the Huguenot and Jewish banking was more predominantly international than domestic banking: especially foreign government finances.

(6) The Rothschild family bank, led by Jacques (James) de Rothschild, was by far the most important of the French Jewish banking firms:<sup>8</sup>

- its home office was in Frankfurt, founded by Mayer Amschel Rothschild (1744-1812).
- with other family branches in London, Paris, Vienna, Naples, and Rome,
- making it the most powerful international banking company in the early 19th century.

c) **Investment Banking**: the birth of the 'New Bank', or new banking:

i) **This was the most important financial innovation of the 19th century:**

(1) It was essentially limited to the European continent -- it was not really found in Great Britain.

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<sup>7</sup> See Lecture no. 2 (September).

<sup>8</sup> See the Appendix on the Rothschilds banking family.

(2) We will revisit British banking at the end of this course, and look at some investment banking by so-called merchant banks, mostly of foreign origin or ownership.

ii) **The first such investment bank was the Société Générale de Banque:**

(1) It was set up in 1822, in neighbouring Brussels, in what was then the Kingdom of the Netherlands

(2) The Kingdom of the Netherlands: formed in 1815, after the Napoleonic Wars,

- to include the former Austrian Netherlands, in the south (or what is now modern day Belgium) , as well as the former Dutch Republic in the north
- the southern area revolted against this Dutch-dominated kingdom
- and gained its independence from the Netherlands as the separate kingdom of Belgium, in 1830.

(3) Indeed, the new Société Générale de Banque (General Bankmaatschappij – in Dutch, now called just De Generale Bank) in effect replaced the famous Wisselbank van Amsterdam, which was formally dissolved that same year;

(4) and perhaps to satisfy the newly acquired Belgian provinces, its headquarters was established in Brussels rather than in Amsterdam.<sup>9</sup>

iii) **Chief Functions:**

(1) to make long term loans for financing fixed capital formation in private industry -- i.e., for plant and machinery;

(2) and for the government, especially for municipal governments, in financing public works.

(3) Some of these loans were arranged in the form of the sale of bonds or debentures.

(4) to invest directly in private industry through the purchase of equity: i.e., purchasing blocks of shares or stocks in private companies.

iv) **investment banks often acted together**, and with other financial institutions (insurance companies) as financial syndicates to underwrite stock or bond issues by private companies: buying a block of stock or bonds, and then selling them to their clients.

v) **How did the investment banks acquire the funds for such activities?**

(1) through the sale of stock in the banks themselves.

(2) through funds attracted to deposits accounts in the banks.

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<sup>9</sup> For its official history, see Herman Van der Wee and Monique Verbreyt, *The Generale Bank, 1822 - 1997: A Continuing Challenge*, trans. by Frank Parker from *De Generale Bank, 1882 - 1997: Een permanente uitdaging* (Tielt: Lannoo Publishers, 1997). Recently, however, in 1998, this renowned and powerful Belgian investment bank was taken over by a French insurance company: Fortis, which was then merged into BNP Paribas Fortis, an international bank which now has its main focus, again, in Belgium. The final merger and operational negotiations were concluded in May 2009.

(3) through borrowing to engage in underwriting.

vi) **Why were investment banks so important and necessary for continental European economic development and industrialization?**

(1) Principally because of underdeveloped capital markets on the continent,

- or indeed because of a real vacuum in capital markets:
- with inadequately developed joint-stock companies,
- and with the lack of well-organized stock markets and other financial institutions that could engage in financing fixed capital formation.
- Since these capital markets were so much more developed in Britain, this form of investment banking was not needed there.

(2) Secondly, the technological question: because of the much more advanced technology required in industrialization from the 1830s, especially with steam engineering and the railroads.

- That more advanced and much more costly technology, much more so than in initial days of British Industrial Revolution, meant that many industrial concerns had to be established with initially large scale, and thus with very large initial capital investments:
- far larger than could be raised by family firms or partnerships.

(3) Nevertheless, this does not mean all or even most French businesses required investment banks: family firms still remained predominant.

d) **Beginnings of Investment Banking in France:** in the 1830s, but mixed or combined with normal commercial deposit banking.

i) **Caisse Générale du Commerce et de l'Industrie (1837):**

(1) of Jacques Lafitte, in 1837, was the most important of this new type of French banking.

(2) In the later 1830s and 1840s, this quasi-investment bank was active in financing railroads, cotton textiles, chemicals, iron-making, etc.

ii) **But since this bank, and similar ones, were not joint-stock companies** (but rather *sociétés en commandite*),

(1) they could not raise capitals by selling bank shares;

(2) and thus they were fundamentally weak in financial structures.

iii) **In 1848, a year of revolution across Europe, a severe financial and economic crisis led to the crash of the Caisse Générale and many other French banks**, especially when the Bank of France utterly refused to aid them during this economic crisis.

iv) **That crisis and the ensuing 1848 Revolution brought the French monarchy to an end (deposed Louis**

**Philippe):**

- (1) It established the Second Republic, and brought to power Napoleon Bonaparte's nephew, Louis Napoleon.
- (2) First as President of the Second Republic, and then from 1852 as Emperor of France (Emperor Napoleon III), he was determined both to reform French banking and to promote economic development.

5. **Crédit Mobilier: 1852 - 1867**

a) **(Louis) Napoleon III seemed to achieve both of his objectives:**

i) **for the 1850s and 1860s marked the Golden Age of the French economy,**

- (1) with very rapid economic growth and industrialization;
- (2) but this was also a period of general prosperity and growth in European economy.

ii) **Also marked a new and more profitable era in French banking.**

b) **Crédit Mobilier:** was certainly Louis Napoleon's greatest achievement:

i) **Distrustful of both the Bank of France and the Rothschilds,**<sup>10</sup>

- (1) Louis Napoleon and his officials in 1852 arranged for their chief rival, the Péreire banking family (Emile and Isaac: a Jewish family), to set up this new bank,
- (2) as a joint-stock bank, with a capital of 50 million francs, second only to the Bank of France in size.

ii) **Both the Bank of France and the Rothschilds were greatly angered:** especially the latter, who had recently been partners of the Péreire Bros. in many financial and commercial enterprises.

iii) **It had a brief but dazzling career, from 1852 to 1867.**

c) **Crédit Mobilier represented France's first and in fact only true investment bank:**

i) **For almost 15 years,** it took a major role in financing French railways and public works (national and municipal).

ii) **Provided fixed capital financing by and in the form of:**

- (1) direct long term loans
- (2) underwriting: stock and bond issues of railway companies, government bonds, etc.

ii) **The funds for such corporate financing, as suggested earlier, came from several sources:**

- (1) from the sale of stock in the Crédit Mobilier itself.
- (2) from deposits placed with Crédit Mobilier.
- (3) from underwriting stock and bond issues:

ii) **in the 1850s and 1860s,** it was responsible for about a third of the stock issues.

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<sup>10</sup> See the Appendix on the Rothschilds

iii) **Its greatest achievement:** may have been in financing one of the original German investment banks: helped to found the Darmstädter Bank in 1853.

d) **From the later 1850s, Crédit Mobilier turned more and more into government investments, domestic and foreign;** and into foreign finance.

e) **Its 15-Year Career Abruptly ended in 1867: for two reasons:**

i) **It had invested far too much in risky foreign ventures and unproductive public works,** especially in Paris.

ii) **It had made too many long term loans on the basis of short-term funds deposited with it:** too much of its loans were based upon deposits.

iii) **The more general (European wide) financial crisis of 1867 had depleted its reserves:**

(1) Crédit Mobilier then appealed to both the Bank of France and the Rothschilds for help

(2) and both refused to lend it a single solitary centime.

(3) Note that the Banque de France indeed did refuse to act as 'a lender of last resort'.

iv) **Crédit Mobilier, now bankrupt, then crashed:** but then, once the Péréire Bros. had left, the Bank of France did lend assistance to reorganize it as a normal commercial bank.

v) **The result was the end of independent investment banking in France:** and any would be imitators were frightened off by Bank of France and by the Rothschilds, obviously.

## 6. French Banking after 1860

a) **Two new major banks had been formed in 1860s (just before demise of Crédit Mobilier):**

i) **both were limited liability joint-stock banks** (*société anonyme*):

(1) **Crédit Lyonnais:** in 1863.

■ Originally established in Lyons, to assist the French silk industry,

■ this bank later shifted to Paris.

(2) **Société Générale de Banque,** in Paris: established in 1864.

ii) **Initially, both of these banks did some investment banking, making long-term loans to manufacturing industries:**

(1) but with the crash of Crédit Mobilier, both learned the dangers of such investments;

(2) and thereafter largely restricted themselves to making short-term capital loans, commercial discounting, and acceptance banking (on British model),

(3) with only occasional forays into industrial or investment banking.

iii) **Both however were soundly established joint-stock banks:**

which established a branch-banking system that provided great stability.

b) **Investment banking did not entirely disappear, however:**

i) **The Rothschild bank**, ironically, as the arch foe of *Crédit Mobilier*, took up some investment banking functions after the crash,

ii) **but this was almost entirely devoted to foreign investments**, a point to which we shall return.

c) **French banking structure:**

i) **compared to other countries**, ca. 1870, French banking facilities as a proportion of national income are not very impressive:

**Bank Resources as a Percentage of Net National Income**

| COUNTRY | Year | percentage of NNI |
|---------|------|-------------------|
| FRANCE  | 1870 | 16%               |
| ENGLAND | 1844 | 34%               |
| BELGIUM | 1875 | 42%               |
| PRUSSIA | 1865 | 31%               |
| RUSSIA  | 1910 | 61%               |
| USA     | 1871 | 30%               |

ii) **as the table on the screen indicates:** only 16% of NNI in France, compared to

- 42% in Belgium, 31% in Prussia, 61% in Russia, 30% in USA
- and much earlier, in 1844, 34% in Britain.

d) **More interesting are statistics on relative shares of French capital investments:** i.e., between domestic and foreign investments.

i) **in 1870, about a third (35%) of domestic savings were invested abroad.**

ii) **By 1910, over 50% of domestic savings were invested abroad:**

- Of this amount, about \$9 billion (US dollars), 28% went to Russia, and 30% to Latin America.

iii) **As table on foreign investments shows**, France ranked second only to United Kingdom in investing abroad (20% of total vs. UK 44%), France did not have a comparable foreign trade sector.

iv) **as these figures thus suggest**, there was no real shortage of savings or funds for investment in the French economy.

**Foreign Capital Investments of the Chief Lenders  
expressed in millions of current American dollars**

| <b>COUNTRY</b> | <b>1870</b> | <b>1910</b> | <b>1914</b>   | <b>% of 1914</b> |
|----------------|-------------|-------------|---------------|------------------|
| <b>UK</b>      | 4,900       | 12,000      | 20,000        | 44.0%            |
| <b>FRANCE</b>  | 2,500       | 5,800       | 9,050         | 19.9%            |
| <b>GERMANY</b> |             | 4,800       | 5,800         | 12.8%            |
| <b>USA</b>     | 100         | 500         | 3,500         | 7.8%             |
| <b>OTHER</b>   | 500         | 1,100       | 7,100         | 18.6%            |
| <b>TOTAL</b>   |             |             | <b>45,450</b> | <b>100.0%</b>    |

**Source:** Sidney Pollard, 'Capital Exports, 1870 - 1914', *Economic History Review*, 2nd ser., 38 (November 1985).

**e) What explains this French emphasis on foreign investments?**

**i) traditional structure of French banking**, as another form of path dependency:

(1) as dominated by the *haute banque* in early 19th century: as we have seen these banks, with their international Protestant and Jewish connections, had been largely engaged in foreign finance;

(2) and their financial activities were emulated by the new banks that formed in 19th century France.

**ii) Differential rates of return?**

(1) The evidence, however, does not show that yields on foreign investments were that much higher than domestic investments, certainly not to justify the much higher risk.

(2) Indeed, the bulk of foreign investments were lost during World War I (and the Russian Revolution).

**iii) Political Factors explain this better:**

(1) the French government exerted very strong pressures in encouraging foreign investments to enhance French political initiatives,

(2) especially to secure Russian support against France's principal enemy, imperial Germany;

(3) and so the French anxious to help finance Russian military and industrial expansion.

(4) Note that by 1900, 28% of French foreign investments had gone to Russia.

iv) **Relative Lack of Domestic Demand?**

(1) Furthermore, this apparent imbalance between foreign and domestic investments may also reflect a relative lack of demand for bank loans and other traditional investments within the French economy;

(2) and that reflects partly the structure and attitudes of French businesses.

(3) As noted, there were very few joint-stock companies in France, even after the major barriers had been lifted in 1863 (permitting limited liability).

- Major exceptions were in transportation and public utilities
- for which technology demanded large scale and
- where local monopoly encouraged large scale joint stock companies.

(4) As the French economic historian Claude Fohlen has commented:

- ‘The great majority of industrial firms were and remained family enterprises’.
- Most of these family firms and partnerships were also small-scale.

(5) There were, however, some exceptions:

- the Anzin firm in coal and De Wendel in iron and steel.
- Though they were family firms, they were nevertheless very large scale, growing by amalgamations (horizontal and vertical integration).

(6) As David Landes, Rondo Cameron, Claude Fohlen himself, and Trebilcock have all noted:

- such family firms, whether small or large, were extremely reluctant to deal with banks for capital financing, whether in terms of loans or stock and bond underwriting,
- for fear of losing their independence, of sacrificing the family nature of their enterprises.

(7) When we come to Germany (next major section), we shall see that,

- when their large industrial firms resorted to financing from investment banks, the investment banks often obtained large blocks of shares in these companies and thus seats on their boards of directors;
- and hence a major role in directing these firms;
- indeed, as we shall then see, the German investment banks came to exercise a very strong leadership role in German industrialization, after 1860.

(8) So the reluctance of so many French firms to seek bank financing, for quite rational reasons, may have been another strong factor in encouraging French banks and financial institutions to invest abroad.

v) **Read Trebilcock on Significance of French Foreign Investments:<sup>11</sup>**

He argues that unlike the British, the French in investing so much abroad did not stimulate French industrial

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<sup>11</sup> Clive Trebilcock, *The Industrialization of the Continental Powers, 1780 - 1914* (London and New York: Longman, 1981).



growth through foreign trade: i.e., investments abroad did not generate demand for French industrial goods (as was case in Britain).

**APPENDIX: THE ROTHSCHILDS: history of a European banking family**

Answers.com:

(1) The Rothschild family (often referred to simply as the Rothschilds), is an international banking and finance dynasty of German Jewish origin that established operations across Europe, and was ennobled by the Austrian and British governments. The family's rise to international prominence began with Mayer Amschel Rothschild (1744–1812). Born in the ghetto (called "Judengasse" or Jew Alley) of Frankfurt-am-Main, he developed a finance house and spread his empire by installing each of his five sons in European cities to conduct business. An essential part of Mayer Rothschild's strategy for future success was to keep control of their businesses in family hands, allowing them to maintain full discretion about the size of their wealth and their business achievements. Mayer Rothschild successfully kept the fortune in the family with carefully arranged marriages between closely related family members. His sons were: Amschel Mayer Rothschild (1773-1855) - Frankfurt; Salomon Mayer Rothschild (1774-1855) - Vienna; Nathan Mayer Rothschild (1777-1836) - London; Calmann Mayer Rothschild (1788-1855) - Naples; James Mayer Rothschild (1792-1868) - Paris. The German family name means "Red Shield".

(2) The Rothschild banking family of France was founded in 1812 in Paris by James Mayer Rothschild (1792–1868). James was sent there from his home in Frankfurt, Germany by his father, Mayer Amschel Rothschild (1744–1812). Wanting his sons to succeed on their own and to expand the family business across Europe, Mayer Amschel Rothschild had his eldest son remain in Frankfurt, while his four other sons were sent to different European cities to establish a financial institution to invest in business and provide banking services.

(3) Jacob Mayer Rothschild, the youngest son, settled in Paris in 1812 where his name Jacob was translated to James. In 1817, he formally created the bank, de Rothschild Frères whose partners were brothers Amschel of Germany, James of France, Carl of Naples, Nathan of England and Salomon of Austria. Highly successful as lenders and investors, the Paris operation also became bankers for Leopold I of Belgium. In 1822 the influential James and his four brothers were awarded the hereditary title of "Baron" by Emperor Francis I of Austria. Following the July Revolution of 1830 that saw Louis-Philippe come to power in France, James de Rothschild put together the loan package to stabilize the finances of the new government and a second loan in 1834. In recognition of his services to the nation, King Louis-Philippe elevated James to a Grand Officer of the Legion of Honor. In his book, *The House of Rothschild (vol. 2) : The World's Banker: 1849-1999*,

Niall Ferguson wrote that according to the records, in 1815 the capital of the Paris banking house James Mayer de Rothschild founded amounted to £55,000; by 1852 the figure was £3,541,700 and just ten years after his death, £16,914,000. There is a theory that before Louis-Phillipe came to power the Rothschilds were fronting for the House of Orleans. A major portion of the business has consisted of selling French government bonds to French investors through London to protect their anonymity. There was a general perception on the part of the French that otherwise their government might unilaterally reset terms. No French fortune was more likely to face the problem than the younger branch of the royal family. The theory follows that when the Orleanists came to power they became less provident but by then the Rothschilds had numerous other clients. The de Rothschild Frères banking business was passed down to ensuing generations. Run by his sons Gustave and Alphonse, during the Franco-Prussian War the bank put together a syndicate that raised the five billion francs the country was obliged to pay Prussia under the terms of the 1871 armistice. becoming its largest shareholders.

(4) James Mayer de Rothschild had stipulated "that the three branches of the family descended from him always be represented." For the next two generations that was the case but in 1939, Edouard Alphonse de Rothschild and cousin Robert Philippe, incompatible with their other cousin Maurice de Rothschild, bought out his share. Maurice went on to be enormously successful and, having inherited a fortune from the childless Adolphe de Rothschild of the Naples branch of the family, he moved to Geneva, Switzerland and perpetuated the new Swiss branch of the family. In 1873 de Rothschild Frères in France and N M Rothschild & Sons of London joined with other investors to acquire the Spanish government's money-losing Rio Tinto copper mines. The new owners restructured the company and turned it into a profitable business. By 1905, the Rothschild interest in Rio Tinto amounted to more than 30 percent. In 1887, the French and English Rothschild banking houses lent money to, and invested in, the De Beers diamond mines in South Africa, becoming its largest shareholders.

(5) Changes in the heads of government, war, and other such events affected the family's fortunes both for their benefit and to their detriment. However, the interests of all Rothschild banking families across Europe were adversely impacted in a very major way by three historical events: 1) the Revolutions of 1848, 2) the Great Depression of the 1930s and 3) Nazism of the late 30s through World War II. For the French branch, the 1981 nationalization by the newly elected socialist government of François Mitterrand was an equally significant disaster[1][2].

(6) In 1953, future President of France, Georges Pompidou, joined de Rothschild Frères and from 1956-1962 he served as General manager. In 1962, the Rothschild's created Imétal (now named Imerys), an umbrella company for their considerable mining ventures. Headed by Guy de Rothschild, Imétal looked outward, investing in Great Britain and the United States, a move that put him on the December 20, 1963 cover of Time. In the 1960s, government reform of banking regulations ended the legal distinction between banques d'affaires and deposit banks and in 1967 de Rothschild Frères became Banque Rothschild, a limited-liability company.

(7) A part of the success of the bank that James Rothschild built was through the funding of loans to European governments. This sector of banking began to decline during the latter part of the 19th century following the introduction of new methods for government financing. Still highly successful, the Rothschilds were a major force in European financial markets until their bank and Imétal were nationalized in 1981 by the French government, the bank becoming the state-owned Compagnie Européenne de Banque. It took until 1986, when the Socialists lost power, for Rothschild family members to get a new banking license. In 1987 a successor company called Rothschild & Cie Banque was created by David R. de Rothschild who was joined by his half-brother Edouard and cousin Eric de Rothschild. In 2003, following the retirement of Sir Evelyn de Rothschild as head of N M Rothschild & Sons of London, the English and French firms merged into the Group Rothschild under the leadership of David R. de Rothschild. In 2006, the French banking division expanded into Brussels, Belgium.

(8) Decline of economic power. By the end of the 19th century, the introduction of national taxation systems had ended the Rothschild's policy of operating with a single set of commercial account records resulting in the various houses gradually going their own separate ways. The coherence that had worked so well for the five brothers and their successor sons had all but disappeared by World War I. In Britain, the introduction of estate taxes resulted in Rothschild inheritors handing over multi-millions to the government that brought an end to the passing down of their great mansions. However, the estate tax relative to the bank and corporate assets was far more detrimental long-term because it restricted growth at a time when publicly owned banks were expanding rapidly with huge resources raised on capital markets. The decline of the French and British Empires particularly after World War I along with increased nationalization by governments restricted growth potential for the Rothschilds. However, business analysts generally agree that their failure to shift their focus to opportunities in the United States, where the greatest industrial expansion in history was occurring, is a major factor in the Rothschild bankers of today being apparently only a minor player in the global economy.



**Table 1.**  
**Bank Resources as a Percentage of Net National Income**

| <b>Country</b> | <b>year</b> | <b>percentage of NNI</b> |
|----------------|-------------|--------------------------|
|                |             |                          |
| <b>FRANCE</b>  | 1870        | 16%                      |
| <b>ENGLAND</b> | 1844        | 34%                      |
| <b>BELGIUM</b> | 1875        | 42%                      |
| <b>PRUSSIA</b> | 1865        | 31%                      |
| <b>RUSSIA</b>  | 1910        | 61%                      |
| <b>USA</b>     | 1871        | 30%                      |
|                |             |                          |

**Table 2.**

**Foreign Capital Investments of the Chief Lenders  
expressed in millions of current American dollars**

| <b>COUNTRY</b> | <b>1870</b> | <b>1910</b> | <b>1914</b>   | <b>% of 1914</b> |
|----------------|-------------|-------------|---------------|------------------|
|                |             |             |               |                  |
| <b>UK</b>      | 4,900       | 12,000      | 20,000        | 44.0%            |
| <b>FRANCE</b>  | 2,500       | 5,800       | 9,050         | 19.9%            |
| <b>GERMANY</b> |             | 4,800       | 5,800         | 12.8%            |
| <b>USA</b>     | 100         | 500         | 3,500         | 7.8%             |
| <b>OTHER</b>   | 500         | 1,100       | 7,100         | 18.6%            |
|                |             |             |               |                  |
| <b>TOTAL</b>   |             |             | <b>45,450</b> | <b>100.0%</b>    |
|                |             |             |               |                  |
|                |             |             |               |                  |

**Source:** Sidney Pollard, 'Capital Exports, 1870 - 1914', *Economic History Review*, 2nd ser. 38 (November 1985).

Table 3.

**International Acceptance Banking by British  
and Continental Banks in 1900 and 1913  
in Millions of Pounds Sterling**

| <b>Name of the Bank</b>   | <b>Date Founded</b> | <b>1900:<br/>Acceptances in<br/>£ millions</b> | <b>1913:<br/>Acceptances in<br/>£ millions</b> |
|---|---------------------|--|--|
| <b>London Merchant Banks:</b><br>* German origin + Dutch origin<br>++ US origin |                     |  |  |
| Kleinwort, Sons & Co.*  | 1796                | 8.2  | 13.6   |
| J. Henry Schröder & Co.*  | 1815                | 5.9  | 11.6   |
| Baring Bros & Co. Ltd.+   | 1763                | 3.9  | 6.6  |
| Brown, Shipley & Co.++  | 1805                | n.d.   | 5.1  |
| W. Brandt's Sons & Co.*   | 1805                | 1.2  | 3.3  |
| N.M. Rothschild & Sons *  | 1798                | 1.5  | 3.2  |
| C.J. Hambro & Son*  | 1800                | 1.9  | 3.0  |
| <b>British Joint Stock Banks</b>  |                     |  |  |
| London Country & Westminster  | 1834                | 0.2  | 7.8  |
| Union of London & Smiths Bank   | 1839                | 3.1  | 5.8  |
| Parr's Bank   | 1865                | 2.4  | 5.4  |
| London Joint Stock Bank   | 1836                | 1.4  | 3.2  |
| Manchester & Liverpool District   | 1829                | 1.7  | 2.7  |
| Glyn, Mills, and Co.  | 1753                | 1.2  | 1.4  |
| <b>Continental Banks</b>  |                     |  |  |
| Dresdner Bank   | 1872                | 6.1  | 14.4   |
| Discontogesellschaft  | 1851                | 3.0  | 12.5   |
| Crédit Lyonnais   | 1863                | 0.0  | 5.7  |
| Russian Bank of Foreign Trade   | 1871                | 2.2  | 3.7  |
| Credito Italiano  | 1870                | n.d.   | 1.9  |

**Source:** Stanley Chapman, *The Rise of Merchant Banking* (London, 1984), Table 7.2, p. 121.



**Table 4: Official Rates of Rediscount in St. Petersburg, Berlin, and Paris, on 12-Month Notes, 1885 - 1912 (in percentages per annum):**

| <b>Years</b>   | <b>St. Petersburg</b> | <b>Berlin</b> | <b>Paris</b> |
|----------------|-----------------------|---------------|--------------|
| <b>1885-90</b> | 6.10                  | 3.72          | 3.00         |
| <b>1890-95</b> | 5.95                  | 3.63          | 2.63         |
| <b>1895-00</b> | 7.80                  | 3.30          | 3.00         |
| <b>1900-05</b> | 5.90                  | 3.90          | 3.00         |
| <b>1908-12</b> | 5.10                  | 4.80          | 3.20         |

**Source:**

Paul Gregory, *Before Command: An Economic History of Russia from Emancipation to the First Five Year Plan* (Princeton, 1994), pp. 74-6.