THE SOUTH SEA BUBBLE

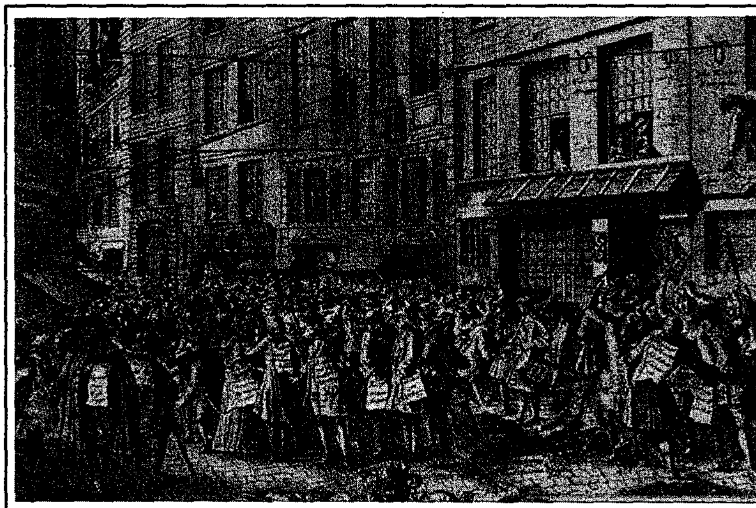
by David Domke   Part I

As mercantilist practices spread in the latter part of the 17th and the early 18th century in Britain, so did schemes to enhance credit and maximize profit. Men of trade sought - and expected - the protection of the State. All economic expansion was considered in the general national interest, and therefore something the State should be intimately involved with. Those in government were all too willing to comply - as they sought ways to consolidate administrative authority over a steadily growing and intertwining complex of military and commercial interests. Economic expansion and colonialism were almost synonymous - and so was personal gain; many government ministers lined their pockets. One such scheme, which came to be known as the "South Sea Bubble," was to have disastrous effects for many people.

> *At length Corruption, like a general Flood*
> *Did deluge all, and Avarice creeping on*
> *Spread like a low-born mist and hid the Sun.*
> *Statesmen and patriots plied alike their Stocks,*
> *Peeress and butler alike shared the Box,*
> *And mighty Dukes packed cards for half-a-crown-*
> *Britain was sunk in Lucre's sordid charms.*
>
> *- Alexander Pope*

South America was considered the choicest area for exploitation - much more so than India, which was considered less accessible and more highly civilized, and therefore more resistant to colonization. South America, with its rich natural resources, was a ripe market for African slaves (a "commodity" in which the British traded quite profitably) to work its mines. At the time, South America was for the most part a wholly owned subsidiary of the country of Spain, which had already granted slaving concessions to the Dutch and Portuguese. Britain, however, had the competitive edge - it could deliver more slaves at cheaper prices and therefore the special privileges were transferred to British slave traders.

Slavery was the key to South Sea trade. The indigenous peoples, who at the time were undergoing the process of "Christianization," had been granted protection by the Catholic Church and could not be used as slaves. What was needed was a British corporation to consolidate Britain's commerce with that part of the globe - along with the necessary military protection. In 1708 the British governor of Jamaica summed up the situation by saying "If we can find a method to prevent the French from trading with Peru and the South Seas, trade around here will soon be in a flourishing condition."



Rue Quincampoix, the "Exchange Alley" of Paris

In early 18th century Britain, the idea of competition among two or more corporations was considered unorthodox, against the best interests of both business and the State. The monopoly form of capital was considered the most natural, and the most easily subject to government oversight and control. Government and business were united on many levels. Had competition been encouraged, the State would essentially have been competing with itself.

The usual procedure was to create a joint stock company after the issuance of a patent by Parliament, which gave monopoly right to whomever held the patent. This was made law in 1624 under what was called the Monopolies Act. The East India Company, one of the earliest joint stock companies founded to take advantage of trade with British colonies in India, was created in this way. In 1660 the East India Company found its monopoly threatened and Oliver Cromwell stepped in to protect the Company - "the Company stood for England in the East as no casual, free-trading... group of merchants could."[1] To exploit the enormous benefits to be accrued from South Sea trading, Parliament decided in 1711 to pass a bill incorporating all trade with the South Sea colonies under the auspices of an entity to be called the South Sea Company.

To pave the way for the passage of the bill, the Whigs (the majority party in parliament, for whom the global expansion of British mercantile power was an urgent priority) worked in secret to make sure that no monies were allocated to service the national debt that year, which totalled 9.5 million pounds (an enormous sum in those days). A plan was then announced to form a company that would take on the entire national debt from the profits of the company's monopoly on South Sea trade. Furthermore, public shares in the company would be sold. One provision of the bill was that the 9.5 million pounds of unfunded government securities would be exchanged for an equal amount of shares in the Company. The South Sea Company was guaranteed a kick-back of £568,279, or six percent of the debt, plus management fees. This annual payment was to be funded by indirect taxation, in the form of import duties. Of course, those government ministers and members of Parliament with inside knowledge were able to reap rewards immediately, since many of them got their hands on securities before the bill was even put forward. However, despite government guarantees, the Company was slow in getting off the ground. Since the Company was founded on the assumption of debt, it needed a large influx of credit to actually get moving. The Exchequer was slow to provide the promised six percent to the corporation and the whole idea did not as yet catch on with the public at large. Stock in the company stayed below par for a long time and the Spanish government had its own tariffs and import duties to impose on British trading ships. Not until 1715 did the stock actually reach par and trading was, to say the least, far below expectations. Perhaps what was needed was more government intervention.

That is exactly what happened. By the end of 1715 both the Duke of Argyll and the Prince of Wales were elected to the governing board of the Company. The Duke was made director and the Prince became Governor. The Prince was always looking for new ways to increase his income, for the most part to decrease his dependence on his father (The first ship launched by the Company was christened

The Royal Prince). The Duke was well known for his avarice, having even gone so far as to marry below his rank for money. It was also a sign of the times that men of business and men of birth had begun to associate for their mutual advantage. And both classes sought out newly fashionable London neighborhoods in which to live.

As owning property in the rapidly expanding urban areas became more necessary and therefore more valuable, many water and textile companies expanded into insurance and real estate investment trusts. Grants of privilege were given to real estate and insurance companies for large parts of major cities (such as the York Buildings Company,) making them government-backed landholding powers. These "public works" companies were in turn insured by government-backed companies (for example the Royal Exchange Assurance company) and this system was quickly expanded into the northern coal mining regions, where both real estate and insurance interests were charted to exploit the mineral wealth of a region. The growing merchant class longed for the prestige and aura of power of nobility. Much of the nobility needed capital. Feudalism was giving way to mercantile capitalism and the predominance of finance capital, leading to a decrease in rental income. The Scottish nobility, for example, was developing a reputation for dabbling in finance of all kinds. Indeed, for all European countries with access to foreign and colonial trade, an Age of Speculation was dawning.


A founding Director of the South Sea Company

France was a country with colonial holdings similar to Britain and Spain, which were mostly in North America. Its main territory was called Louisiana, which at that time stretched from the Gulf of Mexico to the Great Lakes. It had also set up a government-sponsored joint stock company called the Mississippi Company which had been incorporated to exploit trade with its own and other nations' colonial holdings throughout the world. Around the time of the death of Louis XIV the French court and the government were near bankruptcy. To counter the downward spiral, a new system of paper money was quickly introduced. A private bank, with the backing of the government, was set up in Paris to distribute and regulate the new paper currency. To ensure the use and circulation of the new money, the government put a limit on the amount of silver that could be redeemed at the bank.

In Britain as well as France, the influx of paper currency catalyzed all sorts of financial exchanges, from capital investments to commercial transactions, leading in part to a greater Gross National Product for France. This influx also led to a great increase in speculative schemes. As knowledge and science were progressively put to practical uses, new technologies were being invested in as companies received patents and monopoly privilege for inventions such as Savey's steam pump, a burglar alarm invented by a man named Tyzack, a 'musket-proof chariot,' tin-plating and a rather dubious process designed to desalinate sea water (the English Parliament had even passed the 'Act to Make Salt Water Fresh' some years earlier in the hopes of creating incentive for the invention of such a procedure). Under the umbrella of Royal and or Parliamentary sponsorship, the entrepreneur and government minister more often than not walked into the market hand in hand.

The investment and speculative boom in France catalyzed a similar boom in England, as "the energy of the boom was now dancing to and fro across the Channel like a series of electric sparks."[2] France's Mississippi Company stock soared to 2,000 and the word millionaire was invented to account for the new class of persons with tremendous capital resources. "Everybody speaks in millions," wrote the Duchess of Orleans. "I don't understand it at all, but I see clearly that the god Mammon reigns an absolute monarch in Paris."[3]

Meanwhile in anticipation of a similar boom in England, King George himself was made Governor of the South Sea Company. This was done to symbolize the "happy union," as it was called, of government and commerce. The King was, as head of the company, compensated with £100,000 of stock. Suddenly, a lot of people were in a position to make a lot of money. Within a week of the King's being made Governor, the value of a £100 share of Company stock rose to £375; by the beginning of the following week the same stock was trading at £495. As this was going on, well-placed stories in newspapers were already telling of huge gains being made by investors. This led to a credit boom, as would be investors were being allowed to mortgage property to obtain shares. On paper, at least, the Company was looking enormously profitable. In reality, though, the Company was not actually increasing its colonial trade - and relatively little new wealth was being created. The Company Directors, however, were making a bundle. Several of them went on spending sprees, paying several thousand Pounds cash for country estates with hundreds of surrounding acres.

The expanding South Sea Bubble created and fed smaller bubbles in its wake in what was known as Exchange Alley, the newly expanding stock exchange. There were insurance schemes sprouting everywhere - a Company to Insure Seaman's wages quickly sold 2,000 shares of stock, and everything from the Sail Cloth Company to Wyersdale's Turnpike Concern were issuing stock quickly and in large quantity. Newspapers expanded, sometimes doubling in size, just to carry Exchange Alley stock quotations. A number of South Sea Company directors were also profiting from trading in the Alley. Meanwhile, the South Sea Company decided to issue more stock - it was now trading at 610 - to take advantage of the trading fever. The stock market became ecstatic and the value shot up to 870 in two days. The Royal African Company, which had monopoly privilege in the procurement of African slaves, saw its stock doubled in consequence.

All this circulating stock and money had another consequence. Land in and around London was shooting up in price. Some choice parcels increased in value by as much as 45 times in a single year. In fact, property prices and South Sea stock prices were running almost parallel and quotations for both were often given side by side in the newspapers. One speculator, who reportedly died of the sheer overexertion of making money, claimed he was dying happy: "for though I have lost my life, I have got an estate."[4] In fact, a new square was being planned for one of the newly fashionable London neighborhoods - it was to have had the fitting name of South Sea Square.

Next time: The South Sea Bubble finally bursts... but inspires arguments for free trade.

NOTES

1. Clapham, Sir John, *A Concise Economic History of England*, 1949, Cambridge University Press, pg. 267.
2. Carswell, John, *The South Sea Bubble*, 1960, Stanford University Press, pg. 91.
3. Ibid., pg. 101. 4. Ibid., pg. 159.