

THE SOUTH SEA COMPANY, 1711-1855

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TWO centuries before the Wall Street debacle of October, 1929, memory was still fresh of another panic—that of 1720—in which one company played the leading rôle. To the present day the name of the South Sea Company is linked as a result with the idea of swindle and fraud in the grand manner. A review of the financial history of this corporation may prove enlightening as concerns the novelty of the stock-market disaster of 1929, which was declared by one writer to be “an entirely new kind of panic.”

In November 1710, a Tory majority was returned to parliament, and upon the shoulders of the ministry it brought to power descended a horde of difficult financial problems. A decade of war had increased the demands made on the Government, and the Whig ministry had left a large fiscal deficit as a heritage to its successors. For this, Robert Harley, the Chancellor of the Exchequer, was forced to provide. Weighed down by the excessive taxation that is a necessary concomitant of war, England was faced with an economic crisis of unprecedented proportions.

Harley realized that the salvation of British credit and of his party depended on securing the support of the moneyed classes for whatever moves he might propose. To obtain the favor of the moneyed group, to strengthen his party at the expense of the Whigs, and to reinforce the financial structure of the nation: these were Harley's purposes, and the skill with which he secured all three at once attests his adeptness in finance.

The solution he advanced was a simple one. The whole national debt, amounting to nearly nine and a half million pounds, was to be funded, and a company formed to take it over. This corporation should receive, besides the regular interest-rates, certain rather indefinite trading privileges in the Spanish colonies.

In pursuance of an Act of Parliament of May, 1711, a charter was drawn up in September of that year, organizing the “Corporation and Company of Merchants of Great Britain (trading to the South Seas and other parts of America, and for encouraging the Fishery”). Harley was named as honorary governor, while Sir James Bateman, a London merchant, and Samuel Ongley, a linen draper of Cornhill, were named sub-governor and deputy

governor, respectively. The control of the company was kept firmly in the hands of the Tories.

The Whig-controlled Bank of England and East India Company would have liked to divide the functions of the new company between them, but despite the opposition that arose from this source, the project met with immediate acclaim. Subscription-books were opened, and £6,000,000 was soon subscribed.

In November, 1711, the company's stock was quoted at 76, and by the end of the war in 1713, this had gone up to 94½. This rise was due rather to hopes aroused by the possibilities of trade to the Spanish possessions than to a desire for sober investment in a semi-official corporation. These expectations were apparently justified by the terms of the Treaty of Utrecht, in which Great Britain was given the right to import 4800 negroes a year for thirty years into the Spanish-American colonies, and the right to send one ship a year laden with five hundred tons of manufactured goods to the great fairs at Porto Bello and Vera Cruz. These grants were embodied in the famous "Asiento" agreement.

The importance of the Asiento privileges lay more in their potentialities than in their actual realization. Voyages were made at irregular intervals from 1717 to 1733, nearly all disappointing in the profits they produced. In 1734, the company declared that its net receipts from the trade to America amounted to £32,261 for ten years, a paltry return on an investment of several million pounds.

The history of the South Sea Company, outside of this will-o'-the-wisp Asiento trade and the later Greenland whaling venture, is one of high finance—of the manoeuvring of millions of pounds to produce wealth where none had before existed. It is with this most significant phase of the corporation's story that we are chiefly concerned, for in its sometimes prosaic, sometimes romantic tale lie the factors that gave rise to the legendary illusion of the South Sea fraud.

In 1714, with the arrival of George I in England, the star of the Whig party came into the ascendant, and Harley was harried into retirement. The South Sea Company survived his political demise, however, and flourished under the new Whig ministry. The Prince of Wales became governor of the company in 1715, a position which George I himself deigned to accept two years later.

In 1719 the Whigs, under the Earl of Sunderland, were faced with the need for a reduction of the charges on the national debt, just as their rivals had been nearly a decade before. Harley's creation of 1711 was a convenient solution for this financial problem,

so the Whigs decided to use it for their purposes. The directorate of the company had become largely Whig in complexion by this time, so this was easy to do.

The South Sea Company, undoubtedly with the approval of its official patrons, offered, therefore, to buy the lottery tickets of 1710, which were irredeemable annuities paying £135,000 to 1742. For this purpose, an increase of £2,500,000 in the capital stock of the company was granted, of which about £779,000 was to cover a straight loan to the Government. On this £2,500,000 advance, the company was to receive interest at five per cent, and a charge for management of £2,000 annually, thus effecting a yearly saving to the nation of £8,000. This converted debt was to be redeemable on one year's notice, after 1723.

The holders of the lottery tickets were offered the privilege of exchanging them for an amount of South Sea capital stock equivalent to twelve and three-quarters years' returns on the annuities. The worth of this offer was, of course, dependent on the valuation which the company might place on the stock. That this obvious loop-hole escaped the notice of the Government, intentionally or not, is apparent from the events of the following year.

The generally favorable reaction of the public to this conversion of a portion of the national debt and to the governmental esteem in which the company seemed to stand enabled the South Sea managers to sell half-a-million pounds of South Sea stock at 114, making thereby a profit of about £72,800. The success thus met by this financing scheme led only too naturally to the great redemption plan of 1720. The rise in stock-prices as a result of this first venture led the company to reason, quite logically, that assumption of the remainder of the national debt would encourage further appreciation in the price of South Sea stock.

As a result, early in 1720, the South Sea Company offered to assume all the standing debts of the state, amounting to about £31,000,000, by increasing its capital by that amount. Interest would be paid at five per cent until 1727, and thereafter at four per cent. For this privilege the company would pay £3,500,000, a fair price, into the Exchequer. As in the 1719 plan, the company's stock was to be given in exchange for various issues of irredeemable annuities and of redeemable debts; but the price at which the stock would be valued was once more not stated, a point of extraordinary significance.

The Bank of England, that bulwark of English finance, saw a dangerous rival in this upstart, so that institution rashly raised the premium to £5,000,000 for the same privilege, an offer which

the return would not justify. The South Sea General Court then instructed its directors to obtain the preference at any cost, and retaliated with an offer of £7,567,000, which was finally accepted, in April, 1720.

It is easy now, of course, to analyze the fallacy of this ridiculous offer. The privilege for which the South Sea Company paid over seven million pounds was worth much less than that sum, so the expected profit must have had some other source. The exclusive trade privilege could not have been valued by the most sanguine at more than £200,000 annually; the Government allowance for management was a relatively small amount; and the difference of one per cent over the usual market-rate for money would not make up the remainder of the necessary compensation. The only other source of income obviously lay in a further rise in the price of stock, which had been encouraged by the events of 1719. The people were in a speculative mood, so the company had no other recourse than to force the price up. The offer was utterly impracticable and dangerous to the state, and as one author puts it, "Upon these grounds the ministers of 1720 are chargeable with the ruin and the wretchedness shortly to be related." To the ministry, to the Bank of England, and to a gullible public belongs at least the stigma of abetting the action of the South Sea directors and approving their scheme. The latter did not swindle the public, for the whole offer was spread before them in parliament; it simply profited by the avarice and ignorance of those who could have refused the proffered South Sea stock and who failed to appreciate the opportunity for stock manipulation thus put in the company's hands.

The stock rose rapidly from 126 at Christmas, 1719, to above 500 shortly after the redemption terms were made public. The annuities were to be redeemed by stock priced at £375, a rate at which the bargain would be profitable to the company. There was no compulsion exerted on the debt-holders, but the rise of the price to a point well above that offered for redemption brought about the conversion of over two-thirds of the debt.

Skilful manipulation raised the price of stock to 1,000 soon after midsummer, 1720. Tenseness shortly became apparent on the market, however, and the "Bubble" soon burst with a vengeance. The causes of the sudden decline in prices and of the loss of public confidence need not detain us here.

Suffice it is to note that by the end of September, South Sea stock was being offered at £175, with no buyers. Despite frantic declarations of fifty per cent dividends, the slump continued, and

the speculative stock-market panic of 1720 ran its gamut. Vast fortunes had been made, and many small speculators had lost their entire possessions. The burden of the ultimate loss fell, however, on the unfortunate former holders of the converted annuities, whose greed had aided in giving rise to the frenzied market of the summer of 1720.

A parliamentary secret committee of enquiry was appointed to ascertain the true state of affairs. Under the influence of a public anxious for revenge, the estates of the officers and directors were confiscated, only a small sum being left them as allowances. London rejoiced over the sentencing of the directors, and the speculation-mad public felt reimbursed in some degree for its losses. As one wag put it.

Fools lost when directors won,
But now the poor directors lose;
And where the South Sea stock will run,
Old Nick, the first projector, knows.

It is important to observe where the South Sea stock did run, for after 1720 comes a period when the history of the company is particularly illuminating. Instead of dropping out of existence, as might have been expected, the company continued as a corporate body for a century and a quarter. Vilified and condemned as a deliberate fraud, it reorganized its financial chaos. Had there not been a firm basis on which to build, it is doubtful whether the company could have long survived.

In 1722 the Bank of England, in order to aid in reducing the South Sea capitalization, bought £4,000,000 of its stock. The Bank sold enough of this block of securities at 118 to be able to ingraft £610,169 of the South Sea stock into its own. The fact that purchasers for the former could be found at such a price only two years after the crash shows a decided rise in public confidence. In 1723 the capital structure of the company was completely re-vamped, and the basis laid for the conservative institution it was to become. The capital of the company, amounting to nearly £34,000,000, was divided equally into a joint-stock, to be called South Sea annuities, and a capital trading stock. The former was a bond-issue, bearing interest at five per cent to 1727, and four per cent thereafter. In the period from 1727 to 1736, the Government paid off some £4,500,000 on their obligations, redeeming that amount of the company's holdings. In 1733, because of losses on trading ventures, the capital-stock of over £14,000,000 was again divided, this time into one-quarter capital trading stock, and three-

quarters new annuity stock paying four per cent. Thus came into being the three issues whose names were to grade "Bankers' Prices Current" in British periodicals for over a century—the South Sea stock, the "Old South Sea annuities," and the "New South Sea annuities."

Misfortune dogged the progress of the company's last feeble trading undertaking, for in the eight years it sent ships to the Greenland whale fishery, from 1724 to 1732, a net loss of £177,782 was recorded on its books. This proved to the company that its salvation lay in 'Change Alley, and not in Greenland seas or on the Spanish Main.

In 1750, by the Treaty of Madrid, the King of Spain paid to Great Britain £100,000, which was turned over to the South Sea Company in return for the relinquishment of its Asiento privileges. Although seldom put into practical use, the company's rights to trade with New Spain and Panama had been an anomaly of which Spain felt well rid.

One writer dismisses the company with the statement that "it then ceased to be a trading body, and eventually its remaining stock was converted into annuity stock." The remaining century of its corporate existence holds some interesting side-lights, however, on the true nature of the South Sea Company, and one cannot close with a mere dismissal here.

Evidence of the favour which the company obtained at the hands of the Government is contained in the fact that the four Georges served as governors continuously from 1717 to 1830. Not until William IV came to the throne did an Act fail to be passed in the first year of the reign of each succeeding monarch, giving him the right graciously to accept election to this honorary post. The royal patronage lent an atmosphere of gentility to the stock, and, as an integral part of the national debt, it came to be considered the sort of security to be found quite appropriately among the holdings of sedate public institutions.

The last vestige of the trading rights of the company were taken from it in 1807. Probably as a result of the capture of the Guianas, in 1803, and of Buenos Aires, in 1806, the exclusive trading privilege in any British possession in South America was withdrawn. The *beau geste* of Sir Home Popham and General Beresford in seizing Buenos Aires thus probably led, indirectly at least, to the repeal of the last provisions of the Act passed under Harley's guidance. In 1815 the South Sea Company was reimbursed for giving up these privileges of questionable value, provision being made for a grant of £610,000 of three per cent Consols, which it finally received

in 1844. This enabled the company to continue to pay an extra one-half per cent over the three per cent received from the Government on capital stock and annuities, since the reduction to that rate in 1757. It is pleasant to think that when Sir Home Popham sailed boldly up the estuary of La Plata and stormed the viceregal capital, he started a train of events that ended finally in many a conservative British investor receiving an extra ten shillings a year on every £100 of South Sea securities he held.

So the company led a placid existence, acting as a clearing-house through which the payments of the Government were passed on to its stock-holders. Charles Lamb, who served in the South Sea House from 1789 to 1792, has left an interesting picture of the later activities of the company. Writing in 1821, he recalls the "directors seated in form on solemn days to proclaim a dead dividend;" "here," he says, "some forms of business are still kept up, though the soul be long since fled." The company had passed from its youth, nourished in the wild frenzy of speculation, to a respected old age, preserved in the venerable aura of investment.

The end was presaged when, on April 8, 1853, Gladstone rose in the House of Commons to move a conversion of the national debt to secure a reduction of the interest rate. Almost lost in the £500,000,000 debt were the South Sea stocks, which had shrunk, through redemption and otherwise, to £9,500,000. Referred to as "almost patriarchal stocks," the South Sea Securities were to be converted into Exchequer bonds or bills at a rate slightly less than three per cent, or redeemed in cash at par. By the Act passed May 9, 1853, interest on the capital stock and annuities was to cease after the first payment of 1854.

Despite the first tendency of the holders of South Sea Securities to complain about the nature of Gladstone's scheme, by January, 1855, the General Court had accepted these provisions, and was ready to announce that a division of the company's assets would be made in July of that year. Extensive holdings of securities, the company's buildings and rents, and loans outstanding raised its assets to well over £4,000,000. The surplus was estimated at two and a half million pounds, which when divided would amount to £119 3s., on every £100 of stock.

On May 4, 1855, the last recorded transaction in South Sea stock on the Exchange took place, the price being 115½, around which point it had hovered for the last two years of its existence. Thus if an investor had bought a £100 share of South Sea stock in 1719 or in 1722, and his heirs kept it until 1855, not only would a regular dividend have been received of at least 3½ per cent, but the share

could have been sold at practically the purchase-price; the return would have been increased, furthermore, by various stock dividends declared in the eighteenth century.

So, in July, 1855, the "Corporation and Company of Merchants of Great Britain (trading to the South Seas)" passed out of existence, a hundred and forty-four years after its inception. As Gladstone said, in 1853, "I believe there is no sort of claim to be brought against the highly respectable South Sea Company—which has effectually purged itself from the stain connected with its early history." Thus ended a trading company whose chief interest, unlike its African, Levantine, and East Indian predecessors, had been not commerce, but stock-jobbing.

In surveying the story of the South Sea Company, one can hardly avoid dwelling on the responsibility for the "South Sea Bubble" of 1720. It is my opinion that that questionable honour may be divided among the Whig ministry under the Earl of Sunderland, the Bank of England, the general public, and the director of the Company itself. The fallacy underlying the proposal for the purchase of the national debt was open to all to see, but was disregarded. Undoubtedly the directors realized where it lay, but they gave the British nation a sporting chance to apprehend the impossibility of the proposed bargain. Stock manipulation was the only solution, and the public joined in that with avid readiness. The Bank and the ministry must be judged as colleagues in the company's artifice, in forcing and accepting the offer.

"Speculative epochs may again occur; the events of the past may re-appear in the future," remarks an author writing in 1862. Playing the stock-market was as attractive in 1720 as in 1928 and 1929. "Speculative stock-market panics" are nothing new to financial history, modern writers to the contrary, and find their deepest roots in that openly condemned, but secretly admired, trait in man's nature—the unquenchable willingness to gamble for high stakes.