Financialization in Historic Contexts: The South Sea Company, 1711

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Abstract:
The concept of financialization has seen increased usage in recent years as a way for scholars to understand the increasingly dominant role of financial products and practices in the modern capitalist world system. Costas Lapavitsas, for example, has proposed three symptoms for modern financialization: non-financial organizations performing more finance-related tasks and operations to boost profits; the increasing use by banks of exotic financial products in funding arrangements; the growing adoption by households of complex financial arrangements and debt. Financialization has grown to be a useful device for studying financial crises in particular. There is an obvious connection between the excessive or unhealthy use of financial mechanisms and narratives and the appearance of financial bubbles, which invariably burst. The concept of financialization is closely connected to business history: it is corporations which issue exotic securities and engage in baroque financial operations, usually when their core profits grow weak.

Despite a growing literature in the fields of political economy, sociology and political science on the topic of financialization, there has yet to be a formal establishment of the temporal boundaries of financialization. When did it begin? At what point does it make sense to refer to a certain historical process or event as having been “financialized”? Already in 1894 when Friedrich Engels collected Marx’s notes to assemble Capital, Volume III there was a deep suspicion of “fictitious capital,” meaning strange and exotic financial instruments and securities. This paper will investigate the history of the South Sea Company (founded in 1711) as an example of early financialization. The South Sea company issued stock which became the focus of intense speculation. Through a case study of the South Sea Company I will provide a definition of financialization that is applicable to historic contexts. It will be proposed that there are four characteristics of historic financialization: uninformed speculation; new forms of financial communication; new types of complex financial devices, and the infusion of financial narratives and maxims into economic life.
The Eighteenth-century Context

On 16 October 1776, Lawrence Hallahan, a fisherman, was indicted by naval court in the town of St. John’s, at the Newfoundland fishery, and sentenced to death for falsifying bills of exchange, a standard type of credit instrument used by merchants and traders in the eighteenth century. Hallahan was Irish, which didn’t help his case in the British Atlantic world to begin with. In fact, there were very few crimes in the eighteenth century that could lead to the ultimate penalty and even capital crimes were often commuted in the king’s name. But falsifying credit notes or bills of exchange, the connective tissue of imperial commerce, was unforgivable. The total value that Hallahan was thought to have passed off as genuine was about fifteen pounds sterling. Newfoundland did not have a formal legal system, but rather a jury-rigged legal code that combined local custom with naval justice. Even so, it was clear to elites in the mercantile world of the day that degrading the financial system through the falsification of credit documents would be catastrophic if allowed to spread, so cases of this type were dealt with quickly and severely.

Hallahan’s unhappy demise is an indicator of how financial processes and financial instruments had grown to a state of prime importance in early-modern economic arrangements. This was necessarily so: the burgeoning world market depended upon an edifice of credit, trust, and exploitation in order to proceed smoothly. By the eighteenth century, the mercantile architecture of the European world had evolved considerably from earlier, medieval systems of trade, with their itinerant merchants and idiosyncratic transactions, to a system approaching the more formalized mechanisms of exchange that would be familiar to modern observers. Robust, fungible instruments of exchange, necessary for the transmission of monetary values over long, trans-Atlantic distances, were almost completely standardized. A language of finance had begun to see common usage. Financial metrics, expressions of profit and loss, measurements of risk, and related geometries of oppression saw considerable growth. Financial instruments became commoditized. The Financial Revolution of the late seventeenth century had been part and parcel of the wider 1688 Glorious Revolution which definitively completed England’s turn to a mechanical and technocratic approach to commerce and trade. (Dickson, 1967). The extent to which the growth of European commerce rested upon a massive structure of accounting documents and financial paper is for the most part underappreciated by business historians.

Merchants of the era were in fact refracting into the world of commerce the wider seismic changes happening in the western world. They excelled at innovating mechanisms to facilitate the spread of little commercial empires. In particular, the introduction of formal accounting practices, in addition to an overarching “calculative mentality” allowed for this trend toward in situ merchants directing complex operations from central offices and counting houses (Bryer, 2000a; Bryer, 2000b; Chiapello, 2007). Accounting documents and practices played important philosophical and practical roles in the development of a capitalist mentality oriented toward the calculation of profits from business ventures and then the redeployment of resources back into priority areas. These developments became possible with the introduction of ledgers which recorded extensive business information, particularly costs and revenues (Toms, 2010). Early modern merchants counted, monitored and calculated values in a way that feudal merchants had not. The quantitative awakening was not confined to merchants and trading. French Annales historian Pierre Chaunu and others have reflected on how European civilization in the late medieval period went through a process whereby measurement and calculation, formerly foreign to the majority of the population, became an imperative (Chaunu, 1966). The “mathematization of the world” saw advances in science, commerce and even music (Wallerstein, 1980; Crosby, 1997).

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¹ Provincial Archives of Newfoundland and Labrador, Colonial Secretary’s Office, Outgoing Correspondence, GN/2/1/a volume 6, p. 191.
The particular process whereby the employment of financial instruments, processes, metrics, and narratives grew in importance in the early modern period might be termed financialization. The term is a modern one and emerges from critical, even radical traditions within modern scholarship. Financialization has gained currency among sociologists, political economists, and political scientists as an analytical frame for enquiring into the ways that finance and financial markets impact society. The term has come into common usage as a result of the global financial crisis that began in 2008 and is, as yet, still being felt (Sorkin, 2018). The rhetorical strategies common to financialization scholars are for the most part based in a critical approach, and share a philosophical architecture with academic movements that are critical of globalization and, in particular, neoliberalism.

An admirably workable definition of financialization is provided by Manuel Aalbers. For Aalbers financialization is “the increasing dominance of financial actors, markets, practices, measurements and narratives, at various scales, resulting in a structural transformation of economies, firms (including financial institutions), states and households” (Aalbers, 2015; see also Lagoarde-Segot, 2017). Costas Lapavitsas is one of the major voices in the study of financialization. His 2013 book Profiting Without Producing: How Finance Exploits Us All takes an uncompromising stance toward the processes whereby finance has come to dominate modern life. Lapavitsas, an economist and political activist, sees financialization as having three principal manifestations in the modern capitalist economy. Firstly, under financialized capitalism, many corporations have moved to generate more earnings from financial operations and accounting games rather than through their core, productive operations. Firms have found that profits can be pumped up by various forms of financial gamesmanship and creative accounting (Sikka, 2009). The cornerstone of neoliberal corporate finance is the credo that the firm exists solely to increase the wealth of its shareholders, an overtly strange notion flippantly floated by economist Milton Friedman in an opinion article in the New York Times Magazine in 1970. He famously wrote that, under capitalism, “…there are no values, no ‘social’ responsibilities…” (Friedman, 1970). Lapavitsas’ second proposed marker of financialization is that under financialized capitalism, banks have transformed themselves from promoters of business activity through the mediation of risk and the provision of a small number of essential services such as mortgage lending, the taking of deposits, the provision of foreign exchange services and the extension of loans and other services to corporations to a system where banks are the originators of exotic securities and trading mechanisms. Finally, Lapavitsas observes that households have become increasingly, and dangerously, financialized in recent decades. Under the prevailing neoliberal model of economic exploitation individuals, families and retirees are compelled to take on more responsibility for those aspects of life that used to be the responsibility of the state. Education, health care, pensions, transportation, and the care of seniors are some of the areas of life that people are now required to pay for, in full, themselves.

Financialization in History

A hermeneutics of financialization would involve an interrogation of the concept and the extent of its impact on critical discourses on capitalism. Financialization, as a preferred analytical frame for describing late-stage capitalism, seems to have superseded globalization in critical discourses. Scholars across a range of disciplines have used financialization as an anchor to critique or analyze recent financial crises and the so-called “age of entropy” that the global economy finds itself in (Streeck, 2017). Sociologists, economists and political economists, and even geographers have come to see financialization as a fruitful line of enquiry (Block, 2016; Fine, Aalbers, 2015). Even accounting and finance professors have jumped into the pool (Modell and Yang, 2018; Lagoarde-Segot, 2015, 2017; Lagoarde-Segot and Paranque, 2018). Missing from this parade of academics are historians. Though historians as a group are notable for framing historical questions in terms of exploitation and marginalized populations, the specific use of the term financialization,
and the exploration of specific historical events in terms of the mechanics of financial markets and the narratives of financial market players has not found its way into historical writing. A potential fruitful question therefore arises: in historical terms, is financialization, as a concept and as a term, a useful epistemological tool for investigating the early development financial markets, securities and financial discourses? To what degree does it benefit business historians to specifically frame certain economic events in history as having been being financialized, or part of wider transformation in business practices that related to financial metrics and ways of thinking about commerce?

Merchants were the primary initiators of the various processes of financialization, long before the joint stock company took hold as a source of securities issuance in the second half of the 1600s. The different flavours of merchant might be roughly characterized as the technocrat, the price taker and the speculator. Technocrats were good at their work but saw no need to innovate; for them, accounting ledgers were a welcome way to record the comings and goings of men and goods, and credit was but a simple way to quantify the trustworthiness of a man, woman or family. Price-takers were the merchants, petty traders really, who performed a simple role as suppliers of goods and commodities, sometimes in barter, sometimes on credit, and sometimes for cash. They did not use their networked position to access the burgeoning markets for tradable credit instruments. Speculators, finally, saw that in the movement of the little slips of paper that recorded debt or other obligations a secondary or derivative means of making profits. This was not only a major development in the history of accountancy but was a big jump in human history: financial instruments could be divorced from the original purely commercial context in which they were issued and exchanged between people who were interested only in their notional value. The Rothschilds were only one of a large group of European visionaries who saw the value in this kind of jobbing (Ferguson, 1998). The trading of financial instruments was, by the time Engels assembled the notes of long-dead Marx to cobble together Capital Volume III, of apparent concern to Marx who was suspicious of these paper-borne curiosities as mere “titles” to value, rather than carriers of genuine wealth as shares of joint stock companies (Marx, 1894; Hilferding, 1981 rev. ed.)

The “Calculative Mentality” and Primitive Financialization

The discovery of new (to Europeans) lands across the Atlantic had triggered a frantic scramble for the wealth of the Americas, and merchants in their many forms were the prime movers in this process of change. They excelled at innovating mechanisms and processes to generate profits for themselves, even at a time where the measurement of profit was an imprecise gambit. The processes outlined here were complex and occurred at varying rates in different parts of Europe and the Atlantic World. In general, though, transportation networks, themselves expanding as a result of both military conquest and improvements in navigation and sailing technologies, facilitated the spread of both commodities and money for money’s sake (Wolf, 1982; Harland, 1984). Money which generated more money by its mere passage from hand to hand was a key advance in the development of capitalism, and is the first true sign of financialization.

Financialization is not to be conflated with the earlier stage phenomenon of monetization. In the historical context being discussed here, monetization is the introduction of currency (historically, coinage) systems and their diffusion into economic society. Kaye (1988) has pointed out how the Black Death in the middle years of the fourteenth century shocked the population of Europe into seeking more certainty in the measurability and portability, however limited, of wealth. This provided the impetus to the development of mobile wealth, specifically in the form of money and coinage. Money at this stage was merely the notional system for measuring the amount of debt outstanding. Financialization on the other hand emerges later, with a broader program of creatively manipulating economic values and projecting them through time and space. Financialization appeared as a sophisticated mentalité, a way of generating wealth away from the commercial or
productive process: money begetting money in the sphere of circulation as opposed to the sphere of production.

To borrow from Marx, it is possible to propose that there was a form of “primitive financialization” that occurred in the late seventeenth century in Europe, instigated in no small way by the Financial Revolution in England. Dickson (1967) outlined how the securitization of English government war debt and the culture of financial trading and jobbing that took root in London’s already-fertile commercial culture launched a period of frenzied financial experimentation. English lotteries, for example, were a favoured method of raising funds during the seventeenth century, and this evolved into a wider acceptance of finance and investing as being bound up with the concept of chance and speculation (Murphy, 2009). At this early stage, financialization was not characterized by the notion of excess profits looking for a home and subsequently turning to financial markets seeking higher returns. That dynamic is more of a nineteenth-century phenomenon and is the origins of Marx’s concerns with fictitious capital. During primitive financialization, securities are the target of speculation alone. All the same, the availability of excess wealth in amounts that could support market speculation was a marker of social difference. Primitive finance reified socio-economic class. One of the side effects of the Commonwealth, ultimately bolstered by the Glorious Revolution, was an increased culture of investment and respectable wealth-seeking by strivers outside of the gentry. The growth of the prosperous rural English yeomanry, for example, is an example of how Protestant notions of private diligence and public accomplishment swept through English society (Campbell, 1942). Regular people felt that wealth and prosperity could come from market activity and was not the sole preserve of the privileged classes. International trade in the early modern period certainly added to the culture of wealth-seeking, and imperialism provided an underlying bulwark of commodities and confidence to those who sought to live well in a material sense. Lapavitsas (2013) proposes that financialization in the modern era is a way to project power and achieve dominance. This element of finance as being a component of economic relations can be efficacious in assessing financialization during its primitive stage as well. Though investors and speculators benefited from British imperial protections, financial structures in the primitive stage were not in themselves a central part of the imperial project. Even so, the social relations that are exposed by finance and financial trading do support Lapavitsas’ contention that financialization acts as a social solvent and exposes class differences. Paul (2011) points out that the stock market in early modern England was democratic in a way that elites did not like. Jews, women, Roman Catholics… those without title or fame could, and did, gain wealth rapidly in the new world of finance (Shepard, 2015; Laurence, 2006). They also lost it.

The South Sea Bubble and Financialization

Following from this discussion of primitive financialization this paper will analyze the South Sea Bubble of 1720 as an instance of eighteenth-century financialization. It is proposed that there are four specific markers of financialization in historic contexts: uninformed speculation; new forms of financial communication; new types of exotic financial instruments, and the infusion of financial narratives and maxims into economic life. The details of the South Sea Episode have been extensively covered in numerous other publications over the years. In fact, the South Sea Bubble is one of the most extensively researched events of the eighteenth century. This paper will provide only a brief summary of the technical aspects of the crisis. In 1711, the South Sea Company (SSC) was founded on the back of the Sword Blade Company, a joint stock company formed in 1691 to produce swords for the English military. The directors of the firm were financial entrepreneurs and sought to operate the Sword Blade Company as a bank. Though the Sword Blade eventually failed, it became a stepping stone for several key personalities who eventually appeared as boosters of the SSC (Carswell, 1960). Founded in 1711, the SSC was initially structured as a vehicle for trading with colonies in the southern Atlantic for commodities and slaves. The firm had been granted the
monopoly on Spanish slave trading as part of the settlements in the Treaty of Utrecht in 1713. In return for the benefits of the potentially lucrative trade, the SSC was tasked with helping the English government reduce their massive and growing debts. Simply put, the SSC took on the debt of the government and issued shares by subscription to cover the large obligations they had assumed. Investors who held fixed income debt of the government were genuinely happy to swap these bonds into the equity of the SSC, which seemed to be more of a substantial prospect and had, after all, an apparently genuine trading business behind its payouts (Walsh, 2014). During 1720, the shares of the SSC rapidly increased in value amidst a speculative frenzy that has become legendary for the speed of the rise as well as the nauseating magnitude of the losses once the bubble burst. Can these events be viewed as an episode of early financialization, a precursor to the present era of financialized capitalism?

Uninformed Speculation. By the time the South Sea Company announced that it would be taking subscriptions for shares, the population of England had had at least three decades of exposure to various securities-based schemes for reducing the government’s extensive war debt. In recent times, the public had had the opportunity to invest in ostensibly safe government debt through various mechanisms, including bonds, annuities and lotteries (Walsh, 2014). Wagering and gambling were very common in English society, socially acceptable and widely practiced (Paul, 2011). There was a dark side, however, to this otherwise innocent activity. In a society with few social safety nets, a bad run at dice or the horses could drive a person into penury. The SSC, at first apparently appealed to this openness in the population to gambling, but in the case of the SSC it would be more respectable and, in a sense, patriotic. Hoppit (2002) outlines how many of the investors in the South Sea scheme were people who would not normally be involved in this relatively sophisticated form of investing and almost certainly did not understand the risk of the paper they were acquiring. Nonetheless, the securities of the SSC appealed to a desire in the population for rapid gains in wealth, an ethos that had emerged after the Glorious Revolution in London and other large metropolitan centres.

Murphy has pointed out how government lotteries were a particularly attractive form of speculation in the 1690s (Murphy, 2009). This may have sparked off an interest in gambling on the part of the population, and appealed to a pre-existing English interest in games of chance. Lotteries established in people’s minds the link between gambling and investment, since elaborate schemes like the William Adventure lottery in 1694 were exciting, very lucrative for winners, and were structured to raise substantial funds for the relief of government debt. Murphy states that the “aims and actions” of lottery players and joint stock investors were the same. For their part, joint stock investors were liberated in the 1690s from having to show up in person at the offices of the companies in which they hoped to buy stock, and were able to use “letters of attorney” to designate others as their financial representatives (Laurence, 2006). This was a very key innovation as it allowed for the spread of market activity and related patterns of financial thinking.

New Forms of Financial Communication. Carswell (1960) commenced his magisterial work on the South Sea Bubble with a rich description of the city of London in the early modern period. It becomes clear from his study that the ascendance of London, at the expense of Amsterdam, provide a lush commercial culture that contributed greatly to the eventual frenzy of the South Sea Bubble (Carswell, 1960; Carlos and Neal, 2011). There were numerous new forms of communication, or old forms of communication that were redirected for the new purposes of financial boosterism. Coffee houses, for example, were a popular new venue for socialization and many were conveniently located near Exchange Alley, itself a new site of communication (Carswell, 1960; Dickson, 1967; Murphy, 2009). Newspapers were another new mode of communication. Printing technologies had considerably advanced by the early eighteenth century and daily editions of broadsheet papers were readily available in London’s financial district. The boosters of the SSC learned quickly that the press could be used to push the share price ever higher (Carswell, 1960).
Pamphlets were a final medium for pushing joint stock schemes and drawing in punters, and hundreds of them were produced.

_Exotic Financial Instruments._ For the majority of the booming commercial society of London in the early decades of the eighteenth century, the new types of financial devices that appeared with the SSC were within their reach for the first time in volumes that allowed for easy access (Hoppit, 2002). Shea (2007) points out that the subscription shares of the SSC were in fact a form of derivative security and can even be theoretically priced using options mathematics. Markets for standardized options had existed in London since at least the 1690s (Murphy, 2009). By the time of the Bubble, it was natural for stock-jobbers (both formal and informal brokers) to concoct securities whose price depended on the movements of an underlying, more respectable stock: primitive derivatives. Options made it possible for trusted customers to get access to shares with only a small initial outlay of cash. Of course, commissions were charged for all these activities and these new types of markets were even more difficult to regulate than the mainstream shares market.

_Financial Narratives and Maxims._ Much has been written about how Protestant insistence upon the connection between wealth and salvation developed after the Reformation and infused English society. Though the idea that the Dutch brought with them an extensive new set of administrative and economic strategies as part of the Glorious Revolution has been discredited, there has been a recognition that the Bubble was accompanied by a new, public culture of wealth and comfort (Murphy, 2009). Hoppit (2001) makes it clear that there was a patriotic element to investing in the SSC...after all, the governor of the firm was the king. Numerous pro-finance and pro-speculation pamphlets were produced in the years between 1690 and 1720, and the Bubble itself became the topic of voluminous commentary, not all of it positive, during 1720 (Murphy, 2009). Indeed, there was plenty of criticism of the new financial frenzy that seemingly exploded in the last years of the seventeenth century and the first years of the eighteenth. Much of the negative commentary came from the same moralist Protestant suspicions over “usury,” profits gained from frivolous speculation. There is a paradox between the Protestant rejection in the Glorious Revolution of Catholic social and economic fluffery, corruption, and ornamentation on the one hand, and the strange frenzied way in which the elites of London blindly pursued the shares of the SSC and other joint stock schemes in the period under consideration. If the reformation and its eventual Calvinist and then Puritan imperatives were about instilling a Protestant ethic of dignity, diligence and reserve in the populace then it seems strange that by 1690 a new ethos of wealth and speculation gripped London. The answer, it is proposed, lies in the classes of people who accessed the Bubble and other investment schemes and lotteries, as well as in the particularity of London as a densely populated commercial space.

**Conclusion**

In conclusion I borrow from Eric Wolf in his discussion of Marx’s use of the concept of modes of production, of which capitalism is merely the latest and by no means the most exploitative. Wolf noted that the utility of modes of production has less to with classifying different periods of human economic history than in highlighting the “strategic relationships involved in the deployment of social labour” (Wolf, 1982). The same can be said for financialization. The point in tagg a given period of capitalist development as having been financialized, or further, in seeking to propose that there were temporal boundaries to the financial impulse, lies in the utility of financialization as a way of illuminating strategic relationships between the various parties to early modern commerce and trade. The South Sea Bubble was a seminal, early instance of financialization, and by recognizing it as such, historians can begin to uncover the human relations in early capitalism that gave some people access to wealth and the prestige that came from being a market participant. Financialization as a concept focuses the mind of the researcher on relationships of power in capitalist contexts. Where the aristocracy had their wealth based in the land, shares and
derivatives, however crude, offered an opportunity for shopkeepers, poets and entertainers to strive for wealth, albeit in an environment of risk. Securities markets were the “new thing” in 1720 and much of the resultant purchasing, and ultimately selling, was conducted in a spirit of speculation and hoped-for windfall, just as it had been with lotteries a few years earlier. Even more than in the present day, speculation was uninformed. Where finance in 2018 is an “integral part of [the] sustaining accumulation” of capitalism, two hundred years ago finance was as yet a new development that gained a hold on a public that was entirely unclear as to what the stakes truly were. New types of tradable financial curiosities that offered the same excitement and addictive satisfaction as lotteries had begun to appear through surprisingly alluring pathways. In fact, the obscure and ornamented nature of options and non-redeemable notes likely affirmed their respectability in the eyes of an investing public. Finally, even at a time when England had decisively divorced itself from European Catholic excess, investment schemes offered an opportunity for subaltern and marginalized social groups to access wealth. Though many simply ended up as fodder for stock jobbers and scheme boosters, the wider lesson is one of access, and democracy.

In a somewhat paradoxical sense, the South Sea Bubble was an eminently democratic episode. Hoppit makes it clear that though the buyers of the various securities that were issued during and due to the Bubble were not drawn equally from all classes of society, there was a revolutionary tone to the scheme whereby people from all parts of society could jump into the trade. This was, of course, concerning to elites, who would have preferred that women and Jews stay in their place. In a sense, then, the South Sea Bubble legitimized early modern finance and financial markets as a space for subaltern peoples to access wealth and, to a limited degree, power. It is important to remember that the Bubble was just one of about two hundred joint stock schemes launched in 1719 and 1720. This was a new world where “barrow boys” from East London could, and did, use their considerable powers of calculation and speech to elbow their way into what had formerly been the sole preserve of lawyers, politicians and the gentry: finance.

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References


Dwyer, Financialization


