Economic History Review Virtual Issue:

Tricentenary of the South Sea Bubble

Introduction

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1720 fully deserves its reputation as a watershed moment in financial history: it was the year in which ongoing sovereign debt crises in France and Britain reached a spectacular resolution. But whereas the implosion of John Law's Mississippi scheme in France led to the reinstatement of pre-1720 levels of public debt, Britain emerged having substantially reduced its debt burden without significantly increasing future borrowing costs (Quinn and Turner, 2020). The mechanism by which it did so was the South Sea Bubble: a scheme in which holders of government debt traded that debt for shares in the South Sea Company. This scheme was then accompanied by an unprecedented stock market boom. In addition to its significance for Britain's fiscal development, the South Sea Bubble has provided scholars with valuable evidence on the nature and development of early investment and the (ir)rationality of investors – much of which has been published in the *Economic History Review* and is part of this Virtual Issue.

There are three broad themes covered in this Virtual Issue:

1. *How did the South Sea scheme operate, and what was its effect on Britain's financial and political development?* Kleer (2015) questions the consensus that the boom in the price of South Sea shares was driven by the self-interest of the South Sea Company's directors, showing that said directors gained very little from the boom and experienced substantial losses as a result of being scapegoated for the subsequent crash. Hoppit (1986) shows that, contrary to previous claims, the collapse of the scheme was not accompanied by a major depression or financial crisis. Harris (1997) examines the legacy and eventual repeal of the Bubble Act of 1720, a regulatory consequence of the Bubble that affected Britain's corporate development for over a century.

2. *Who invested during the Bubble?* Carlos and Neal (2006), studying the identity of Bank of England shareholders between 1720 and 1725, argue that the diverse and wealthy investor base of 1720 provided the British financial system with sufficient resilience to weather the bursting of the South Sea Bubble. This paper also shows that a significant proportion of Bank of England investors were women, and women typically gained money during the Bubble while men lost money. Carlos and Neal (2015) show that investors in this era were not typically well-diversified, with 80 per cent owning stocks in only one company. The paper then argues that the most likely reason for this was that company-specific voting rules required a high level of share ownership, and investors preferred to hold shares in quantities that provided them with greater power.

3. *Does the Bubble provide evidence of irrational investor behaviour?* Dale et al. (2005) argue that inconsistencies between the prices of South Sea shares and the prices of tradeable South Sea subscription contracts prove that the episode must have contained some irrational pricing. Shea (2007) disputes this conclusion, arguing that since the subscription contracts allowed the holder to default on future capital calls, they were more akin to options than they were to shares, and thus would not be priced identically in a rational market. Dale et al. (2007) respond by arguing that the legal language used in subscription contracts gave the company

the right to coerce future calls. Although this right was later not exercised, it is argued that it is nevertheless inaccurate to characterise the contracts as having built-in options.

References

Quinn, W. and Turner, J. D. *Boom and Bust: A Global History of Financial Bubbles*, Cambridge: Cambridge University Press, 2020.