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INTRODUCTION

If we dig deep into the history of the philosophy and the true principles of credit, we see that John Law understood the monetary question better than any other man of his time. Rather than limiting ourselves to highlighting his excesses, let us begin by challenging the stereotypes.

Though back then he was only ever talked about as a gambler¹, most of what we hear about him is in fact not completely true.

This does not mean that Mississippi mania was not a crisis. That is, if we understand a financial crisis² to be the sudden and unexpected deterioration of short-term interest rates, transferable securities, commercial insolvencies and all the other monetary and credit indicators. However, perhaps it was not just a financial crisis but also a social and cultural one.

Indeed, a multitude of small traders, farmers, shoe-polishers and butchers, attracted by rumours of increasing share prices, flocked to the Paris market; they were everyday people³ who suddenly caused a rise

¹ J. SAVARY, *Le parfait négociant: ou Instruction générale pour ce qui regarde le commerce des marchandises de France, & des pays étrangers*, Paris 1721, to. I, Part. II, p. 254; J. DUSAULX, *De la Passion du Jeu*, Paris 1779, Part I, pp. 81-83. The representation of John Law as a cheat and a gambler is limiting. This is only the surface of a much more complex character. It is true that Law gambled from time to time, like all gentlemen of his time. His preposterous bet of a thousand louis d'or with the Duke of Bourbon that there would be no more ice that winter or spring was in the middle of March 1719. This was a real gamble. Shortly before 7 April, in fact, the Duke had two carts of ice arrive from his ponds in Chantilly. Mr Law, in the meantime, had already sent him the thousand louis d'or. (Archivio di Stato di Torino, hereafter referred to as ASTo, *Philippo Donaudi al Marchese di Borgo*, Parigi 7 aprile 1719, *Lettere Ministri: Francia*, mazzo 147).

² P.M. GARBER, *Famous First Bubbles*, in *The Journal of Economic Perspectives* 4/2 (1990), pp. 35-54; ID., *Famous First Bubbles: The Fundamentals of Early Manias*, Cambridge MA, 2000.

³ A.E. MURPHY, *John Law: Economic Theorist and Policy-Maker*, Oxford

in prices and changed the nature of the market itself forever.

Thus, while Paris was sinking into speculative madness in the summer of 1719⁴, the important point was that no one really asked themselves what the reason was for those amazing gains.

By as early as the winter of 1720, trading sessions had become informal meetings held in tearooms, bars and even in the middle of the *Rue Quicampoix*⁵: a euphoric display of a true and proper market of hope (futures) for the marvellous returns that could be gained from money coming from the colonies.

The increase in the value of shares in the Mississippi Company (*Compagnie du Mississippi*)⁶ – payable in monthly instalments (debt/equity swaps) and convertible into government bonds – had fed the hope of an entire nation.

Law had thought up and then created a true and proper ‘system’⁷ (at

1997, pp. 201-202, C. MACKAY, first published in 1841 under the title *Memoirs of Extraordinary Popular Delusions*, London, pp. 32-34.

⁴ The precise date is 27 July 1719. Law had secured himself the exclusive right to do business between France and Louisiana. But things on the other side of the ocean were going very wrong. (P.A. COCHUT, *The Financier, Law: his Scheme and his time*, London 1856, Ch. VI, *The bandoliers of Mississippi*, p. 130).

⁵ A. THIERS, *Histoire de Law*, Paris 1858, translated in en. F.S. FISKE, *The Mississippi Bubble: A Memoir of John Law*, New York 1859, recently in it. *La banca di John Law. Bolle speculative e default nella Francia del Settecento*, A. PALAZZI (transletd by), Roma 2013, pp. 68-84.

⁶ The authorisation to set up the *Compagnie d'Occident*, known as the *Compagnie du Mississippi*, was granted in 1717, in exchange for the monopoly over the trade of the territory of French Louisiana for twenty-five years, according to the so-called practice of grafting. The following year Law transformed the *Banque Générale* in to *Royale*, a public institute guaranteed by the State. The *Compagnie du Mississippi* changed its name to *Compagnie des Indes*. PH. HAUDRERE-G. LE BOUËDEC, avec la participation de L. Mézin, *Les Compagnies des Indes*, Rennes 1999; PH. HAUDRERE, *Les compagnies français des Indes orientales: trois siècles de rencontre entre Orientaux et Occidentaux, 1600-1858*, Paris 2006; ID., *Les français dans l'océan Indien (XVIIe-XIXe siècle)*, Rennes 2014.

⁷ See E. FAURE, *La Banqueroute de Law: 17 juillet 1720*, Paris 1977; T.E. KAISER, *Money, Despotism, and Public Opinion in Early Eighteenth-Century France: John Law and the Debate on Royal Credit*, in *The Journal of Modern History*, 63/1 (Mar., 1991), pp. 1-28; MURPHY, *John Law: Economic Theorist and Policy-Maker*, cit.; F. VELDE, *Government Equity and Money: John Law's System in 1720 France*, Federal Reserve Bank of Chicago Working Paper 2003, pp. 2003-31; ID., *Government equity and money: John Law's system in 1720 France*, working paper and book chapter (2004); S. PARINI VINCENTI, *Mercato vs diritto: il caso John Law, financier*

least, that is what it has been called by everyone who has studied it)⁸. It envisaged the creation of a deposit and discount bank authorised to issue ‘paper money’. The idea was to cover the French public debt created by Louis XIV through the issuance of paper money and the management of taxes on the one hand, and through the exploitation of trade with the ‘East and West Indies’ on the other hand⁹.

The basic mindset of the Scottish economist was that the creation of a credit institution was an indispensable step towards the development of a new economic system.

Indeed, before shares, the market and trading could exist, there had to be a framework in place that was capable of supporting financial activities and of transforming an opportunity into reality. In truth, John Law preferred gambling¹⁰ to going to church and mathematical models

or gambler?, in *Rivista di storia del diritto italiano*, 88 (2015), pp. 203-226, spec. pp. 216-222; J. SHOVLIN, *Jealousy of Credit: John Law's "System" and the Geopolitics of Financial Revolution*, in *The Journal of Modern History*, 88 (2016), pp. 275-305.

⁸Nobody had a good word to say about the system. Dutot, Law's former colleague, took up his defence in vain. Hume, referring to Dutot, accuses him of frequently adducing facts and arguments of doubtful authenticity. Galiani calls the System «one the strangest productions of the human intelligence». As for Adam Smith, he does not even discuss Law's ideas but he calls the system «the most extravagant project both of banking and stock-jobbing that, perhaps, the world ever saw». For the texts see: F. GALIANI, *Della Moneta*, Napoli 1750, and R. PETRINI, *Controstoria della moneta*, Reggio Emilia 2014; A. SMITH, *Inquiry into the nature and causes of the wealth of nations* (edited with an introduction by Kathryn Sutherland, Oxford 1993). The nineteenth and twentieth centuries have at times been less critical of John Law. Certain passages written in a restrained and reasonable manner are quoted as expressing the real essence of Law's thoughts. It has also been said that he was an unrecognised forerunner, because certain bankers today have taken up some of his most well-known formulae (J.M. KEYNES, *A treatise on Money*, 2 vol., New York 1930 and FAURE, *La banqueroute de Law*, cit.).

⁹«Pour juger de l'effet du système sur le corps de l'Etat, il faut se rappeler l'extrémité où la finance étoit réduite à la mort du feu Roy. Le découragement des peuples, l'engourdissement du commerce, la négligence de la culture des terres, un amas enorme de dette, et qu'il ne fut proposé pour remède a tant de maux que des maux encore plus grands, tel qu'une banqueroute générale et la persécution d'une chambre de justice» in J. LAW, *Historie des finances pendant la Régence*, in *Oeuvres complètes*, P. HARSIN (ed.) 3 vol., Paris 1934, III, pp. 282-430, cit., p. 396.

¹⁰Always attracted to gambling, Law found the Amsterdam Stock Exchange more seductive than any gambling hall. Law was interested in sellers who spread false rumours to lower VOC share prices and was interested in windhandels who traded shares they did not own. Law himself invented a system for guaranteeing lottery ticket holders against the exit of the zero.

and thus did not fit the mould of the social classes of the time: he was neither a nobleman nor a scientist.

In order to convince a large number of investors to buy shares issued by the Mississippi Company, the future Minister of the Treasury knew from the outset that, in addition to opening the doors of the *Banque Générale*, he had to do more: namely, he had to secure exclusive trading rights over the shares worldwide.

Thus, the bank was transformed in order to increase the volume of money in circulation and use the resulting liquidity to purchase and then finance the company's activities¹¹. The company's value was to be supported by the growth in the money supply – for which Law himself, his reputation and his personal assets stood guarantors¹².

After all, the cornerstone of capitalism is the protection of private property, and the bank is its architrave, the fulcrum, the symbol of the pact between the saver and the credit institution – as explained so long ago in *Money and Trade*¹³. The promise that money deposited is forever safe – even if the bank fails – is an essential precondition to the agreement between the two. However, as we know, things took a very different path¹⁴.

Law had lost control and inflation had taken over. On 21 May

¹¹ Law's main financial innovations were the substitution of paper money and the conversion of fixed interest-bearing government debt into shares of the Mississippi Company. There was an inherent logic into to both operations in his desire to increase the circulation of money in France and to lower the interest costs on government debt. Law believed that he could drive the French economy towards greater prosperity and reduce the burden of Louis XIV's legacy. Law's vision was correct on both these fronts. But he failed.

¹² COCHUT, *The Financier Law: his Scheme and his time*, cit., Ch. V, *The Golden Age*, p. 90. At the start of the Company's operations, there were few investors prepared to risk their fortunes in this venture and Law's willingness to use his own wealth showed a courageous belief in the potential viability of his enterprises. The Gazette de la Régence warned of the imminent demise of the Mississippi Company. It said that the Mississippi affair would fail; it was obvious to create and maintain this type establishment through individual work with such weak measures and mediocre funds (*Gazette de la Régence*), Janvier 1715-Juin 1719, le Comte de Bathélemy, Paris 1887, trans.

¹³ J. LAW, *Money and Trade Considered*, Edinburgh, the heirs and successors of A. Anderson, 1705.

¹⁴ The good bank is the bank that does not pay. The banks that did not pay were 'good', it was thought, because, not giving credits, they always retained the funds deposited wuth them, and thus the depositors ran no risk.

1720¹⁵, his Majesty was persuaded to change course: the planned reduction of the value of the banknotes and shares was imposed. A total of 2.7 billion *livres* remained in circulation according to official estimates¹⁶, 500 million of which had been issued without any supervision; there was thus nothing left for our banker to do but to revise taxes. This bubble¹⁷ therefore presented a complex series of issues that led to its demise: the novelty of it all, the exoticism of the colonies, capitalism, immigration, the growth of urban society, and all the problems and excitement that these issues brought with them.

In 1720, the French, after having experienced money mania, also experienced the harsh warning that resulted from it. But the reasons for this warning have barely been explored and never explained in depth.

The first crash of the international stock market clearly demonstrated not only the irrational behaviour of the market players at the time but also the fragility and the difficulty of a financial system that, for the first time, was attempting to contain public debt¹⁸.

The subject of the speculation, the forms of credit expansion and the episode that triggered the financial upheaval all differ in these initial centuries of crisis compared to current times. The cultural contexts and production methods have since changed, as have private consumption models and the sophistication of the financial system. However, these differences have little impact on the nature of their causes, as legal historians can easily demonstrate.

There are in fact many underlying parallels between the central bankers of the United States and Europe who ultimately responded to the

¹⁵ KAISER, *Money, Despotism, and Public Opinion in Early. Eighteenth-Century France: John Law and the Debate on Royal Credit*, cit., p. 16.

¹⁶ The Treasury had a debt of 1,977,120,061 livres tournois in 1716 (*Recherches Historiques sur le Système de Law, État des finances à la mort de Louis XIV*, Paris 1854, Ch. I, pp. 1-14). For the financial institutions of this period see: M. and R. BONNEY, *Jean-Roland Malet, premier historien des finances de la monarchie française*, Paris 1993; P.T. HOFFMAN-G. POSTEL-VINAY, J.-L. ROSENTHAL, *Des marchés sans prix: une économie politique du crédit à Paris, 1660-1870*, Paris 2001; M. STOLL, *Servir le Roi Soleil: Claude Lepeletier (1631-1711), Ministre de Louis XIV*, Rennes 2011 e N. BUAT, *John Law. La dette, ou comment s'en débarrasser*, Paris 2015, p. 60. Cfr., *infra*, Chap. III.

¹⁷ *Arrêt du Conseil d'Etat du Roy, concernant les Actions de la Compagnie des Indes du 21 mai 1720. Extrait des registres du Conseil d'Etat.*

¹⁸ J. GLEESON, *The Moneymaker*, London 1999.

2008 financial crisis and John Law, who was deeply involved in financial innovation, the excesses of which produced the boom and collapse of the Mississippi Company.

Law had many of the characteristics of a 21st-century banker: a self-interested drive to get rich and to spend the proceeds of this personal enrichment on equity, real estate, gambling and art. But at the same time, he had also understood – just like his 21st-century counterparts – that regulation and the money supply are fundamental for the real economy: an economy in which we all go down on one boat, but in which we are each responsible for saving ourselves¹⁹.

Thus, to understand how to separate each story from its external elements, we must look at the true origins of the *displacement* of the economic prospects that gave rise to new investment opportunities and gains (K. Kindleberger)²⁰.

An increase in credit causes the emergence of inexperienced operators on the market, who weaken the rationality of investors. Chance and euphoria in turn feed a ‘mania’.

An overheating of the markets is caused by a scarcity of necessary cash as concerns both assets and possible price variations: indeed, it is

¹⁹ At the private banker level, John Law was a banking charlatan and a dangerous financial innovator. At the public level, he attempted to manipulate the financial markets. In this paper it will be argued that at one level it may be shown that Law had many of the characteristics of the twenty-first century banker in the form of a self-interested drive to enrich himself and to spend the proceeds of this personal enrichment in equities, real estate, futures, gambling and art. It can also be argued that Law was involved in financial innovation, the excesses of which produced the boom and collapse of the Mississippi Company. However, it will be argued that a new type of banker emerged from the ashes of the financial debacle. This new type understood that money matters and that money has a real effect on the economy. (A.E. MURPHY, *John Law: A Twenty-First Century Banker in the Eighteenth Century?*, in *Financial Innovation and Resilience. A Comparative Perspective on the Public Banks of Naples (1462-1808)*, L. COSTABILE-L. NEAL (eds.), *Palgrave Studies in History of Finance*, Basingstoke 2018, pp. 269-288).

²⁰ A bubble is often started by an exogenous major shock that Kindleberger calls *displacement*. The shock drives expectations toward over-optimism, speculators invest more than it would be rational to do and prices begin to rise. A displacement is a shock that «will alter the economic outlook by changing profit opportunities in at least one important sector of the economy. Displacement brings opportunity for profit in some new or existing lines, and closes others» (K. KINDLEBERGER, *Manias, Panics, and Crashes: A History of Financial Crises*, New York 1978, revised and enlarged 1989, p. 16).

possible to purchase options, or to purchase in instalments, and then to sell in advance and immediately cash in the earnings.

Gregarious behaviour is the best leverage²¹. Indeed, it was thanks to leverage – the mechanism used to pledge an amount as a guarantee in order to borrow a much higher amount – that the entire wealth of France was able to be pledged overnight to obtain a quantity of capital that was difficult to calculate without using astronomical mathematics. Huge amounts: an ‘ocean’ of liquidity suddenly hit the system in order to save it. Millions of people were to lose everything in this way: their homes, jobs – everything²².

²¹ «Monkey see, monkey do», (KINDLEBERGER, *Manias, Panics, and Crashes: cit.*, p. 19).

²² In the *Lettres Persanes*, Montesquieu is bitterly ironic about Law’s *Système*, which he hints about and transfigures the series of events in the narration of a metaphorical story. Hence, Law becomes the son of the god of the winds, Aeolus, who after escaping from the Orkney Islands (Scotland) goes to the kingdom of Betica (France), where he tries to get rich by taking advantage of the arts learnt from his father. Aeolus’ son (Law) had become particularly good at controlling the winds and capturing them in wineskins, but in his country of birth this activity was not very lucrative and hence he decided to move to the kingdom of Betica, where he was able to practice his art profitably, even if he had to wait for the death of the King Saturn (Louis XIV), who previously had stood in the way of his project. Aeolus’ son managed to convince the citizens of Betica that it was enough to use the winds trapped in the wineskins to make the country rich and hence put an end to the very serious difficulties of public debt (C.L. MONTESQUIEU, *Lettere persiane, in Tutte le opere [1721-1754]*, D. FELICE (curated by), Milano 2014, CXXXII [CXXXVIII], Rica a Ibben, a Smirne, p. 375). The new minister turned to the people of Betica saying, «Believe in me: leave the land of the base metals, come into the empire of the imagination, and I promise you riches that will astonish even you» (in Usbek & Rica, p. 395). For a period of time, the citizens of Betica were engrossed by the illusory promises of an imaginary richness, but soon their trust began to waiver, leading to the ruinous decline of the entire system. Imagination proved to not be enough to support the course of the “wind”, which without an intrinsic value, returned to being replaced by metal coins. The son of Aeolus insisted to defend the theoretical assumptions of his project to the very end, without understanding that the problem was structural since only the goods with an intrinsic value, like precious metals, can be used as money (*ibidem*). Montesquieu briefly mentions the various measures that Law introduced in the desperate attempt to stabilise the monetary use of the wind (banknotes), like the prohibitions that he imposed on the export of precious metals, or the halving of the nominal value of shares and the sudden withdrawal of this latter measure. The French philosopher uses the metaphor of the “wind” to highlight the endemic “volatility” of systems based on chartalism that he believes are completely unsustainable, although not excluding a reduced usage of banknotes if they are firmly fixed to the intrinsic

France saved itself. But at what price?

In a short period of time, rational behaviour was replaced with a less prudent lucrative attitude, if not outright gambling. Suddenly, people who usually had no access to trading were involved in speculation. The hope for a quick profit took the place of all reason. When, finally, swindling and fraud came into play – which always come before a crisis – expectations were completely overturned. Not even the law could stop the avalanche.

Were we therefore facing a true financial revolution?

Perhaps not, but a moment of transition, yes.

Indeed, in an initial phase, we undoubtedly witnessed a different form of mobilisation of public debt resources – the burdensome legacy of Louis XIV²³ – through the establishment of the first national bank of issue, the *Banque Générale*. We also witnessed the senseless short sale of shares and the establishment of the Mississippi Company for the purpose of commercial exploitation: first limited to the American colonies, then extended globally as the Company of the Indies. On the other hand, the beginning of the second decade of the 18th century was marked dramatically by the bursting of the Mississippi Bubble (1720).

The tendency from a historiographic perspective is to highlight a certain discontinuity in financial processes, especially when speaking of crisis and revolution²⁴. However, this book aims to put an emphasis on *continuity* with the past.

value of metal coins. For the economic thinking of Montesquieu and his opinion of John Law, see M. BRAVI, *Montesquieu Economista*, in *Revue d'histoire moderne et contemporaine*, 18 (1971), pp. 321-353; C. LARRÈRE, *Montesquieu on Economics and Commerce*, in *Montesquieu's Science of Politics*, D. CARRITHERS-M. MOSHER-P. RAHE (eds.), Lanham 2001, pp. 335-375; J. MOORE, *Montesquieu and the Scottish Enlightenment*, in *Montesquieu and His Legacy*, R.E. KINGSTON (ed.), New York 2009, p. 184.

²³ On financial reform under Louis XIV, see G.B. MCCOLLIM, *The formation of fiscal policy in the Reign of Louis XIV: the example of Nicolas Desmaretz, controller general of finances (1708-1715)*, Ph.D. diss., Ohio State University, 1979; T.J. SCHAEFER, *The French Council of Commerce, 1700-1715: a Study of Mercantilism after Colbert*, Columbus 1983. Cfr. *infra*, Chap. I, note 9 and Chap. III.

²⁴ P. DICKSON, *The Financial Revolution in England: A study in Development of Public Credit 1688-1756*, London 1967; A.E. MURPHY, *The Origins of the English Financial markets. Investments and Speculations before the South Sea Bubble*, Cambridge 2009; C. WENNERLIND, *Casualties of Credit: The English Financial Revolution, 1620-1720*, Cambridge MA 2011.

In reality, in John Law's system, it is possible to find paradigms whose complexity reflects their ancient origin. This is why our interest must lie in looking at the origins of his financial process more than at its final, unfortunate outcome.

Furthermore, the use of sources – rare for this kind of work – will serve this purpose well: because in these pages priority will not be given to the typical tools of economic disciplines but rather to those of cultural history. Thus, quantitative data will not be presented; rather a textual analysis of economic thinking and archival sources will be carried out.

Law's life and his lightning-fast intuition are a tribute to his ability to tame risk and allocate credit in an increasingly efficient manner.

The construction of his 'system' is a 'beacon' of human vanity, made up of generous gains as well as huge failures, dictated at once by talent, arrogance, grandeur, dishonesty and greed.

In the end, the expansion and contraction of speculative bubbles is in fact not so much an indication of the shortcomings of a system as it is the firm result of our emotional instability. That said, the financial system undoubtedly accentuates differences between people, enriching those who are smart and lucky and impoverishing those who are less so. This is why, when our man confessed to having discovered the secret of the philosopher's stone to the Duke of Savoy in an attempt to entice him to establish the *Banque de Turin*, the latter refused, saying «I am not rich enough to ruin myself»²⁵.

And it is on this little-known episode, and others like it, that we will focus our analysis.

²⁵ For the *Memoriali piemontesi*, see Chap. 2.