The Mississippi Bubble, or How the French Eliminated All Their Government Debt (So Why Can't Bernanke?)

The government is running a large deficit and it can't cover its expenses. The government debt exceeds the GDP of the country. The central bank's balance sheet is exploding as the government buys its own debt. Sound familiar? This was France in 1719. Everyone has heard of the South Sea Bubble, but few have heard of the French version, the Mississippi Bubble, which happened one year before. Not only was the Mississippi Bubble bigger than the South Sea Bubble, but it was more successful. It completely wiped out the French government's debt obligations at the expense of those who fell under the sway of John Law's economic innovations. The Compagnie du Mississippi was chartered in 1684 at the behest of Renee-Robert Cavelier who had been appointed Governor of Fort Frontenac, at the mouth of the Mississippi. After getting his charter, he went to Mississippi with four vessels full of inhabitants, but the venture floundered, and Renee-Robert Cavelier died there, killed by a party that mutinied against him. In August 1717, Scottish businessman John Law acquired a controlling interest in the then-derelict Compagnie du Mississippi and renamed it the Compagnie d'Occident. The company's initial goal was to trade and do business with the French colonies in North America, which included much of the Mississippi River drainage basin, and the French colony of Louisiana. As John Law bought control of the company, he was granted a 25-year monopoly by the French government on trade with the West Indies and North America. In 1719, the company acquired the Compagnie des Indes Orientales, the Compagnie de Chine, and other French trading companies and combined these into the Compagnie Perpetuelle des Indes. In 1720, it acquired the Banque Royale, which had been founded by John Law as the Banque Generale in 1716, and which was the source for the quantitative easing which enabled the government to eliminate its debts. John Law then schemed to create speculative interest in the Compagnie des Indes. Reports were skillfully spread as to gold and silver mines discovered in these parts. Law exaggerated the wealth of Louisiana with an effective marketing scheme, which led to wild speculation on the shares of the company in 1719. This was the way Gregor McGregor was to generate interest in Poyais one hundred years later. Law had promised the

French regent that he would extinguish the public debt. To keep his word he required that shares in the Compagnie des Indes should be paid for one-fourth in coin and three-fourths in billets d’Etat or public securities, which rapidly rose in value on account of the foolish demand which was created for them. The speculation was further fed by the huge increase in the money supply introduced by John Law in order to stimulate the economy. The South Sea Company and the British government learned from John Law and imitated these techniques in 1720. The shares traded around 300 at the end of 1718, but rose rapidly in 1719, increasing to 1000 by July 1719, 5000 by August 1719 and broke 10,000 in November 1719, an increase of over 3000 percent in less than one year. By contrast, South Sea Company shares rose by 900 percent in 1720. The Comagnie des Indes shares stayed at the 9000 level until May 1720 when they fell to around 5000. The fall in the price of the stock increased, and at the end of 1720, John Law was dismissed by Regent Philippe II of Orleans.

The number of outstanding shares of the company was probably around 500,000 in 1720. A stock price of 10,000 livres would have given the company a market capitalization of 5 billion livres. By comparison, the French government expenses in 1719 were 150 million livres in 1700, and the French government debt in 1719 was 1.6 billion livres. At its height, the capitalization of the Compagnie des Indest was greater than either the GDP of France or all French government debt. With the demand for company shares being high, the government and John Law set out to buy back the whole 1.6 billion livres government debt for shares in the company. The plan was successful, and in 1720 the whole government debt was acquired by the company.

As the creditors bought shares in the company with their bonds and debt papers, the whole government debt became property of the company. The company then became property of the former creditors, now the shareholders, and the effective control fell into the hands of the government that paid an annual 3% interest to the company, which amounted to 48 million livres. Through these transactions the French government successfully unloaded their whole gigantic debt (perhaps 200% – 400% of GDP) and became basically debt free. The company sought bankruptcy protection in 1721. It was reorganized and open for business in 1722. In 1723 it was granted fresh privileges by Louis XV. Among these were the monopoly of sale of tobacco and coffee, and the right to organize national lotteries. Compare this outcome with that of the South Sea Company, which was unable to find any business that enabled it to make a profit for its shareholders after its collapse in 1720, but relied on the government bonds the South Sea Company held to provide income to its shareholders. From 1726 to 1746 the Compagnie d’Inde flourished from its overseas trade and domestic business. It brought wealth to the port cities it was operating from: in Bordeaux, Nantes, Marseille, and, in particular, its home port of Lorient (initially called L’Orient). During this period the company lost its trading rights for the western hemisphere, but it kept trading with the east and prospered from that business. Its main goods of trade during the period were porcelain, wallpapers, lacquer and tea from China, cotton and silk cloth from China and India, coffee from Mocha (Yemen), pepper from Mahe (South India), gold, ivory and slaves from West Africa. After 1746 the spendthrift policies of the French Government began to hurt the Company, and the Seven Years’ War brought severe losses. In February 1770 an edict required the Company to transfer to the state all its properties, assets and rights, then valued to just 30 million livres, quite a decline from the 5 billion livres the company had been valued at in 1719. The king agreed to pay all the Company’s debts and annuity (rente) obligations. The company was officially dissolved in 1770, although its liquidation dragged on into the 1790s.

The debt-laden governments of today probably wish they could create a scheme similar to the Mississippi Bubble to unburden themselves of the debts they have accumulated over time. With many western government debts equal to or greater than GDP, it would provide a great relief. No one knows how the huge expansion in the Fed’s balance sheet caused by quantitative easing will end, or if there were another recession, if it might even expand. Might the Fed end up buying the debt of Detroit or Puerto Rico or California or Illinois? Might the Fed even buy corporate debt during the next financial crisis, or even shares in companies? Perhaps Ben Bernanke and Janet Yellen should summon John Law’s ghost for some advice on how to get out of their current predicament.