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Reversals of Fortune in the Tea Industry

Part VIII: The Financial Capital of Europe Moves to London

THE FOUNDING OF THE BANK OF ENGLAND, 1694

The *Bank of England* played a major role in raising England to the rank of superpower. Some actually believe that its role was as significant as that of the Royal Navy. At the very time that Louis XIV was forced to cut back on war funding, England was creating a financial institution that would nationalize the war debt and allow sizable expansion.

Upon the death of Louis XIV in 1715, a General Bank was established in France by Scottish financial genius John Law. Early success led to the conversion of Law's bank to the *Royal Bank of France*. For a few years it appeared that France's financial difficulties would be solved, and would enable her to take the upper hand in her enduring tug-of-war with England.

Please turn to page 46.

Our 2008 First Flush Darjeeling Teas have begun to arrive!
Please refer to pages 8-12 for a complete list.

Upton Tea Imports will be closed for our annual vacation from June 28 through July 6. Orders received by June 26 will be shipped by June 27. We will also be closed on Fridays during the month of August so that our staff can enjoy a little extra vacation time!

Reversals of Fortune in the Tea Industry, Part VIII

As discussed in earlier installments of our series, the Dutch Republic of the 16th century has been credited with the formation of the first "modern economy". Their unprecedented success was the envy of all Europe, and the basic financial concepts that facilitated their international trade are pertinent today. However, their endeavors to monopolize Far East trade with Europe were ultimately as unsuccessful as prior attempts of Spain and Portugal.

Constant battles over trade and territory proved too costly for the Dutch in the long term, and they acquiesced to a state of peaceful coexistence -- at least superficially. Their *New Netherlands* settlements were relinquished in order to maintain a stronger position in the Far East.

England's early entry into the Far East trade was hampered by political unrest from within, compounded by financial instability. The colonization effort in North America, a derivative of fruitless attempts to discover alternate routes to the Far East, plus costly wars, had depleted the treasury.

The motivation for seeking a westerly route to the Far East was twofold; it was conceivable that a westbound route would actually be faster than the known route around The Cape of Good Hope, and it would avoid the rampant piracy along the coast of Africa.

Although the early years of the English East India Company showed limited success, many Englishmen and Scots had become wealthy from international trade of their own enterprise. William Patterson, the Scotsman who had made a fortune in trade with the West Indies, and whose proposal was the foundation of the Bank of England, was but one example.

Not all of Patterson's ventures were successful. Arthur Herman (*How the Scots Invented the Modern World*) refers to Patterson as "something of a dreamer who never let details stand in the way of a good plan." His epic failure, commonly referred to as the *Darien Scheme,* was envisioned when Patterson was trading in the West Indies. The Isthmus of Panama was claimed as a Spanish possession since the time of Balboa, but no attempt at colonization was made. Patterson planned to ignore Spanish claims to the isthmus, and establish a trading settlement that would become "the door of the sea and the key of the Universe."

Patterson first presented his plan to England, but there was no interest. When the Dutch, too, showed reluctance, Patterson turned to his fellow Scots. There he found eager subscribers to his scheme. A new enterprise, the *Company of Scotland Trading to Africa and the Indies* was established to pursue the venture. Although England had rejected the plan, they actively opposed the Scottish effort as a potential threat and declared it illegal under the provisions of the *Navigation Acts*.

Scotland shared a common monarch with England, but she was still an independent kingdom at the end of the 17th century. Excluded from officially participating in English international trade by the Navigation Acts, the Scots saw the Darien Scheme as an entry into the arena of international trade. Few in Scotland doubted Patterson's vision. After all, the man whose plan was the foundation of the Bank of England had also been instrumental in establishing the Bank of Scotland a year later.

Approximately half the liquid assets of Scotland were poured into the scheme. With famine at home and the promise of prosperity abroad, there was no difficulty recruiting settlers as well as investors for the new colony of Darien. Patterson and his family were among the 1,200 settlers that set sail for Darien in March of 1699. Within a year, most of the colony would die from disease, fever, and starvation. However, well before the news of the settlement's collapse reached home, another fleet of 1,200 would-be settlers set sail for Darien, only to meet a similar fate. Many blamed the failure of the settlement on the English, who were rumored to have blocked critical supplies from reaching the settlement.

The Darien Scheme cost Patterson his fortune and his family. All told, over 2,000 lives were lost, and the already-poor country of Scotland was in financial ruin. Had Patterson succeeded, Scotland may have remained independent, eventually becoming a major economic force. But the chance of success was small. Nearly two centuries later, France would attempt to build a canal in Panama, sacrificing over 20,000 lives before abandoning the task.

It would take years for the anti-English bitterness over the Darien Scheme to abate but in the end, the event was seen by many as the catalyst that ultimately united Scotland with England and Wales. English Parliament passed the *Act of Union* in 1706, which was ratified by Scottish Parliament in 1707, formally creating the *Kingdom of Great Britain*.

The above graph appears in Mark Skousen's *The Big Three in Economics*. A sharp rise in per-capita GDP in the U.K. began in the 1700's and lasted for three hundred years.

The two centuries to follow would also be glory days of Great Britain's tea industry. When the Dutch first introduced tea to Europe, it was a curiosity that only the wealthy could afford and the national beverage of England was ale. Precisely when tea joined ale as one of Great Britain's national beverages is hard to pinpoint. It was somewhere between 1717 (when Thomas Twinning converted his "Tom's Coffee House" to a tea shop named the "Golden Lyon") and 1889 (when Scotsman Thomas Lipton first entered the tea trade).

Prior to the formation of the United Kingdom, the economy of England remained relatively flat (see inset). *Gross Domestic Product* (GDP) is often used to measure the *size* of an economy, and is usually stated in per-capita terms. GDP is classically defined as the sum of consumer spending (c) plus investment (i), augmented by government spending (g) and trade surpluses (ts). Specifically, GDP = $c + i + g + ts$.

The Black Death (mid-1300s) caused a labor shortage and a noticeable increase in GDP due to wage increases. Per-capita GDP eroded over the next few centuries, bottoming in the mid-1600s.

So, what does this really mean? The graph at the left shows an explosive growth in the economy of Great Britain only after 1700. With the restructuring of the East India Company in the latter half of the 18th century, and the onset of the Industrial Revolution, Great Britain would rapidly outgrow the old model of commerce (i.e. *mercantilism*), which held that the wealth of one nation could only be increased at the expense of another.

A new concept of international commerce would lead to increased prosperity throughout most of Europe, especially in England. As we shall see in later installments of our series, trade surplus (the *ts* in our equation) would play a significant role in Britain's economy, and tea would take center stage, as Great Britain overtook the Netherlands in the race for European economic supremacy.

Although England had an early lead, many believed France would ultimately be the greater power. Indeed, the outcome of the two-century tug-of-war between England and France was often unpredictable and frequently misjudged.

When Louis XIV died in 1715, his extravagant reign of 72 years left France with insurmountable debts. The only recourse, other than bankruptcy, was a complete overhaul of the financial system. This was not unlike the England of the latter half of the 17th century. As in England, it would be a Scotsman who would orchestrate a modern banking system in France.

John Law, the son of a prosperous Edinburgh goldsmith, was a man of many resources, including a keen mathematical mind and an uncanny memory. By applying basic probability theory and card counting techniques, he was able to amass a tidy fortune at the gaming tables of London.

Besides casino gambling, Law had a favorite wager that he would make with any taker: he would offer an astounding prize of £1,000 for anyone who could roll double-sixes with a pair of dice, six times in succession. If the taker lost, Law would collect a mere shilling. The lure of £1,000 was enough to attract many unsophisticated gamblers, but the odds of winning were less than *one in two billion*, while the prize was only 20,000 times the bet!

Law's fortunes in London took a turn for the worse when a deadly duel with a jealous husband landed him in jail. He managed to escape and fled to the Continent, eventually settling in Amsterdam. It was the last decade of the 1600s, and Amsterdam was the financial capital of Europe. The possibilities for Law seemed endless, and soon he landed a job in banking. It was a perfect fit, at least from his perspective.

When he returned to Scotland in 1700, Law was struck by the contrast between the poverty of Edinburgh and the prosperity of London and Amsterdam. He was convinced that a modern bank would provide the financial resources necessary to provide capital for growth and break the chain of poverty that haunted Scotland. Unfortunately, his proposal was rejected, and, as discussed above, Scotland became resigned to the concept of a union with England.

Taking his concepts abroad, Law found a receptive audience in France, which was reeling from the aftermath of Louis XIV and his excesses. It was 1715, and the country's national debt was approaching 1 billion francs. The deficit for the current year was 78 million francs, and tax revenues were nil.

P. A. Cochet (*The Financier, Law: His Scheme and Times*), characterizes Louis XIV with the following, "Few French princes, in civilized times, have handed down the country to their successors in such a state of utter ruin." Law easily sold his plan to the Regent, who saw in Law's proposal the hope of avoiding financial ruin. A *General Bank*, to be established and run by John Law, was authorized by Parliament on May 2, 1716. A year later, branches were established in Lyons, Rochelle, Tours, Amiens, and Orleans. In less than three years, Law's General Bank was officially designated the *Royal Bank of France.*

Law's reputation as a financial genius echoed throughout Europe. The French national debt was being serviced, tax revenues were restored, and a stable paper currency was put into circulation. As we shall see, the years of prosperity were brief. Law failed to quit while he was at the top of his game, and ultimately gambled away his legacy.

Our series on *Reversals of Fortune in the Tea Industry* will continue in the next issue of the *Upton Tea Quarterly.*