

# Entrepreneurs, promoters, and beautiful illusions: The irrational foundations of modern capitalism

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## Development of corporate capitalism in 19th century Britain:

- 1825: Bubble Act repealed, can legally form corporations, but with unlimited liability
- 1855–56: limited liability generally available

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main objections to corporations: inefficient and facilitate swindling of investors by promoters

## Giant investment manias in 19th century Britain:

- 1824–25: foreign loans and foreign mines (primarily Latin America)
- 1835–36: banks and railways (equiv. to \$2 trillion for US today)
- 1844–49: Railway Mania (equiv. to \$4 trillion)
- 1862–66: banks and railways (equiv. to \$2 trillion)

## Entrepreneurs and promoters:

- entrepreneur: moves capital to *more productive* uses
- promoter: moves capital from investors' pockets to *some* uses

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the most effective promoters believe their own stories (so gullibility is a plus, but not essential)

- promoters key but neglected element of modern capitalism
- source of much of capitalism's vitality
- major contributors to capitalism's instability

## Promoter thesis complements other insights:

- Schumpeter: entrepreneur
- Keynes: “animal spirits”
- Akerlof and Shiller: “tales”

## Governing elite of 19th century Britain:

- general convictions that investors were prone to occasional giant outbursts of irrationality
- general convictions that investors were generally irrational
- until contrary demonstration by Robert Lucas Nash the younger in 1880, general conviction that investors were steadily and irrationally losing money by lending it to foreign governments that frequently defaulted
- general prejudice against foreign investment (e.g., Keynes in 1924)

## Gunboat diplomacy before end of 19th century:

- yes for trade (Opium Wars with China)
- no for investments (defaulting Greece, Argentina, ...)
- Palmerston, Jan. 1848 memo to British diplomats:

*... It has hitherto been thought by the successive governments of Great Britain undesirable that British subjects should invest, their capital in loans to foreign governments instead of employing it in profitable undertakings at home ... the British government has considered that the losses of imprudent men who have placed mistaken confidence in the good faith of foreign governments would prove a salutary warning to others ...*









# JOHN BULL'S LOCOMOTIVE LEG.



## Railway Mania of the 1840s:

- total capitalization of all projects: equiv. to \$20 trillion
- skeptics: can't invest more than equiv. of \$500 billion per year
- supporters: can safely go up to \$2 trillion per year
  
- investments: highly leveraged, initial 10% deposit, then obligation to pay “calls”

A very light but very enlightening introduction:

hilarious satirical 1845 short story by William Aytoun

google/bing *The Glenmutchkin Railway*

incl. promoters Augustus Reginald Dunshunner and Bob M'Corkindale, who “abhorred [work] with a detestation worthy of a scion of nobility,” and were eager to “[have] a pluck at the public pigeon,” as “the magical bands of iron” were uniting “all the populous towns” and creating opportunities to get rich through “a slapping premium.”



LORD BROUGHAM'S RAILWAY NIGHTMARE.

## Controlling the Railway Mania:

- slight paraphrase of frequent response of Mania supporters to calls to limit investments and their distorting influence: “if you don’t let them play domestically, they will take their marbles and play internationally”
- another defense: “domestic spending, even if wasteful, will circulate and stimulate the economy”



## Controlling the Railway Mania (cont'd)

- Lord John Russell, June 1846 (taking over as Prime Minister from Sir Robert Peel), question for Samuel Jones-Loyd (later Lord Overstone): should we try to restrain the Mania?
- Overstone response: “Can it be expedient to apply any restriction to the application of capital ... to public works in this country, whilst the power of exporting that capital for the promotion of similar works abroad necessarily remains unrestricte?”

## Controlling the Railway Mania (cont'd)

February 1847 Chancellor of the Exchequer budget speech:

*... there has been less of the wild spirit of speculation apparent, than is connected with the history of some former years. People have invested their money in works at home, instead of Mississippi stock or Pennsylvania bonds. Capital has been applied principally to the construction of great lines of communication throughout the country, affording employment to large bodies of the people, and benefiting the Exchequer to a considerable extent.*

## The push for limited liability in early 1850s:

- often regarded as a puzzle
- *The Times*, 5 November 1851: “The prospect that the steady increase in the bullion of the Bank may continue for a lengthened period is regarded in the city as giving additional urgency to the question of the law of partnership. With Consols already approaching par, it is evident that if a further accumulation of capital should go on for several months, some new outlet will be forced. ... enterprise at home is checked by the state of the law ... A knowledge of the way in which our partnership law operates to discourage individual enterprise and to dam up capital till it breaks all bounds in a sympathetic mania is sufficient, however, to explain the anomaly.”

## Conclusions:

- research into origins of corporate capitalism in mid-19th century Britain provides new insights
- promoters play a key role
- tolerance and even encouragement for promoters “baked into” modern capitalism
- promoters a source of instability (in addition to those of Minsky, ...)

More information about Railway Mania and related topics:

<http://www.dtc.umn.edu/~odlyzko/>

or just google/bing “odlyzko”

Paper on the specific topic of this lecture in preparation.