The Pernicious Art of Securities Regulation

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Two simple ideas motivate Stuart Banner's book Anglo-American Securities Regulation: legal responses to securities markets are highly similar across place and time and they reflect a common set of cultural responses to speculation and volatility. Banner begins by observing that modern commentators rarely discuss the pre-twentieth-century antecedents of modern securities regulation. This inattention is puzzling given the wealth of writing about the New Deal reforms and the skirmishing that preceded them in state and federal legislatures starting with the first Blue Sky laws of the early 1910s.¹

The puzzle becomes even more striking, Banner notes, when we recognize the similarities between early and modern attitudes toward securities markets:

[M]ost of the ways of thinking about and regulating securities markets characteristic of the twentieth century were present in England and the United States long before securities markets were important economic institutions. The fa-

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¹ See, for example, Joel Seligman, The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance (Houghton Mifflin 1982); Michael E. Parrish, Securities Regulation and the New Deal (Yale 1970); Ralph F. De Bedts, The New Deal's SEC: The Formative Years (Columbia 1964).
miliar modern rift between Wall Street and Main Street—
between a community of securities professionals pursuing its
private interest while certain that it is meanwhile essential
to the public welfare, and a wider political community suspi-
cious of both the practices and the power of the securities in-
dustry—is as old as securities trading (p 4).

The New Deal, then, was only one iteration of a longstanding
cycle of political reaction to securities trading. The similar regu-
laratory responses stem, in part, from shared cultural attitudes to-
ward securities markets. Sharply rising markets serve as light-
ning rods for criticism of *nouveaux riches* from both the wealthy
whose ranks they join and the less privileged they leave behind.
This was equally true in 1720s England and 1920s America. De-
clining markets inevitably prompt a political backlash. This re-
sponse is again automatic—whether it is the English Parliament
blaming the securities market for the economic downturns of the
1690s or the 1890s, Franklin Roosevelt exulting that the “money
changers” had fled the “high temple of civilization” in 1933, or
Bill Clinton running against the “decade of greed” in 1992. Some
of these examples come from periods well after those covered by
the book, but Banner would argue, I think, that the thread con-
necting them is an instinctive popular distrust of speculation. We
“cannot understand why securities markets were regulated the
way they were without situating them in the broader culture” (p
3).

The book makes a convincing case for the similarity of eight-
eenth-, nineteenth-, and twentieth-century regulation and cul-
tural attitudes. In doing so, it provides a thorough survey of
popular writings about, and legislative reactions to, securities
markets that make it a starting point for future research in the
field. The surprise, however, is that Banner does not follow his
central insight a step further. The book would be even more use-
ful and provocative had it asked whether the movement from cul-
tural criticism to legislative action is influenced by political and
economic phenomena, such as rent-seeking and interest group
conflict, that may also operate similarly throughout the centuries.
We learn that attitudes toward securities markets in popular cul-
ture and political thought are highly durable and that the regula-

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2 See Samuel I. Roserman, ed, 2 *The Public Papers and Addresses of Franklin D. Roo-
sevelt* 12 (Random House 1938); Mona Charen, *Reagan is a Victim of Clinton's Attacks*, St
Louis Post-Dispatch 3C (Dec 24, 1992); Scott Shepard and A.L. May, *Boos on the N.Y.
Campaign Trail; Jews upset with Brown, Wall Street with Clinton*, Atlanta J and Const
tory outputs themselves maintain a strong family resemblance. But questions that we would ask today as a matter of course (To what extent are the market’s critics motivated by self-interest? Does the legislature listen to the opinions of the “public” or of interest groups? Do the regulators control the regulated industry or are they controlled by it?) remain unaddressed.

To see where such an analysis might have led, consider two steps that have been taken elsewhere. Historians have situated English antispeculation commentary within a broader seventeenth-century dispute about the role of the state in “managing” the economy. Many of the commentators who believed that government must enforce moral precepts against profiting from trade in necessary commodities also argued more generally for “the subordination of economic life to social and political considerations.” Such commentary provided intellectual support for mercantilism, a system of pervasive economic regulation that sought to maintain social order by bringing economic activity under the centralized control of the state. Economists have taken the further step of identifying rent-seeking interest groups who took cover under that desire for stability. Once we discover in seventeenth-century arguments about speculation an undercurrent of ideological dispute about the desirability of industrial planning, fueled in part by producers trying to hobble their competitors, the whole debate begins to look remarkably modern.

I therefore want to sketch out in this review a few examples of how the book might have taken its core claims further. To keep the task manageable, I will focus on the birth of organized securities markets and securities regulation in England in the late seventeenth and early eighteenth centuries. The book provides a wealth of fascinating detail about how Englishmen talked about and criticized the new institutions, but it offers less help in assessing whether those criticisms were accurate and whether they were in fact what prompted Parliament to act.

Under the surface of the criticisms, however, lie phenomena familiar to a modern observer of economic regulation. Antimarket rhetoric often masked economic and political objectives unrelated

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5 See Section II.
to maximizing the social benefits of securities trading. The best (and most entertaining) example of this comes from the writings of Daniel Defoe, the best-known of the early stock market critics. In Section I, I take Defoe as an example and argue that his objections to securities markets were motivated by his own economic and political interests. In Section II, I generalize the point by arguing that what we know about early securities markets is sharply at odds with the contemporaneous commentary the book provides. The stated justifications for regulation were a set of crude and unsupported theories of how stock markets operate. Moreover, Parliament chose a regulatory style that seems likely to have harmed rather than helped investors. Where Banner finds strong parallels between early and modern concerns about the social costs of securities trading, I suspect that even more striking parallels could be drawn between early and modern evidence on the tendency of regulation to favor producers over consumers.

I. THE FORTUNES AND MISFORTUNES OF THE FAMOUS DANIEL DEFOE

As is probably inevitable when discussing events spanning two continents and more than two hundred years, Banner's treatment of his subject is uneven. The discussion of the New York stock market in the mid- to late-nineteenth century is outstanding. It is full of institutional detail and careful analysis of the effects of the New York Stock Exchange's rules and practices. Of the many discussions of the early history of the New York Stock Exchange, only Michie's excellent book on the London and New York Stock Exchanges provides a similarly rich account of the economic and organizational problems faced by the infant markets and the ways in which market participants addressed them.6

By contrast, Banner's discussion of the early London securities market is dominated by analysis not of what traders did, but of what their contemporaries said about them. The bulk of the material shows how securities markets were depicted in popular culture. Banner collects a wide-ranging and highly amusing set of quotations from plays, poems, novels, and pamphlets commenting (in inevitably outraged or satirical language) on the new and mysterious practices and institutions growing in the City of London.

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The most well-known of these early critics was Daniel Defoe, pamphleteer, journalist, and novelist-to-be. From almost the beginnings of an organized securities market in London, Defoe was a vitriolic critic. Banner quotes and cites Defoe at length for the proposition that contemporary observers were deeply troubled by the emerging market’s practices (pp 27, 29, 32-33, 35-36, 39, 74).

Starting in the mid-1690s, Defoe wrote a series of pamphlets attacking “stockjobbers.” The term would eventually come to refer to professional securities dealers who bought and sold on the organized market as principals, but at the time Defoe wrote the term was used loosely to refer to anyone who traded in securities. (Samuel Johnson later defined “stockjobber” as “a low wretch who gets money by buying and selling shares in the funds.”) Defoe’s and other authors’ condemnation of stockjobbers coincided with Parliament’s first attempt to regulate the new market by an act of 1697 (pp 39-40).

That Defoe wrote about the stock market is not surprising—his writings ranged over nearly the whole of early eighteenth-century English life. It is, however, startling to encounter the visceral distaste for stock markets that fairly leaps off every page of his commentary. One biographer observes that stockjobbers seem to rank lower in Defoe’s moral universe than his fictional pirates, thieves, and prostitutes. A literary scholar notes that Defoe’s “passionate denunciations of speculators” are “[c]harged with a weight of emotion not easily discernable in his best-known fictions.” This is particularly strange when we note that Defoe was not simply a conservative defender of traditional ways. He was instead a defender of the new economy, centered on credit and trade rather than landed wealth.

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1 See Daniel Defoe, An Essay upon Projects (1697); Daniel Defoe, The Free-holders Plea Against Stock-Jobbing Elections of Parliament Men (1701); Daniel Defoe, The Villainy of Stock-Jobbers Detected, And the Causes of the Late Run upon the Bank and Bankers Discovered and Considered (1701); Daniel Defoe, The Anatomy of Exchange-Alley: or, A System of Stock-Jobbing (1719). There is considerable scholarly debate at the moment about which of the many unsigned pamphlets that have been attributed to Defoe are in fact his. See P.N. Furbank and W.R. Owens, Defoe De-Attributions: A Critique of J.R. Moore’s Checklist (Hambledon 1994). I have taken Furbank and Owens’s Defoe canon as authoritative.

2 Samuel Johnson, 2 A Dictionary of the English Language (1755).

3 See Laura Ann Curtis, ed, The Versatile Defoe: An Anthology of Uncollected Writings by Daniel Defoe 2 (Rowman and Littlefield 1979) (“Few aspects of the life of Defoe’s times escaped his alert and sympathetic eye; grasping Defoe’s protean consciousness is tantamount to grasping the entire early eighteenth century.”).


5 Curtis, ed, The Versatile Defoe at 244 (cited in note 9).

When we hear a modern businessman speak with such relentless passion on an issue of economic policy, it is only natural to ask whether self-interest is a motivating factor. In Defoe’s case, self-interest played a central role. This is not to say it was the only factor. Defoe was well-known in his own day as one who could (and gladly would, for the right price) support any side of a controversy, so it is possible that some of his “self-interested” motivations were no more complicated than the desire to get paid or to try out an interesting argument. That said, however, his economic and political commitments provided strong reasons to oppose stock trading in general and certain individual companies and traders in particular. Overall, I will argue that Defoe is an utterly unreliable source of information about the social costs and benefits of early eighteenth-century stock markets. We can learn much from him about some of the private costs and benefits of those markets, however, and his use of antimarket rhetoric to serve only tangentially related political goals gives his polemics a timeless quality.

As a preliminary matter, it is worth noting that Defoe’s contemporaries would not necessarily have taken him to be providing a careful assessment of the social value of stock trading. He was a propagandist working in a medium—the pamphlet—that was not typically a forum for cool, detached argument.\(^1\) It is hard to take seriously Defoe’s description of “this destructive Hydra; this new Corporation of Hell, Stock-Jobbing,” that “can ruin Men silently, undermine and impoverish by a sort of impenetrable Artifice, like Poison that works at a distance,”\(^2\) just as it is difficult to credit some of the more outlandish claims of Defoe’s political commentary. Even by the standards of the genre, moreover, Defoe had and has a reputation for ignoring the truth. His biographers employ terms like “liar,” “fabricator,” and “hack” to describe Defoe the pamphleteer.\(^3\) Defoe recognized that he had such a reputation, as he took pains to argue that facts were less important than the ends to be served.\(^4\)


\(^2\) Defoe, *The Villainy of Stock-Jobbers Detected* at 9, 22 (cited in note 7).


\(^4\) See West, *The Life and Strange, Surprising Adventures* at 12 (cited in note 15), citing Daniel Defoe, *Serious Reflections during the Life of Robinson Crusoe*; Backscheider,
Banner alludes to the least important of Defoe's personal interests—his bankruptcy, which gives his diatribes a strong flavor of sour grapes (p 29)—but the brief mention does not nearly do justice to Defoe's remarkable commercial career. Defoe inherited from his father the privileged status of a liveryman of the City of London, one of the powerful few able to engage in trade, vote in Parliamentary elections, and reap the privileges of control of a local government devoted largely to rent-seeking on behalf of merchants. He was doubly fortunate in marrying a woman who brought with her a dowry sufficient to make Defoe a wealthy man.

Defoe, however, sought to amass an even greater fortune through the risky business of long distance trade. Through a series of bad breaks and bad decisions, he managed to lose his entire wealth and then some. He responded with the standard moves of desperation, borrowing heavily and engaging in ever riskier ventures. As these too failed, he descended to the level of a common swindler, embezzling money from his mother-in-law, tying up his creditors in litigation, hiding assets, and selling the same assets to multiple purchasers. After his exasperated creditors finally had him committed to a short stint in debtors' prison, Defoe was reduced to making a living writing pamphlets and making bricks and tiles.

Defoe thus had ample reason to feel uncharitable toward successful financiers. He made the now shopworn arguments that securities dealing ties up funds that could be better lent to businessmen (particularly, one suspects, those a bit down on their luck). It is remarkable, however, how little Defoe's writings about stockjobbers have to do with securities markets per se. Each of his pamphlets about stockjobbers focuses to a consider-

Daniel Defoe: His Life at 18 (cited in note 15) ("The fable is always made for the moral, not the moral for the fable.").

17 See Backscheider, Daniel Defoe: His Life at 22-25 (cited in note 15).
18 See West, The Life and Strange, Surprising Adventures at 15 (cited in note 15); Sutherland, Defoe at 30 (cited in note 10).
19 See West, The Life and Strange, Surprising Adventures at 51 (cited in note 15). The remainder of this paragraph draws on West, The Life and Strange, Surprising Adventures at 51-56; Backscheider, Daniel Defoe: His Life at 50-61 (cited in note 15); Sutherland, Defoe at 31-47 (cited in note 10).
20 Thus, in Moll Flanders Defoe speaks from personal knowledge not only of Newgate Prison (Moll's birthplace), but also of the maneuvers of Moll's bankrupt second husband. The husband takes cover in the Mint (a haven for bankrupts trying to escape debtors' prison) and instructs Moll to sell assets and flee with the proceeds. Daniel Defoe, Moll Flanders 51 (W.W. Norton 1973).
21 See, for example, Defoe, The Villainy of Stock-Jobbers Detected at 2-3 (cited in note 7).
able degree on specific people, events, and controversies. A few bêtes noires—the East India Company in particular—recur in ways that provide insight into why Defoe found the whole business of stockjobbing so distasteful.

Defoe’s most consistent complaint about stockjobbers is that they were responsible for the existence of two competing East India Companies. The “Old Company” received its first royal charter in 1600 and enjoyed a monopoly of the trade to India until Parliament created the “New Company” in 1698. Defoe argues that competition between the two reduced the prices of imported goods to the detriment of domestic manufacturers

by glutting the Nation so with Goods, as to prejudice the Manufacture of England . . . ; and by reducing the Prices of their own Goods to out do and under-sell one another. . . . So that from the Contention between these two Companies, Trade in General is Injur’d, our Manufactures discouraged, both Companies will in the end be ruin’d, and the East-India Trade spoil’d if not lost.

A reader might wonder why Defoe was so enamored of monopoly and blind to the benefits of competition, and how the issue is related to stockjobbing. The answers have to do in part with the nature of the East India trade and in part with the evolution of the joint-stock company in the seventeenth century. Many early trading monopolies were so-called “regulated companies.” They were essentially government-sanctioned cartels; each member traded for his own account, but each contributed to the provision of common assets, and the company received exclusive rights to the trade. Membership was limited to merchants (and therefore to freemen), their heirs, and apprentices.

The joint-stock company, by contrast, was closer in form to the modern business corporation. Its members held property in common. Membership was not restricted to merchants, and shares could be freely sold. The joint-stock company had obvious advantages over the regulated company: it created a more con-

24 The reader can get a good feel for the controversies and the arguments made by the East India Company’s supporters and opponents from a pamphlet published on the company’s behalf in 1681 and generally attributed to Josiah Child. See A Treatise Wherein is Demonstrated I. That the East-India Trade is the most National of all Foreign Trades (1681).
venient form of property right that was of equal value to the pos-
sessor whether or not he was a merchant or had sons who wished
to continue the business.26 It also facilitated the attraction of
capital by opening share ownership to anyone with money to in-
vest. Indeed, the Old Company argued that it was not a “monop-
oly” because share ownership was open to all, unlike the regu-
lated companies that limited membership to freemen.27

The net impact of the innovation of the joint-stock company
on London merchants is difficult to assess. It made it easier for
them to transfer interests in their businesses and in that sense
must have increased their wealth. But it also decreased the value
of their hard-won status as freemen. Anyone who could convince
the crown to grant a charter (which in practice meant paying for
a charter through loans or gifts to the King) could establish a
business. In that sense, the joint-stock company represented an
incursion by national authorities on municipal privileges. It
makes perfect sense for a freeman like Defoe to attribute the
harm associated with that loss of privileges to “stockjobbers”—
that is, the thousands of holders of joint-stock shares who now
earned part of the rents that were previously reserved to mer-
chants. It is therefore important to understand that to Defoe and
his merchant contemporaries, “stockjobber” was in part a code
word meaning the proprietors of businesses organized as joint-
stocks rather than regulated companies. Their real complaint was
about competition, not the securities markets themselves. This
has modern parallels. People commonly use “Wall Street” as an
omnibus term to represent anything they happen to dislike about
business. In popular usage, the term need have nothing to do
with stockbrokers or traders.

Merchants did not object to the Old Company merely by vir-
tue of its joint-stock status, however. It had earned the special
enmity of many English manufacturers and wholesalers by im-
porting manufactured goods.28 Most overseas trading companies
followed the standard strictures of mercantilist political econ-
yomy—they exported English manufactures in return for raw ma-
terials. The East India trade, however, was different. The
spices—particularly pepper—that had been the staple of that
trade declined in value over the course of the seventeenth cen-
tury. As a result, the East India Company branched out into
manufactured goods, particularly textiles, that competed with

26 See Robert B. Ekelund, Jr. and Robert D. Tollison, Mercantilist origins of the corpo-
ration, 11 Bell J Econ 715 (1980).
28 See Scott, 2 Joint-Stock Companies at 135 (cited in note 22).
Moreover, the Company paid principally in bullion rather than by barter. Thus it antagonized the home trade coming and going—it did not buy from English suppliers for the outbound voyage and it brought in competing goods on the inbound. As the owner of a manufacturing business (and one-time textile merchant), Defoe was merely repeating the party line in criticizing the "stockjobbing" (i.e., joint-stock) East India Company for ruining England's commerce.

Stockjobbing did not merely implicate Defoe's economic interests but his political interests as well. This gave the subject a special urgency, for anything that touched upon the Protestant succession to the English crown was of paramount importance. As one modern observer notes, one thread runs through all of Defoe's diverse activities and writings: an "unrelenting opposition to Jacobitism and [ ] unfaltering support of all who engaged in keeping James II and his exiled Stuart successors away from the British Isles, maintaining the Protestant line on the throne, and resisting the feared return of Roman Catholicism."

Defoe's writings—even about the stock market—cannot be read without appreciating the religious and political divisions of seventeenth-century England, which produced two revolutions and a regicide. Under Charles II and James II, Dissenters (Protestants who refused to conform to the practices of the Church of England) were persecuted to greater and lesser degrees. Defoe had suffered minor harrassment and some of his friends had endured loss of career, property, and even life. The threat to Dissenters and other "true" Protestants did not pass after the Glorious Revolution. Many Tories preferred the Catholic, exiled James II to William (particularly after Mary's death in 1694). By allying England with his native Holland against France, William dangerously pitted England against one of the two most aggressive Catholic powers. Defoe and his fellow nonconformists were deeply afraid that France and Spain might combine to defeat

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30 The principal focus of the East India Company's 1681 pamphlet (cited in note 24) was to argue that it was beneficial to England to permit the company to export bullion and import manufactured goods.
31 David Macaree, Daniel Defoe and the Jacobite Movement 1-2 (Salzburg 1980).
33 Note the title of a pamphlet sometimes attributed to Defoe, A Dialog between Whig and Tory, alias Williamite and Jacobite. Furbank and Owens do not include the pamphlet in the Defoe canon. See Furbank and Owens, Defoe De-Attributions at 6 (cited in note 7) (naming Ben Overton as the likely author).
William, recall James II, and ensure a Catholic succession to the English throne.\textsuperscript{34}

Defoe likely believed his attacks on stockjobbers were made in the cause of the Protestant succession. The best evidence is that Defoe singled out one stockjobber—Josiah Child—for special abuse.\textsuperscript{35} Child was the largest shareholder and Governor (in modern terms, the chairman) of the Old Company. He had supported James II against William and was suspected of continued Jacobite sympathies. This, almost surely, was why Defoe hated him so bitterly.

During the 1690s, debates over the East India trade were partisan, with Tories generally supporting the Old Company and many Whigs arguing for the termination of its monopoly.\textsuperscript{36} The Whig faction within the Old Company itself was outraged by Child's open support of the Stuart kings and tried to force Child out.\textsuperscript{37} Failing in that quest, the dissidents sold their shares but ultimately sought and received a charter for the New Company from Parliament.

While Defoe was a bitter foe of Child, he also had many harsh words for the New Company and its founders. Defoe viewed the struggle between the Old and New Companies in political terms. His purpose in opposing the Old Company was the defense of William III against France and Jacobitism. The New Company's shareholders, of course, had more complicated motivations. They also wanted to make money—to "divide the rich cake of eastern trade more equitably amongst England's commercial elites."\textsuperscript{38} This motivation led them to make political compromises in hopes of securing favorable regulatory treatment, a move that Defoe could not forgive. He was outraged that City Whigs were actually deciding which Parliamentary candidates to support based on the candidates' willingness to grant the New Company similar privileges to the Old, rather than on the staunchness of their defense of Protestantism:

Here we are plagu'd with the Impertinence of two \textit{East India} Companies, as if the Interest of either Company were to be Nam'd in the Day with the \textit{Protestant Religion and the pub-

\textsuperscript{34} Even at home, the position of Dissenters was far from secure. Under Queen Anne, Defoe spent time in the pillory for writing a satire of high-church diatribes against non-conformists.

\textsuperscript{35} See Defoe, \textit{The Anatomy of Exchange-Alley} at 13-14 (cited in note 7).

\textsuperscript{36} Lawson, \textit{The East India Company} at 52-53 (cited in note 29).

\textsuperscript{37} Scott tells the story in detail. See Scott, 2 \textit{Joint-Stock Companies} at 144-68 (cited in note 22).

\textsuperscript{38} Lawson, \textit{The East India Company} at 51 (cited in note 29).
lick Peace, or as if they, who are fit to be Representatives of the People in the great Matters of Peace and War, Leagues, and Alliances of Neighbours, Succession of Crowns, and Protection of the Protestant Religion, should not be capable of deciding the petty Controversy in Trade between two Rivial Companies.\textsuperscript{39}

In a later pamphlet, Defoe wrote that he could more easily forgive the stockjobbers were they Jacobites acting deliberately to undermine the nation, but for Whigs to be so blind to the evils they might unleash was a greater offense.\textsuperscript{40}

It was easy enough to make the leap from there to the proposition that both the Old Company and the New Company, by competing to gain political advantage and distracting Parliament from the great issues of the day, were engaged in treason. Defoe's pamphlet \textit{The Free-holders Plea Against Stock-Jobbing Elections of Parliament Men} even provided the dark hint that "Some, and not a few, of our Stock-jobbing Brokers, are French men."\textsuperscript{41} By the time of Defoe's later pamphlet \textit{The Villainy of Stock-Jobbers Detected}, this conspiracy theory had become fully formed. Defoe argued that stockjobbers were allied with "\textit{the Nations Enemies}"\textsuperscript{42} and suggested that the Old Company's partisans wished to ruin the King's credit in revenge for their failure to gain more seats in Parliament.\textsuperscript{43} By 1719, Defoe's views were harsher still: "[S]tock-jobbing, as it is now practised, and as is generally understood by the word stock-jobbing, is neither less or more than high treason in its very nature, and in its consequences."\textsuperscript{44}

It would be unfair to criticize Defoe too harshly for these lunatic ideas. His fear of an alliance between France and Spain that would overpower Holland and England and reimpose an aggressive Catholicism was genuine and not unreasonable, and the consequences to Dissenters would have been catastrophic. They had only to think of the plight of French Huguenots to imagine their fate under a Catholic king allied with France. That these concerns were connected to the question whether the East India trade should be done through monopoly or competition sounds strange to modern ears, but Defoe's views were founded in a fear that the City was too focused on narrow commercial concerns to appreciate fully the French and Jacobite menace. Defoe's writ-

\textsuperscript{39} Defoe, \textit{The Free-holders Plea} at 7 (cited in note 7).
\textsuperscript{40} Defoe, \textit{The Anatomy of Exchange-Alley} at 21-22 (cited in note 7).
\textsuperscript{41} Defoe, \textit{The Free-holders Plea} at 23 (cited in note 7).
\textsuperscript{42} Defoe, \textit{The Villainy of Stock-Jobbers Detected} at 7 (cited in note 7).
\textsuperscript{43} Id at 6, 21.
\textsuperscript{44} Defoe, \textit{The Anatomy of Exchange-Alley} at 24 (cited in note 7).
ings, then, show the remarkably long pedigree of unfocused populist diatribes against bankers and financiers. But do they tell us anything useful about the operation of eighteenth-century financial markets or the need for regulation? The answer, I think, is a resounding “no.”

II. BEYOND THE LUNATIC FRINGE—OTHER EIGHTEENTH-CENTURY COMPLAINTS

It would be easier to dismiss Defoe’s criticisms if they stood alone. As Banner shows, however, scores of eighteenth-century writers complained about the stock market. He identifies four recurring complaints. Securities trading was described as “a breeding ground for deceit” (p 49); a nonproductive activity that “diverted time and effort from other, more worthwhile activities” (p 58); an activity that tended “to divide the public into factions” (p 62) and divert the government from pursuing the public interest; and an activity that “upset accustomed patterns of social life” (p 65) by creating a moneyed class that was neither propertied nor well-bred and in many cases not Christian. Banner notes that “[s]ome of these complaints are unlikely to sound persuasive to modern readers” but maintains that these views were widely and sincerely held (p 49). Moreover, he argues, these criticisms “would become long-running motifs in English and American culture” (p 48). The overall implication appears to be that these public attitudes were born of genuine social costs to which regulation responded.

Banner provides an impressive array of passages from plays, novels, pamphlets, and other writings from the early eighteenth century to support the proposition that securities markets were widely viewed as socially harmful. Although he notes that it is hard to judge how much these characterizations were exaggerated for effect, they “could not have become such a fixture without some grounding in reality” (p 52).

Here Banner comes closest to ignoring his own warning to take the evidence provided by popular culture with a substantial grain of salt. It would in fact be all too easy for these characterizations to exist in fiction and polemic without a grounding in reality. We need look no further than current popular culture for confirmation. Consider the picture of financial markets that a twenty-third-century observer might construct by taking seriously 1980s and 1990s movie dialogue. The poor CEO threatened by takeover artist Larry the Liquidator (Other People’s Money) makes the impassioned attack:
This man leaves nothing. He creates nothing. He builds nothing. He runs nothing. And in his wake lies nothing but a blizzard of paper to cover the pain... God save this country if that is truly the wave of the future. We will then have become a nation that makes nothing but hamburgers, creates nothing but lawyers, and sells nothing but tax shelters.45

Indeed, Hollywood's financiers not only accept the idea that their activity is socially valueless, they revel in it. Gordon Gekko (Wall Street) makes it into his signature line: "I create nothing. I own."46 Note that the modern screenwriters' descriptions of financial markets are remarkably similar to those of seventeenth-century playwrights. Without more evidence, I see no reason to trust the accuracy of the latter any more than the former.

Indeed, to take these characterizations entirely seriously (and to believe that the contemporary public did) would create a significant anomaly. As Banner recognizes, these criticisms were essentially warmed-over versions of the traditional attacks on grain speculators and money-lenders. It seems bizarre that a century of English thought that challenged traditional ideas about science, mathematics, philosophy, and government—a century that produced Newton, Milton, and Locke, among others—could have produced no improvement on medieval ideas about wholesale markets. To take the contemporary complaints at face value is to believe that at the end of the century in which Francis Bacon described the process of induction, at a time when European scientists were studying the orbits of the planets with sufficient care to write down the fundamental laws of motion, their contemporaries failed utterly to notice that the London stock market enabled the English crown to raise money more cheaply than the French and thus to wage war effectively against a more populous and wealthy country.47

Banner is undoubtedly right to argue that eighteenth-century opinion condemned the pursuit of private commercial advantage heedless of the public good.48 That is not enough by itself,

46 Wall Street (20th Century Fox 1987).
48 See, for example, J.E. Crowley, This Sheba, Self: The Conceptualization of Economic Life in Eighteenth-Century America 101-10 (Johns Hopkins 1974). But see Albert O. Hirschman, The Passions and the Interests: Political Arguments for Capitalism before Its Triumph (Princeton 1977), for an argument that significant segments of seventeenth- and eighteenth-century thought viewed pursuit of private commercial gain as politically beneficial.
however, to demonstrate that stock traders were ruthlessly pursuing private advantage while their critics pursued the public good. Indeed, were it precisely the reverse, we would expect to see the same rhetoric. The market’s critics would have hurt their cause had they said “this new institution is making my business less profitable” and accordingly would have to cast their arguments in public-regarding terms. We can recognize that contemporary opinion condemned the use of governmental processes to serve economic ends; unfortunately, that tells us nothing about whether the traders or their critics were more guilty of this offense.

The historical evidence Banner presents may nevertheless help explain why financial markets are so heavily regulated. Current scholarly attempts to explain securities regulation fall into three categories. The first is a public interest explanation that attempts to identify externalities or coordination problems that regulation might solve. The second is known as the “politics of finance” approach. It argues that politicians with short time horizons favor regulation as a way to satisfy angry constituents who do not understand the functioning of financial markets and lack the incentive to learn. The third is a public choice approach. This approach posits that different types of market participants with different interests compete for legislation that reduces the cost of their preferred market structures and raises the cost of rival structures.

The historical evidence can surely shed some light on these competing theories. To the extent he addresses the question, Banner appears to waver between a public interest and a “politics of finance” explanation for securities regulation, but he is never very explicit about it. It is notable that apart from the contemporary commentary, the book provides almost no evidence that early securities markets created large social costs that were addressed through regulation. With additional work, the historical

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50 For examples, see Harry DeAngelo, Linda DeAngelo and Stuart C. Gilson, Perceptions and the politics of finance: Junk bonds and the regulatory seizure of First Capital Life, 41 J Fin Econ 475, 495-503 (1996); Michael C. Jensen, Corporate Control and the Politics of Finance, 4 J App Corp Fin 13, 16, 18 (Summer 1991).

evidence might be used to construct an account of early English securities regulation along the lines of either the public choice or politics of finance literature. I will not here try to determine which of these alternative accounts is more plausible, or indeed claim that we can definitively reject all public interest explanations for seventeenth- and eighteenth-century securities regulation. My more limited objective is to point out that the evidence from the seventeenth and eighteenth centuries raises the same sorts of issues with which modern academics struggle when trying to explain why governments opt to regulate. Let us take the claims made by the market’s critics one at a time.

A. Fraud and Deceit

What evidence do we have about the existence of widespread fraud in early English securities markets? If, as the plays and novels suggest, securities traders routinely manipulated prices, floated shares of inherently worthless enterprises, and duped less sophisticated market participants, eighteenth-century securities markets would surely have been less efficient than modern markets. Yet the statistical properties of eighteenth-century stock prices are nearly identical to their twentieth-century counterparts.\(^5\) Moreover, the econometric evidence supports the hypothesis that eighteenth-century stock markets were informationally efficient.\(^6\)

This is unsurprising when we consider the level of sophistication of eighteenth-century securities professionals. My suspicion is that some historians have been misled by early traders’ lack of a modern lexicon and theoretical framework within which to describe their actions, with the result that early securities professionals are described as not understanding the economic forces underlying their activities.\(^7\) Yet consider a more recent assessment:

The practices of eighteenth-century brokers were sophisticated. For instance, the pricing of stocks then was identical to that found in modern finance texts. Investors . . . valued stocks according to their discounted stream of future divi-

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\(^7\) See, for example, R.K. Webb, *Modern England: From the Eighteenth Century to the Present* 20-21 (Harper & Row 1980) (“The founding of these famous [financial] institutions must not, however, be taken as indicating any high degree of sophistication in understanding the operation of financial machinery.”).
dends . . . . There were published tables showing the appropriate discount for different interest rates and time horizons. . . . [Traders] also used "modern" investment strategies, such as forming portfolios, diversification, and hedging.55

Banner presents but misinterprets a strong piece of evidence against the hypothesis that these markets were plagued with a high degree of fraud. He notes the growth of a derivatives market in which participants traded options and futures contracts on stocks. This, he suggests, may have increased the extent of fraud (pp 29-30). Yet the opposite inference is surely more plausible. Late seventeenth-century London securities traders constituted a small community of repeat players. The fact that they were willing to enter into futures contracts and purchase options—paying cash in hand against a promise to enter into a losing bargain in the future under certain circumstances—shows that these traders trusted one another a great deal. If stock traders perceived their fellows to be dishonest, options and futures markets could not have existed.

B. Investment as Unproductive

The notion that trading, as opposed to production, does not increase social wealth is much older than securities markets. There is a remarkable continuity in this subset of antimarket rhetoric, whether it be medieval and early modern complaints about grain speculators (a parallel Banner draws (pp 17-20)) or current condemnations of derivatives traders. On the other hand, in each case the discontinuity between commentary and practice should give us pause. While laws against speculation are ubiquitous temporally and territorially, they are never enforced with sufficient rigor to stamp out the practice. Indeed, when the English government temporarily stepped up its enforcement of grain speculation laws in the early seventeenth century, the effect was to reduce food supplies in London and the effort was abandoned.56

For the most part, people seem to understand instinctively what they often deny explicitly—that middlemen are essential to trade, and trade is essential to increased well-being.

55 Harrison, Similarities in the Distribution of Stock Market Price Changes at 77 (cited in note 52).
56 See Christopher Hill, The Century of Revolution, 1603-1714 31 (Thomas Nelson & Sons 1961). One might, of course, think of Soviet collectivization as the same experiment on a larger scale, with correspondingly disastrous results.
C. Politics

Particularly after the South Sea Company debacle, pundits argued that securities trading gave rise to an increase in non-public-regarding political activity. Traders, they claimed, influenced the political process to benefit themselves regardless of the consequences to the remainder of the polity. Banner notes that modern readers, reconciled to the inevitable play of interest groups in the political process, would not find this line of argument terribly convincing. In "a system of political thought that abhorred faction," however, the argument would have been much weightier (p 64).

It strains credulity well past the breaking point to believe that the creation of securities markets caused a substantial increase in private parties' use of governmental processes for personal gain. To see this, we need only recognize that economic regulation in seventeenth-century Europe was a free-for-all of rent-seeking, suppression of competition, and bare-knuckled interest group conflict. Consider Christopher Hill's description of the average subject of James I in the early part of the century,

living in a house built with monopoly bricks, with windows (if any) of monopoly glass; heated by monopoly coal . . . burning in a grate made of monopoly iron. His walls were lined with monopoly tapestries. He slept on monopoly feathers, did his hair with monopoly brushes and monopoly combs. He washed himself with monopoly soap, his clothes in monopoly starch. He dressed in monopoly lace, monopoly linen, monopoly leather, monopoly gold thread.57

One can of course attribute this pervasive monopolization to an intense desire for stability rather than rent-seeking by producers, but producers fought hard to gain their monopolies and, once gained, to defend them against interlopers. Mercantilist regulation, whatever its defenders said about it, enabled producers to gain rents at the expense of consumers and government officials to share in those rents.58

Why, then, was there a sudden outpouring of concern about corruption both in late seventeenth-century England and late

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57 Id at 32. This quote constitutes roughly one-third of the paragraph; there's a lot more monopoly where that came from.
eighteenth-century America, in both cases following the creation of organized securities markets? The most likely reason is that securities markets helped make the costs of rent-seeking and corruption more transparent. Compared to the official who took a bribe, the legislator who owned securities and favored policies that maximized their value was more visible. Given the small community of brokers and the centralization of trading on the organized market, the legislator’s interest was no secret. Because securities prices were observable on a daily basis there would be little doubt about the effect of newly adopted government policies.

Moreover, because securities markets generate a large number of observable prices, they send signals about the relative returns to various activities. This, too, must have increased awareness of the welfare losses caused by government-sponsored monopolies. In short, it seems likely that the existence of securities markets tended to decrease, rather than increase, political corruption by making its existence and consequences measurable.

Securities regulation, on the other hand, was clearly a forum through which brokers gained rents at the expense of their customers. We get our first hint from the wonderfully named “Act to restrain the number and ill practice of brokers and stock jobbers” of 1697,8 the first statute to regulate the new securities market. Its principal feature was indeed to limit the number of stockbrokers to one hundred. The Lord Mayor of London was given the power to hand out the licenses. The brokers apparently understood the benefits of entry barriers without the help of modern economic theory.

The famous South Sea disaster also illustrates the use of regulation for private gain. The collapse of the price of South Sea Company shares in 1720 occupies a prominent place in the history of securities regulation, and Banner describes the public reaction to the fiasco in detail (pp 45-48). Recent scholarship has argued that the South Sea debacle was less an example of irrational speculative frenzy (the traditional account) than of rent-seeking gone awry.

The traditional story is that the South Sea Company, despite the flimsiness of its business prospects, managed to tout its shares to a spectacular height before the price collapsed. At this point Parliament intervened by enacting the Bubble Act, which banned joint-stock companies that did not have a charter. The reality is considerably more complicated. The Bubble Act was en-

acted before, not after, the steep drop in the South Sea Company's share price.\textsuperscript{60} Moreover, it is clear that the statute was enacted at the South Sea Company's behest. One recent commentator argues that the Company's purpose was to cut off competition for scarce capital.\textsuperscript{61} Whether or not that was the motivation, the Company induced Parliament to enact a statute that then backfired by causing a financial panic that brought the Company down with the rest.\textsuperscript{62} Rent-seeking can be a dangerous business.

D. Social Upheaval

The observation that eighteenth-century writers criticized the stock market for upsetting the social order certainly strikes a chord with a modern reader. Speculation attracts opposition in part because it does not respect birth, breeding, schooling, or other variables that can increase the chances of success in many other walks of life. Whatever we think of the genuineness of the early critics' complaints about fraud and waste, it is all too believable that they saw men of low birth obtaining great wealth and reacted with disgust.

Then, as now, the opposition appears to come in two flavors. One is a simple distaste for arrivistes. Popular culture enjoys making fun of parvenus, particularly when markets are rising (think of Tom Wolfe's two novels, published in 1987 and 1998, satirizing a bond trader and a hick-turned-real-estate-tycoon, respectively\textsuperscript{63}). Banner provides an amusing survey of plays, rhymes, songs, and cartoons from the boom year of 1720 parodying the men who were born to serve but had gained enough money to command (pp 66-68).

The other, more ugly, side is the dislike of social outsiders who flock to speculative markets because they like their chances there better than in, say, management or law. Speculation, because of its individualistic and impersonal nature, is a ready means for those who face barriers elsewhere to make a living—a feature that undoubtedly contributes to its unpopularity. Thus attacks on speculation (and, of course, on the related evil of usury) have often had an anti-Semitic tinge. Moreover, some

\textsuperscript{60} See Peter M. Garber, Famous First Bubbles, 4 J Econ Persp 35, 51 (Spring 1990). Garber concludes that the South Sea episode is not a "bubble" (that is, an unwarranted price rise) at all. Id at 52-53.


\textsuperscript{62} See Garber, 45 J Econ Persp at 51 (cited in note 60).

commentaries on the 1929 stock market crash argue that the strongest sign that the market had taken leave of its senses was the growing presence of women as stock traders.⁶⁴

I suppose we can view it as progress of a sort that today’s commentators refer to the proverbial twenty-five year old in suspenders rather than the greedy Jew to demonstrate that stock markets are simply casinos. That said, the underlying instinct remains a shameful and thoroughly illegitimate reason to regulate. Banner shows that it was nevertheless an important source of the regulatory impulse in the eighteenth century, and if we take popular culture as our barometer, it is not completely gone today.

CONCLUSION

Anglo-American Securities Regulation admirably fills a gap in the literature on financial regulation. Banner uncovers remarkable similarities between early and modern views about speculators and between early and modern regulatory techniques. I suspect that looking to economic as well as cultural factors would have provided a more compelling explanation for the similarities. Indeed, I think modern economic thinking about regulation will provide a promising means to carry forward the work Banner has begun.

⁶⁴ One example comes from John Kenneth Galbraith, The Great Crash 80-81 (Houghton Mifflin 1955):

Perhaps the failure to visualize the extent of one’s innocence was especially true of women investors, who by now were entering the market in increasing numbers. . . . To the typical female plunger the association of Steel was not with a corporation . . . . Rather it was with symbols on a tape and lines on a chart and a price that went up . . . . One of the uses of women is that their motivations, though often similar, are less elaborately disguised than those of men.

Another Harvard professor, William Ripley, argued that the presence of women as stockholders provided an additional reason for government oversight of corporate governance:

For a surprisingly large number of great corporations more than half of the shareholders are women—in American Telephone for 1926, 200,000 of the 366,000 were on the distaff side. Such a multitude are ill-fitted by training—begging the moot point of sex—to govern directly, less so than in politics.

William Z. Ripley, Main Street and Wall Street 129 (Little Brown 1927). Banner notes a similar sentiment in England around the time of the South Sea fiasco (pp 70-72).