

Despairing Men crave Desperate Projects

Peder A. Berg, Deputy Director General
Ministry of Finance, Norway

<http://www.concept.ntnu.no/english/>

Despairing men crave desperate projects

Peder Berg

Deputy Director General

Ministry of Finance Norway

Case 1

The Mississippi Scam

The Desperate



**Philip, Duke of Orléans
Regent of France**

The Wizard



**John Law, scotsman
Bankier, Gambler,
Convicted murderer**

France in 1715

- On September 1st Louis 14. died after a reign of 72 years
- His successor, Louis 15, was a boy 5 years old
- His grand-uncle, Philip, Duke of Orléans, was installed to rule until the king attained his majority
- Louis 14 was a great personality, he shaped an era, for good and bad. Opinions on the legacy vary.
- *Financially* however, the French government was in a state of undeclared bankruptcy. The main reason was a number of costly wars, especially the last one, the War of the Spanish Succession (1701-13/14).

The Fiscal Situation

- Nobody knew exactly how much The Crown owed, but it was in the region 2 – 3 billion livres. A recent study suggests 2.8 billion.
- Annual revenue in a normal year was at a little over 100 million livres. A continuation of war time extra taxes yielded an additional 50 million.
- Interest on the debt amounted to 80-90 million livres a year.
- The tax revenue for 1716, 1717 and 1718 was pledged as security for loans.
- Available silver and gold in the Treasury: Less than 0.8 million.

First attempt at consolidation: Traditional measures in times of crisis

- Part default. A special committee, *Le Visa*, imposed a haircut on all state-issued debt instruments unless the owner could prove that they had been acquired for at least par value.
- A special Chamber of Justice investigated alleged malfeasance among those who had been party to a contract with the Treasury during the preceding 27 years. Perpetrators were fined heavily.
- Austerity measures were introduced. The expenditures on the Military were cut back drastically, as were the state pensions.
- The coin was tampered with, amounting to an effective devaluation of 33%.

Policy shift

- The measures were effective, but unpopular.
- The Regent was told that another 15 years of prudence and fiscal restraint would be necessary in order to reduce the debt further, to a comfortable level. Upon learning this the Regent lost interest in pursuing this line of policy.
- Instead the Regent approached John Law, whom he had known for some years. Law was running a successful private note-issuing bank.

Law's grand design: Monetizing the debt

- Law explained to the regent that the prime problem in the French economy was a lack of money. Hence money should be created.
- If the Crown bought his bank (but retained him as CEO) and made its notes legal tender, then the bank could buy most of the still outstanding debt, thus solving the Regent's problems too. The deal would be settled with newly created paper money, issued by the bank.

Precautionary measures

- For the public to have confidence in the new paper money, it had to be declared convertible in silver or gold.
- But as there was very little of precious metals in the bank's vaults, measures had to be taken to discourage people from actually demanding conversion.
- Law had the ingenious idea to entice people to invest in something they could perceive as more valuable than precious metals: Shares in a promising joint stock company.

The Project: The Mississippi Company/*Compagnie de l'ouest*

- France had a colony in North America called Louisiana. It was vast, encompassing all of the Mississippi river valley and adjacent territories. There were very few French settlers and very few in Europe who had any knowledge about the area. Law let rumours be spread that Louisiana had an abundance of gold, rubies and emeralds.
- Law owned a modest trading company, The Mississippi Company. He let it be known to the parisians that a floating of the company was on the agenda in the form of an Initial Public Offering (IPO), into which anyone could subscribe.

The Scheme is set in motion

- In December 1718 Law's bank was by Royal Edict converted to the *Banque Royale*, France's first reserve bank, with a monopoly on issuing paper money.
- Simultaneously, a Royal Edict created out of the Mississippi Company the public joint stock company *Compagnie de l'ouest*. The IPO set a price per share of 500 livres, with the promise of a yearly dividend of 200 livres, or 40%, of course payable with the notes of the *Banque Royale*. There was no real trading activity going on with Louisiana.
- For those who wanted more shares than they could pay for, relief was at hand. The *Banque Royale* was willing to lend out money, taking the shares as collateral. 40% dividend on the shares compared with 4% interest on the loan made for a wonderful carry trade.

Initial success

- There was an enormous public interest in the shares. During 1719 the price rose 20-fold, to 10 000 livres.
- The Regent was very happy, distributing shares to family and friends. His confidence in Law was now without limits. In May Law was allowed to merge the *Compagnie de l'ouest* with the companies trading with China and India, forming the *Compagnie des Indes*. This company got a monopoly on all French overseas trade. He was also bestowed with a very lucrative tax-farming contract, effectively giving him control of a third of the national tax revenue. In January 1720, he was even made Comptroller General.
- The two colluding men now embarked on the most daring experiment: Monetizing public debt on the unprecedented scale of 1.6 billion livres.

Distress

- In January 1720 new stock in the *Compagnie des Indes* was issued at the prevailing market price, 10 000 livres apiece. But the dividend remained 200 livres. Cautious investors concluded that the stock was overvalued and started to sell.
- Inflation pressure was building up, in foodstuffs, commodities, housing and land. Law decided that something needed to be done to reduce the money supply.
- In May 1720 the notes as well as the shares were devalued. The devaluation should take place in increments until reaching approximately 50%. This was an obvious mistake, as people became desperate to sell paper they knew would fall further. But now there were no buyers.

Collapse

- Law was placed in house arrest, but reinstated in some of his functions by his friend, the Regent. His increasingly desperate attempts at regaining public confidence met with no success, however. In December 1720 he had to leave France, never to return.
- It ended with a double bankruptcy, including the bank as well as the company.
- A new *Visa* committee was appointed. It liquidated the mess in a draconian way.

Aftermath

- The French lost confidence in the financial sector for decades. For more than 50 years France was without a central reserve bank.
- There were winners and losers. Among the winners were the Treasury and many noblemen. The lower bourgeoisie was overrepresented among the losers.
- The government gradually amassed new debt until the situation became unbearable in the course of the 1780's.
- Then came the French Revolution.

What about Mississippi?

- A few emigrants returned to France, telling a sobering story: There was no gold in Louisiana, nor any rubies nor emeralds. Instead there was an abundance of alligators and mosquitoes carrying malaria and yellow fever.
- In fact, there was not much economic activity in Louisiana. The name New Orleans is about the only legacy today. Its name does not derive from the French city of Orléans, but from the Duke of Orléans, under whose reign the city was founded.

Case 2

The Bachem BA-349 Natter («Adder»)

The Desperate



Heinrich Himmler
Reichsführer SS

The Wizard



Erich Bachem
Airplane Designer
(with Hanna Reitsch)

Germany in 1944

- World War 2 was slowly but relentlessly drawing to a close and Germany was not on the winning side.
- In fact, the situation was precarious on all fronts, including in the air.
- Big US and British fleets of heavy bombers were mauling the German cities.
- Germany had increasing problems in maintaining an adequate fighter force. The steady loss of experienced pilots was especially worrying.

Competition for a new fighter

- In early 1944 the Air Ministry initiated a competition on a new fighter design.
- The requirements specification stated that the aircraft should be simple and easy to assemble in vast numbers. Furthermore, it should be possible for a less experienced pilot to fly it effectively.
- It was decided that this project would fall within the category of V-weapons (the V is for German «Vergeltung», which in English means «retaliatory»). The development of V-weapons was a Waffen SS responsibility. Thus, Himmler would be the man to choose the winner design and not the Luftwaffe generals.

Himmler's choice

- All the big aircraft manufacturers submitted designs.
- To the amazement of many, an outsider was awarded the development contract: Erich Bachem
- His design was the most radical among the competitors, and that might give a clue to why he was chosen. Radicalism translated to political correctness in the SS community.

BA 349. A specimen on display in Deutsches Museum, Munich



Tund bei Kommandantur
Truppenübungsplatz Heuberg
melden
Tel. Stellen am kalten Markt 222

Tund bei Kommandantur
Truppenübungsplatz Heuberg
melden
Tel. Stellen am kalten Markt 222
Belohnung!

What was so special about the design?

- The aircraft would never land. It had no undercarriage.
- Starting vertically, it would rapidly attain a speed in excess of 1000 km/h.
- Propulsion was by rocket engines. The fuel would not last long, but during the brief vertical flight the interceptor would have attained an altitude above the bombers.
- The pilot would then take the plane, now effectively a glider, down and shoot a salvo of missiles at the nearest bomber.
- After that, he would ram the aircraft into a second bomber. Immediately before impact, the aircraft would split in two. The rear part would be salvaged in a parachute, the pilot in a second parachute, while the nose section only would continue forward and actually hit the enemy.

Development and test-flights

- Bachem worked during development on making the plane and the operational concept safer. He proposed to omit the final ram assault, which was accepted.
- The plane flew a few times as a glider after having been towed up in the air by a bomber.
- The first and only test with a vertical launch ended with a crash in which the test pilot was killed.
- Thus the BA-349 shared the fate of most other German «wonder weapons». It flopped.

Concluding remarks

- When under consistent severe stress people's judgement tends to be blurred.
- An incorrect assessment of risk is common.
- Many tend to develop risk-loving features, more or less like a gambler. This may make them susceptible to the luring tunes of real, professional gamblers, as was the case with the ill-fated duke.
- Or they may end up resorting to infantile patterns of thought, like Himmler («Radicalism is good»)
- Sometimes we can observe the desperate and the wizard together as a pair. Usually this happens in a fund-raising setting. Look out and don't open your purses!
- By the way, which of the cases did you find the most relevant for our times? The oldest, maybe?