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 **Natural catastrophes,**
the unstoppable torment!

July 19, 2000

How John Law's Failed Experiment Gave Us a New Word: 'Millionaire'

THROUGHOUT HISTORY, the people who have become very wealthy have had two things in common: Each had a great gift or idea, and each lived in a society where that gift was highly valued. A brawny and aggressive man with state-of-the-art spears probably wouldn't get rich in modern America, but he might have been the Bill Gates of the year 1000. Similarly, today's brainy Internet entrepreneur might very well have been a slave 1,000 years ago.

In 18th-century France, the scarcity of gold impaired the country's ability to trade its surpluses with other nations. Many of the French enjoyed great affluence, yet they and the profligate government of Louis XIV always seemed to be scrounging for gold.

It was the great fortune of a man named John Law that he could introduce his ideas about paper money to the country. "My secret is to make gold out of paper," he once said. The result was famously lucrative and then even more famously catastrophic for the French, but Law's demonstration of the flexibility afforded by paper currency and by the creation of money by bank or government fiat has been the basis of finance ever since. His exploits gave the world a word it cherishes to this day: millionaire. The following excerpts from a new book by Cynthia Crossen about the amassing of great fortunes through the ages shows linkages between Law's epoch and our own.

Born in 1671, John Law grew up in Edinburgh, where his father was a goldsmith who lent money on the side. As a child, Law displayed an aptitude for arithmetic, geometry and algebra. When he was 13 years old, his father died, and his mother took over the family business. Law worked for the firm for three years, learning the principles of banking, and after work he studied tennis and fencing. Before he left to seek his fortune in London, he was described as "nicely expert in all manner of debaucheries."



In London, Law gambled, studied finance, and practiced what was then called "gallantry" -- all at

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considerable expense to his widowed mother. He was a good athlete, quick-witted, eloquent, and fastidious in dress. He was also a great favorite among women, who called him Beau Law. For reasons lost to history, Law began feuding with a man named Beau Wilson, another London dandy. The two arranged to fight a duel, which lasted only a few seconds: In Law's one pass, he fatally pierced Wilson's chest with his sword.

From the book 'The Rich and How They Got That Way' by Cynthia Crossen. Copyright 2000 by Dow Jones & Co. Published by Crown Business, a division of Random House Inc.

Because duels were assumed to be premeditated, Law was charged with murder and convicted. Imprisoned while awaiting a public hanging, he escaped. For the next 10 years, Law drifted around the Continent, supporting himself by gambling. In Venice, Genoa and Amsterdam, he also studied fledgling banking companies. His mathematical mind was persistently reflecting on the intricacies of high finance.

At Europe's many gambling houses -- Paris alone had more than 60 at the time -- Law became known as an expert at calculating mathematical odds. Eventually, he was winning so much money that he commissioned the casting of a large gold coin to facilitate the handling of his stakes. He began to travel around in a polished coach attended by men in livery. Charming and wealthy, Law was able to get letters of introduction to the drawing rooms of powerful Europeans. At one home in Paris, he met the Duke of Orleans, who a few years later became regent of France.

Law learned the most about banking and finance in Holland, where the Bank of Amsterdam was already 100 years old. In Law's time, the bank primarily handled transfers -- merchants brought coins to the bank and received credit for their value in the form of banknotes. Because the bank simply transferred money among accounts, under normal circumstances it wouldn't be caught short of metal reserves.

In the early 1700s, Law continued moving among the Continent's big cities, gambling for his living. In 1715, he and the woman he lived with moved to Paris, where Louis XIV had recently died. Louis had passed France to his

five-year-old great-grandson, Louis XV, whose regent, the Duke of Orleans, was Law's friend.

Corrections

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In Paris at the time, wealth was seen as an unalloyed good, and the wealthy pampered themselves with grotesque and silly magnificence. The mistress of a rich nobleman wanted to exceed the legendary Lucullus, who swallowed a diamond worth 100,000 francs, so she ate a bill worth 500,000 francs. While some of the wealthy were children of the landed aristocracy, others made their fortunes by milking the national treasury.



Archive Photos/Hulton Getty

Louis XIV had been living on loans for years, borrowing from his subjects and issuing worthless paper that went by different names to promote confusion. In the last 14 years of his reign, Louis XIV had spent two billion livres more than he had collected in taxes. The coinage had been so debased that it was almost worthless. Tens of thousands of workers were unemployed, and agriculture was in distress. Trade was almost at a standstill.

John Law (above), once described as 'nicely expert in all manner of debaucheries,' became an expert at calculating mathematical odds by frequenting Europe's many gambling houses.

Law believed he could fix France with his "system." He began by proposing a bank that would issue notes and hold and transfer deposits, much as the Bank of Amsterdam did. As an incentive to the government to endorse his bank, Law would sell shares of the new bank for a combination of cash and government securities, which, although then trading at a deep discount, he would honor at face value.

In 1716, Law established a private bank called Law & Co. So sure was he of his system's promise that he invested his entire fortune in it and promised to give 500,000 livres to charity if the project failed.

Many others had tried to replace metal with paper, but it was difficult to persuade people they should exchange coins, which had a known value, for the promise of other coins in the future. Coinage everywhere was subject to sudden and arbitrary devaluation or augmentation, making its purchasing power somewhat hypothetical. But Law made a promise to the French people that their government hadn't: His notes were redeemable on demand for coin "of the weight and standard of the day of issue." That meant the value of the notes would be unaffected by future fluctuations in coinage.

Gradually trust in the bank began to build. In 1717, the notes were made receivable for taxes and other royal revenue. The following year, Law's bank became the state-royal-bank. One of the nationalized bank's first actions

was to change the terms of its notes to be redeemable for "current coins" -- subjecting Law's notes to fluctuating values.

Law had become one of the most revered people in France -- he was a financial pied piper, and the nation danced to his music. He said what his audience wanted to hear: He could make them rich merely by printing paper.

In 1717, Law proposed establishing a company that would have the exclusive rights to trade with and exploit the resources of the Mississippi River, the Louisiana Territory and Canada's fur trade -- all under French control at the time. Another part of the scheme: Law would pay down some of the government's enormous debt from the company's profit.



Read an additional excerpt about Bill Gates from "The Rich and How They Got That Way."

The regent and Parliament approved the plan, and the Company of the West was established. Shares in the company sold slowly at first: For nearly two years, they could be bought below

par. To attract public attention, Law declared that in six months he would "call" for a small number of shares of the company at par, even though the shares were then selling at about half of face value. Share prices began to rise.

Law's company gradually began to acquire other contracts for government business, occasionally issuing more shares to finance its acquisitions. It bought the tobacco monopoly in 1718, when consumption of tobacco was rapidly escalating. In 1719, the French government gave the company the right of coinage. John Law now controlled the mint, public finances, the bank, the sea trade and the Louisiana, tobacco, and salt revenues.

At the same time, Law was encouraging holders of government annuities -- whose debt financing was crippling the crown -- to exchange their instruments for shares in the company. He issued 200,000 shares of his company and again accepted discounted paper at face value. Several months later, he issued another 50,000 shares. All were snapped up enthusiastically, so Law issued still another 50,000 shares. Then, in September 1719, Law announced that he would buy the entire debt of France by issuing more shares of his company and basically swapping dividends. By the end of the year, he had sold 600,000 shares in the company.

To keep the share price rising, Law published exaggerated accounts of Louisiana's riches, mineral resources, and people. He created duchies, earldoms, and marquisates in Louisiana (and gave himself the duchy of Arkansas).

The reality, of course, was quite different. Much of the Mississippi valley was unconquered wilderness. But in Paris, no one knew this. The only thing the French knew with certainty was that prices of the company's shares would never stop climbing. Stock that had come on the market at 500 livres

was selling for 10,000 livres. This price unnerved even Law himself, although he had become one of the richest men in the world. Meanwhile, the regent ordered more money printed. In one year, the supply of money almost doubled. Inflation soared.

In Paris, people of every class enjoyed the novelty of making a fortune while they slept. Rags became riches, and riches became inordinate riches. So many people were becoming rich that the French needed a new word to describe them, and millionaire was it.

In 1720, Law, the national hero, was appointed France's comptroller general of finances, making him the de facto prime minister. The day after he assumed office, shares of his company reached an all-time high. Using his trading profit, Law bought dozens of parcels of land and buildings in Paris, some 20 estates, jewels, a 45,000-volume library and a wine cellar.

Eventually, all financial fevers break. In Law's case, professional speculators began selling, but instead of accepting paper as payment they demanded coin. Law knew his bank would soon be depleted if this continued, but he also knew it would be suicidal not to honor his redemption promise. Share prices fell, and attempts to convert paper into gold or jewels accelerated.

At Law's urging, the government introduced a series of edicts aimed at forcing the public to use paper instead of metal. On Feb. 27, 1720, the government ordered that no person "of whatever estate or condition" should have more than 500 livres in coins or ingots. The authorities commenced so-called domiciliary visits, resulting in widespread confiscations. In the cellars of an ex-chancellor named Pontchartrain were found 57,000 gold coins. On March 11, the government announced that gold and silver could no longer be used to pay debts. This made France the first country in the civilized world where a commercial transaction couldn't be conducted with gold and silver.

The public was incensed. Law was given a detachment of Swiss Guards to protect him from enraged crowds. Once when his empty carriage was recognized on the street, an angry mob tore it to pieces. The windows of his house were smashed. Yet he still had the ear of the regent. He was, after all, the only person in the world who understood the system.

On May 21, the government issued the edict that broke the system. It devalued all the company's notes and shares and fixed their prices. The value of the company's shares was reduced by almost half. The public outcry was so vociferous that the edict was repealed a week after its publication, but the damage was done. Law submitted his resignation as comptroller general.

The rush on the bank was so great that it closed for 10 days; it opened again on June 10, but so many people tried to get in that some suffocated or were crushed to death. On July 17, the crowd arrived at the bank to find barricades around it. This so incited them that they rushed the barriers; 12

were killed, many others injured.

Meanwhile the price of food was rising, and shopkeepers would accept paper currency only at discounts as high as 90% and sometimes not at all. The government began to withdraw paper from circulation by announcing that all notes of 1,000 livres or more were canceled unless they were used to buy government annuities or for opening accounts at Law's bank. Another edict soon did the same for all other notes. A few months later, the use of gold and silver was resumed in all commercial transactions.

On Nov. 27, the bank closed its doors for the last time. John Law's experiment with paper money had lasted less than two years. He left France in December. All his property, except a small amount of cash he carried, was confiscated by the government. He returned to England, where he asked for and was granted a formal pardon for his 30-year-old murder conviction.

In 1725, Law moved to Venice, where he made a modest living by gambling. He died of pneumonia in a lodging house four years later at the age of 58. An inventory of his wealth noted 488 paintings, including works by Titian, Raphael, Michelangelo and Leonardo da Vinci. A satirical epitaph published in France after his death read, "Here lies that celebrated Scotsman, that peerless mathematician who, by the rules of algebra, sent France to the poorhouse."

John Law's experiment, like many experiments, was a failure, even a tragedy for some. But his ideas were like smoke from a bottle: Once out, they could not be put back. He had proved that the value of money is an agreement among people, not an objective standard measurable in nuggets or ingots, a distinction that fostered future stages of wealth creation.



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