

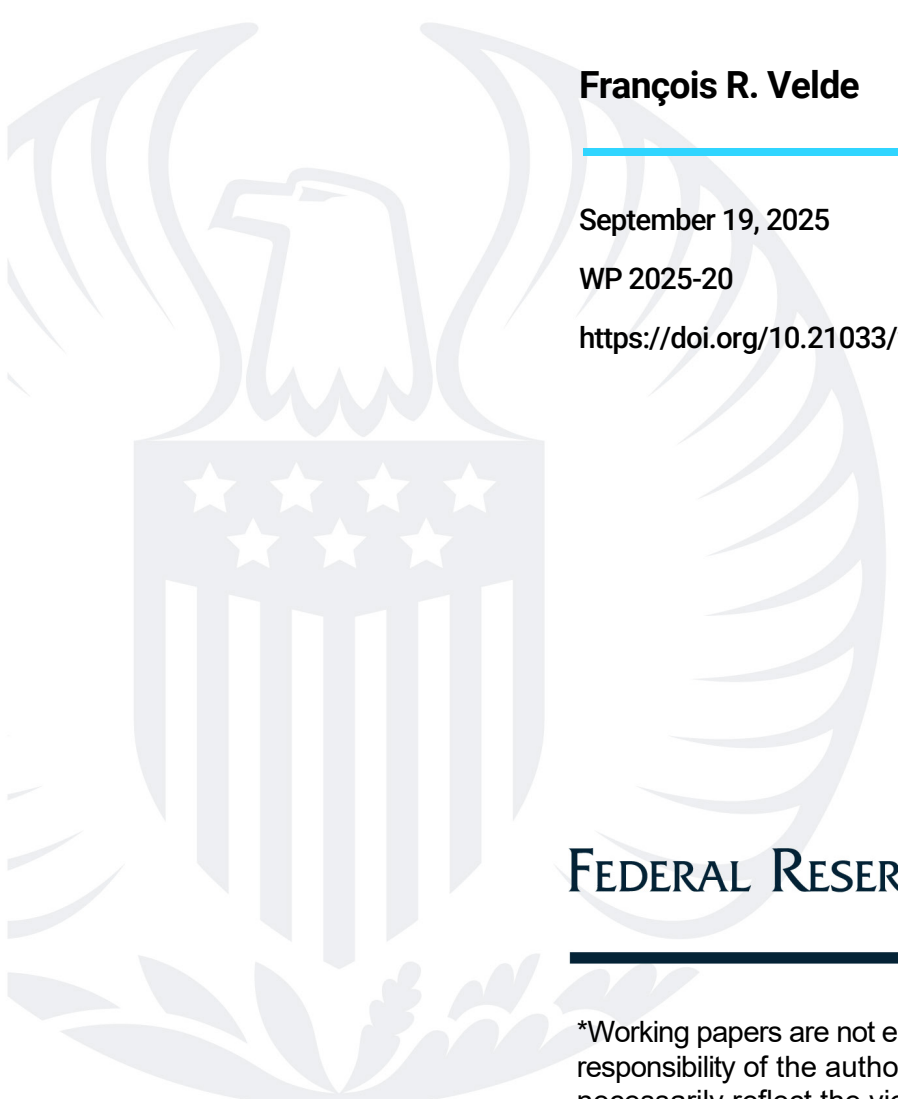
An Institutional Investor in 18th-Century Britain

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Abstract

Queen Anne's Bounty was a corporation created in 1704 to redistribute income within the Anglican clergy. Structurally a saver needing a liquid asset, the corporation pursued a conservative strategy of investing in the dominant form of government debt, adapting as the market changed. It was involved in the South Sea Bubble but only made losses and steered clear from corporate equity and bonds thereafter.

Keywords: South Sea bubble, British public debt, investors, Anglican church (JEL: N23).

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1 Introduction

This paper is a case study of an institutional investor in eighteenth century Britain.

Individual investors in eighteenth century Britain have been the object of a number of studies (Temin and Voth 2004; Carlos and Neal 2006; Carlos, Fletcher, and Neal 2015). One episode of particular interest is the South Sea Bubble of 1720, when rising prices tempted many investors to enter the market. Less is known about institutional investors, that is, investors who (albeit just as human as individual investors) had a planning horizon longer than an individual life, and had to fulfill a mandate.

The investor studied here was neither a wealth manager nor a savings vehicle, but an institution created to redistribute income from richer clergy to poorer clergy. However, being long-lived and patient naturally led it to redistribute to future as well as present clergy, hence to save. The institution therefore was an institutional investor.

It was not a large investor. The revenue it received was fixed in nominal terms, and small: about 0.3% of government revenues in 1714, 0.08% by 1793. By 1793, the peak of its portfolio in the eighteenth century, it owned 0.2% of the public funded debt (the same proportion of UK national debt today would amount to around £5bn).

The goal of the paper is to describe this investor's purpose and behavior, and reconstitute its portfolio and investment decisions over the period 1712–93. Attention is paid to the critical period of 1720, when many other investors were swept up by the South Sea bubble.

2 The Investor

The investor was called *Queen Anne's Bounty*, hereafter the Bounty.¹ Queen Anne established the corporation by letters patent of 1704 to implement the provisions of an act of the same year (2 & 3 Ann c.20). The Act intended to improve the living conditions of the poorest members of the Anglican clergy, and established the Bounty to carry out this intention. Until 1836, the Bounty was the only corporation owning property for the Anglican Church in general. It subsisted until it was merged into the Church Commissioners in 1948.

2.1 The Bounty's Purpose and Means

Since the Reformation and the abolition of regular orders in England, the Anglican clergy consisted mainly of parish priests who derived their income exclusively from sources within their parish: either tithes (taxes on the parishioners) or revenues from land parcels attached to the parish (the "glebe"). There was no mechanism for redistribution across parishes and income disparities had grown over time as some parishes became poorer and others grew wealthier Savidge (1955, 9). The Act created such a mechanism.

¹Its full name was "The Governors of the Bounty of Queen Anne for the Augmentation of the Maintenance of the poor Clergy." Its history is described in LeFanu (1933), Savidge (1955) for the period to 1736, and Best (1964). The archives are in Lambeth Palace Library (henceforth LPL), and the treasurers' books to 1793 are available online.

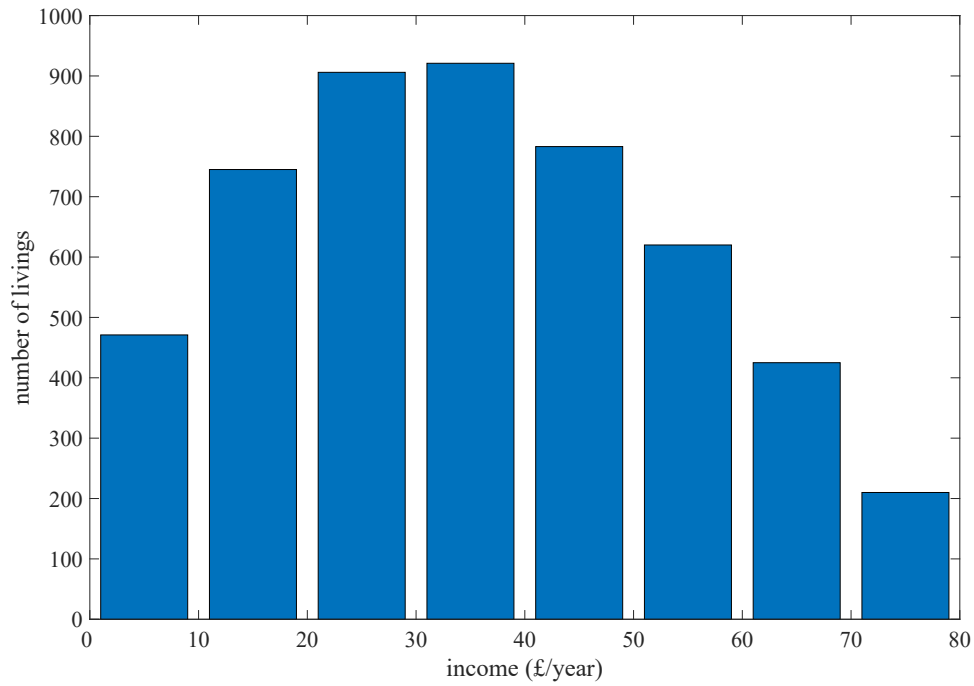


Figure 1: Number of livings below £80 per year in 1711, by income levels. The total number under £80 was 5082, the total above was 4098. Source: Ecton (1721, 249).

What counted as poor? Although the Act did not define what constituted poverty, it instructed the Bounty to gather information on parishes with annual incomes below £80: that category accounted for 55% of all parishes. Figure 1 shows the income distribution of clergy across parishes below £80 found by the inquiry. For reference, the median household income in England was £20 in 1688 (Lindert and Williamson 1982, Table 2), and 13% of all parishes fell below that level. The prospect of poverty discouraging vocations and diminishing the status of clergy were the reasons for the passage of the Act.

To fund the improvements, Queen Anne gave up the revenues of two taxes that had been levied by the Crown on the clergy since 1534 and used for general purposes.² Since these taxes were levied on the whole Anglican clergy except the poorest members,³ the Bounty was effectively a scheme to redistribute income within the Church, without additional burden on the laity. The Bounty's only other public source of income until the twentieth century was a sequence of annual £100,000 grants from Parliament between 1809 and 1820, outside the scope of this study.

2.2 The Governance

The corporation called "the Bounty" consisted of about two hundred and fifty individuals, called "governors." They all belonged to the Bounty *ex officio* and can be grouped in four classes: (a) members of the Privy Council, in other words the upper echelon of gov-

²The "tenth" was an annual income tax, the "first fruits" was a transfer tax levied upon appointment to a position and amounting to one year's income from that position. For our purposes the distinction between the two taxes is irrelevant. Both had been collected by the pope in medieval times and reassigned to the Crown by Henry VIII. An assessment of incomes across parishes was made in 1535 but was not updated thereafter.

³Livings with incomes below £50 were exempted from both taxes by an act of 1708.

ernment; (b) the upper Anglican clergy, namely bishops and deans; (c) senior judges and law officers; and (d) lords lieutenant, mayors and aldermen of various cities, representing local government. In practice, only a small number ever participated. A quorum for a meeting of governors (after the charter was modified in 1714) required the presence of (a) one of either first three groups, and (b) six other governors, of any group. One bishop and six other clerics were sufficient to meet the quorum, so that from the 1720s attendance by laymen was rare and by the mid-century only bishops met (Savidge 1955, 27–29, 64–70). In short, when I use the phrase “the governors” one should think of a group of about seven to ten bishops.

The corporation had three salaried officers: a secretary and a treasurer, both appointed by the Crown, and a solicitor chosen by the governors. As will be described below, after 1724 the financial operations were closely supervised by the governors and the officers had very limited authority.

2.3 Operating Rules

The charter of 1704 instructed the governors to devise rules of operation for implementing its redistributive mandate and submit them for approval to the crown, which was eventually done in 1714. The corporation made several choices which remained broadly unchanged until the twentieth century and determined its behavior as institutional investor.

Distribution

The first fundamental choice was the mode of distribution. The two options were (1) distribute each year’s revenues from the two taxes to the livings, or (2) invest them and transfer future returns on investment to the livings.⁴ The first course would immediately improve the condition of a large number of livings, but not all, because needs exceeded resources: from 1717 to 1814 the Bounty’s revenue from the two taxes averaged £14,200, enough perhaps to bring every living to a minimum of £25 but no higher. The second course allowed greater improvements for all benefice-holders in the future, at the expense of the current poor benefice-holders: the tradeoff was therefore between current and future generations.

As the simple model in the Appendix shows, the choice depended on the Corporation’s rate of time preference relative to the return on investment. A Church more patient than the market would prefer the investment path, which is what Rule 1 chosen by the Corporation stated: augmentations would be made “by the way of purchase, and not by the way of pension.” The rule was strictly followed until 1919 (LeFanu 1933, 35).

Every year the corporation selected grantees among eligible livings (in a way to be described shortly) and made capital grants out of its annual income, in standard amounts

⁴A *living* or *benefice* is an ecclesiastical office, usually a parish. The temporalities of a living are the assets, usually located within the parish, whose income represent the office holder’s remuneration.

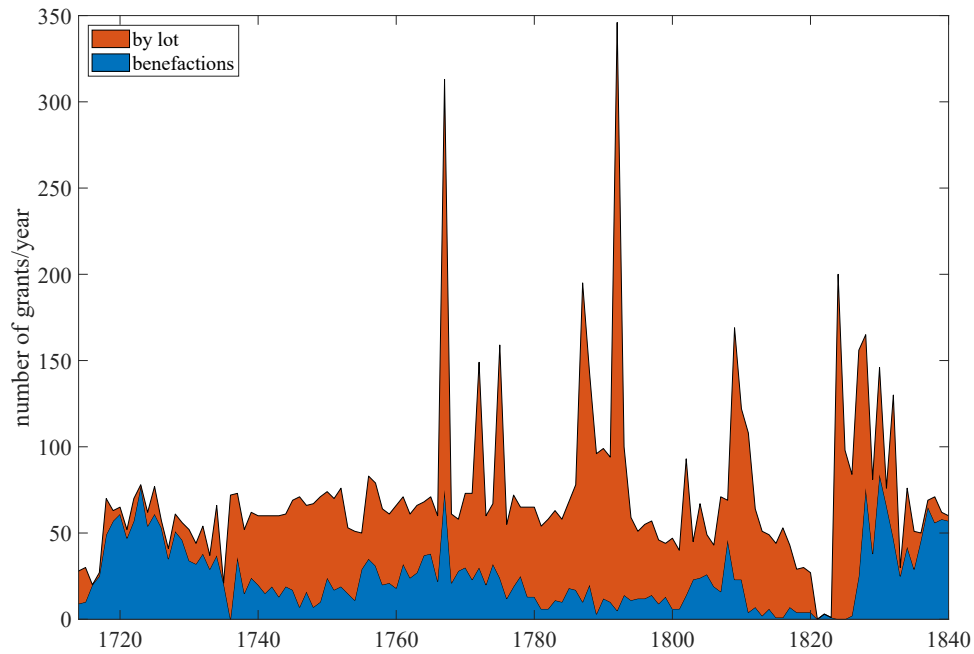


Figure 2: Number of grants by lot and by benefaction, 1714–1840. Source: Best (1964, 537–38).

of £200. To leverage private charity, the rules also provided that private gifts of £200 or more to augment specified livings would be matched by a grant of the Bounty.

Eligibility

The next design choice was to determine who would be in the running for grants each year. Based on the result of the inquiry described above, the governors decided to deal with livings below £10 at first, and move up the income distribution over time. The eligibility threshold was thus raised to £20 in 1747, £30 in 1788, £50 in 1810, and £60 in 1836 (LeFanu 1933, 39–40).

Private benefactions were encouraged by allowing a higher threshold for their recipients, £35 initially, and it was also raised over time.⁵ To maintain a priority for the poorest, however, at least two thirds of grants were made to the livings under the lower, general threshold.⁶

Every year, new private benefactions (if their intended recipient met the income threshold) were added to a waiting list. A meeting of the governors in December would select new grantees as follows. Benefactions at the top of the waiting list were matched with £200 grants from the Bounty up to the one-third limit, after which livings below the lower threshold were selected by lots until the year’s available income for grants was exhausted.⁷ Figure 2 shows the number of grants of each type over time. The total was 73 per year on average; benefactions were initially important because the limit on benefaction grants was

⁵It was raised to £50 in 1718, lowered back to £35 to 1736, then £45 in 1757, £50 in 1788, £60 in 1804, £80 in 1809, £120 in 1810, £150 in 1811, £200 in 1820. This meant, in particular, that benefactions might be held in reserve for a number of years until the required threshold reached the income of their intended recipient.

⁶This proportion was lowered to one third from 1718 to 1736 to encourage benefactions.

⁷Livings could only be drawn once, but reception of a private benefaction did not remove a living from the pool.

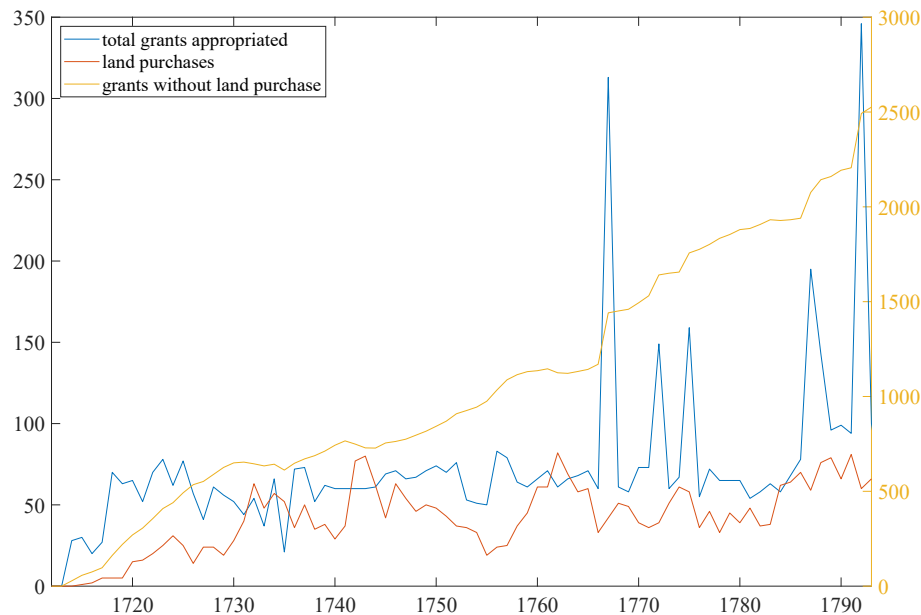


Figure 3: Grants appropriated, augmentations by land purchases, and grants remaining landless. Source: Best (1964, 537–8), treasurers' books (LPL, QAB/4/1/1 to 4).

raised to two thirds from 1718 to 1736, but fell later. In 1836 the limit was removed altogether and grants were henceforth exclusively of this kind.

The Use of Grants

The standard £200 grants (or £200 augmented with a benefaction of at least £200) were meant to buy land that would become part of the living's temporalities or assets. The land did need to be located within the parish but this was strongly preferred.

The Corporation paid all transaction costs, but finding suitable land in the first place was not easy: it had to be in or near the parish, worth about £200, and someone had to find it. In the meantime, the £200 remained in the hands of the Bounty, which paid an annual interest to the living at a rate set by the Governors and adjusted over time.

Figure 3 shows what I call landless grants, that is, appropriated grants (livings selected by lot or benefaction) not yet invested in land. Appropriated grants averaged 74 per year from 1714 to 1793 but land purchases only 43. The stock of landless grants consequently grew by 30 per year on average, and the Bounty had to find investments that would generate income for them, since it was paying interest until suitable land was found.

In short, The inelastic supply of suitable land at £200 is what made the Bounty an institutional investor.

2.4 Operations

The corporation's financial operations began in February 1709 when it received its first funds from the Exchequer, but for several years there was little left for the Bounty after prior claims on the taxes were satisfied. Collecting information on the eligible livings also

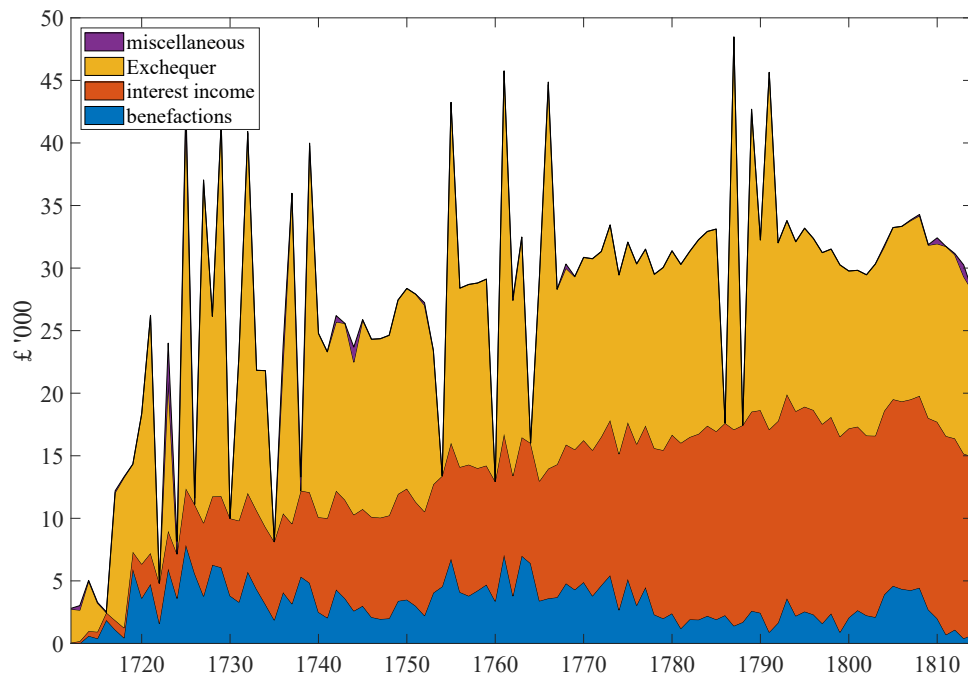


Figure 4: Revenues of the Bounty, 1708–1813. Source: LPL, QAB/4/1/1; *Parliamentary Papers*, 1802–03, VII.405 and 1814–15, XII.381; Best (1964, 537–38).

took time and delayed the first grants to 1714. Thereafter, the Bounty’s operations were quite straightforward, given the explanations provided above.

Revenues, shown in Figure 4, came from (a) the Exchequer, (b) private benefactions, (c) investment income, and (d) miscellaneous income. The principal source was the payment from the Exchequer, but it was at first highly variable and only became regular and reliable in the 1740s.⁸ Benefactions were not small but never determinant. Interest income grew over time in spite of the secular decline in interest rates, because the Bounty’s portfolio grew faster than the rate of return fell, as we shall see in more detail.

Expenditures, shown in Figure 5, comprised (a) salaries, fees, and operating expenses, (b) purchases of land, (c) interest paid to livings on existing grants. I count land purchases as expenditures because, once purchased, lands were out of the Bounty’s control and part of the recipient’s temporalities. Land purchases was the largest component but also the most variable, for reasons given above.

in Figure 6, I relate the stock of landless grants from Figure 3 with the expenditure on interest paid to landless grants from Figure 5, using the assumption that a grant corresponds to £200. The interest due and interest paid on landless grants track each other well, as expected. But interest income exceeds interest paid out after 1730. The reason, shown in Figure 7, is that the rate set by the Bounty’s governors to be paid to landless grants was markedly below the rate earned on the Bounty’s portfolio. This is not due to the need to pay for operational expenses: they averaged around £3150 in the decade 1784–93, much less than the gap visible in Figure 6.

⁸From the late 1720s the payments were made once a year in December, but occasionally payment was delayed into January, hence the variations in the 1760s and 1780s.

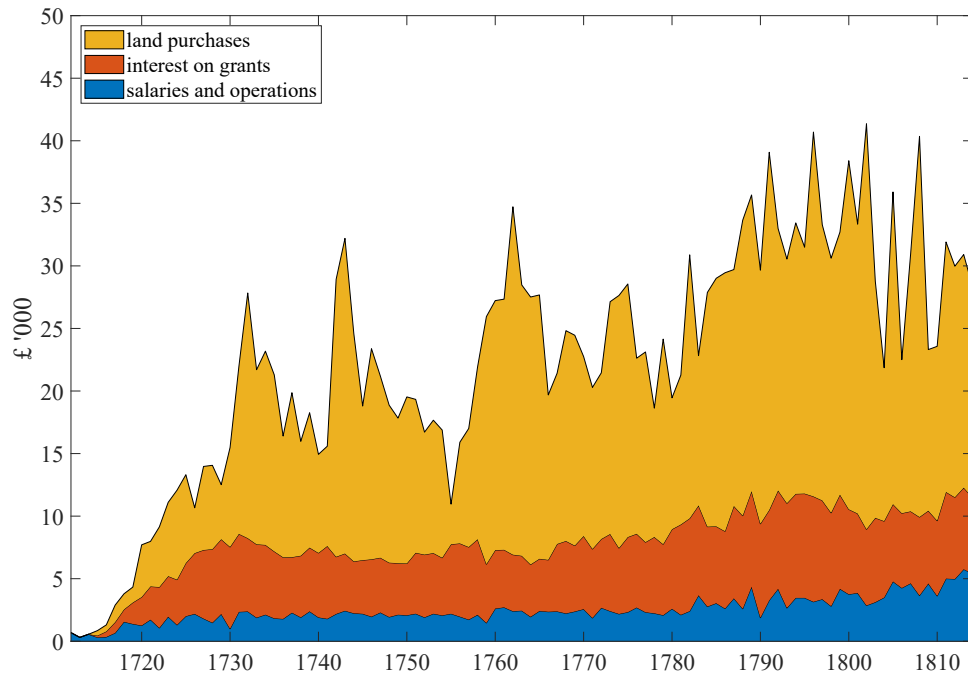


Figure 5: Expenditures of the Bounty, 1708–1813. Source: as for Figure 4.

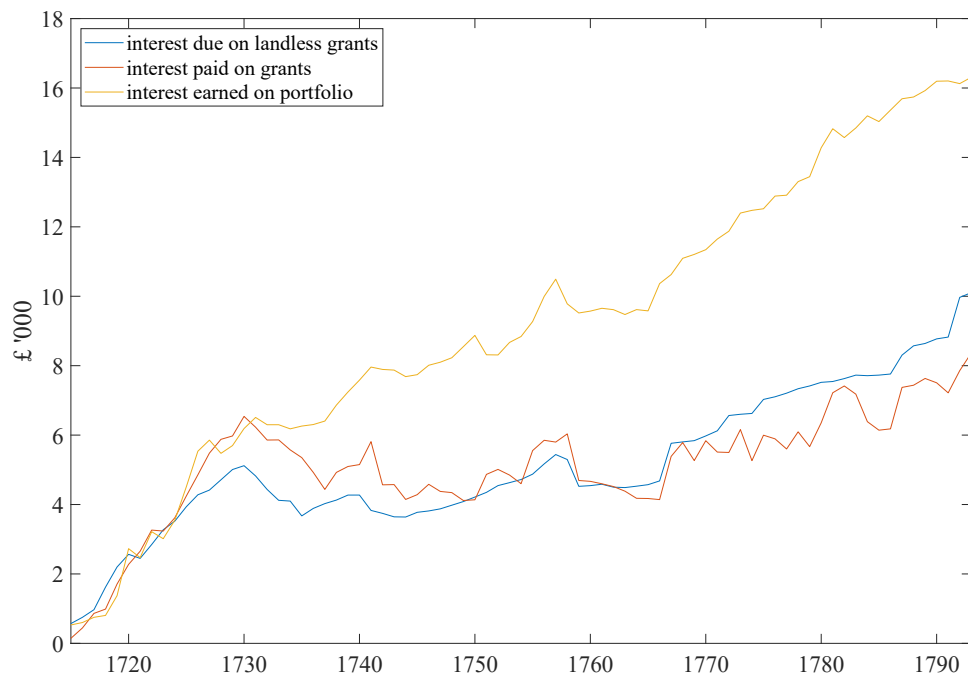


Figure 6: Interest due on grants, interest paid on grants, and interest income earned on the Bounty's portfolio.

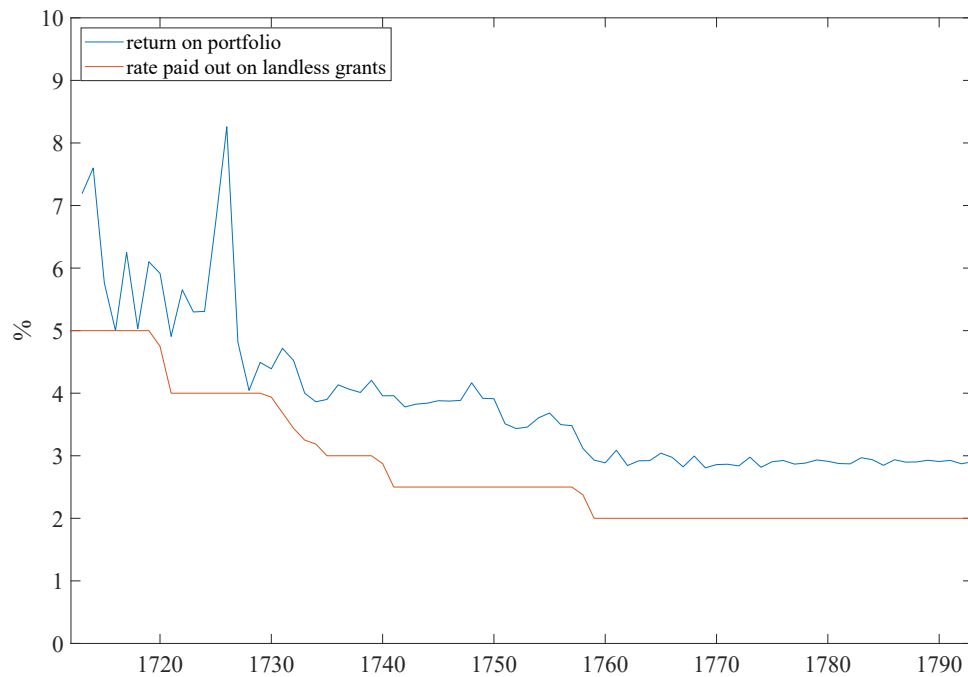


Figure 7: rate earned on the Bounty's portfolio (my calculations) and rate paid to landless grants (LeFanu 1933, 21–22).

3 The Bounty's Portfolio

How did the Bounty invest?

I first describe the sources and methods I used to construct the portfolio over time, then present my estimates and describe their evolution over time. The most complex period corresponds to the South Sea Bubble; the story is rather dull after 1730.

3.1 Sources

The surviving documents for the eighteenth century are the cash books of the successive treasurers from 1708 to 1793 (LPL, QAB 4/1/2 to 8) and a summary of the cash books for the period 1708 to 1776, from the beginning of the Bounty to the death of the second treasurer (QAB 4/1/1). In addition there is a register of benefactions (QAB 4/3/1/1) and the minutes of the governors (QAB/2/1).

3.2 Tracking the Investments

The accounting procedures changed between the first and the second treasurer, so that tracking the Bounty's portfolio requires a somewhat different approach.⁹ Before 1724, procedures were informal, and we have to rely on traces left by investment decisions in the receipts and expenditures: commission fees (on both sales and purchases), interest received on securities held, and interest paid on purchased bearer securities.¹⁰ As we

⁹Edward Barker (1671-1759) was treasurer from 1709 until March 1724, becoming secretary and in 1730 receiver of the First Fruits.

¹⁰For some securities, the buyer paid to the seller the interest accrued since the last coupon payment. Other securities' quoted prices included the accrued interest.

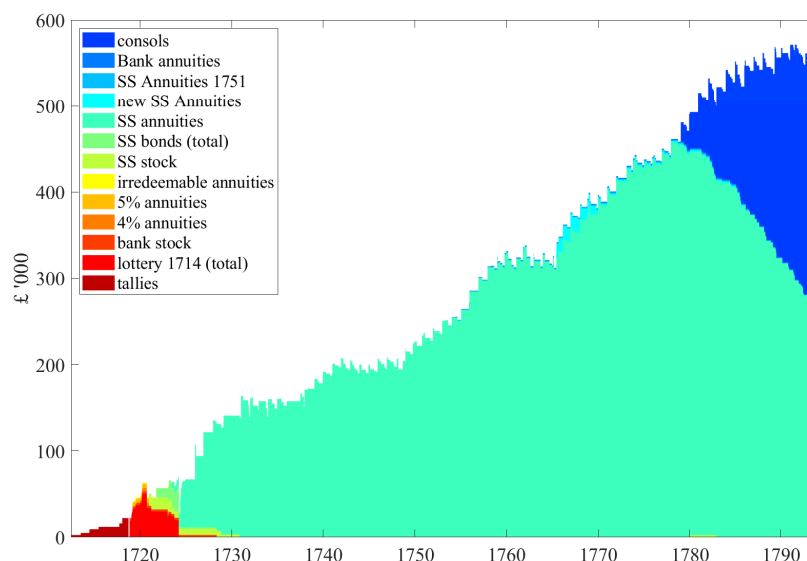


Figure 8: The Bounty's financial portfolio, daily, 1712–93.

will see, this leaves some uncertainty about the timing of portfolio changes and some guesses have to be made. After 1724, purchases or sales of securities were recorded as expenditures or receipts.¹¹ The cash balance therefore consisted only of cash, and the portfolio can be tracked through the recorded purchases and sales, and checked against the reported interest.

the minutes of the governors' meetings show that the securities were always held in the name of the corporation and that the Treasurer needed a power of attorney for every purchase or sale: such powers were authorized by the governors at their meetings and sealed by the archbishop of Canterbury as needed.

Purchases were made very soon after receiving the Bounty's annual payment from the Exchequer: the Treasurer notified the governors that the money was in the Exchequer, and the governors ordered him to collect it and invest it in specific securities. When the Treasurer expected to need funds, he acquainted the governors and they authorized specific amounts of sales. These formalities developed, some securities were taken out of the Treasurer's cash account and physically deposited in the Governors' iron chest. In such case purchases and sales were recorded as such and the security was taken out of the Treasurer's hands as well as his cash account. But some securities either remained in the hands of the Treasurer or, in the case of registered securities (stocks and annuities), were registered in his name. That part of the portfolio was implicitly part of the cash balance. When the Treasurer changed in 1724 after a lengthy audit, the securities in his name were detailed in the account book and transferred to the Governors' name, while the Treasurer transferred his cash balance to his successor. Thereafter purchases and sales were always recorded and the investment portfolio ceased to be part of the cash balance.

¹¹The purchases and sales were entered net of the commission fee, which was invariably $\frac{1}{8}\%$ for annuities and stocks and 0.05% for South Sea bonds.

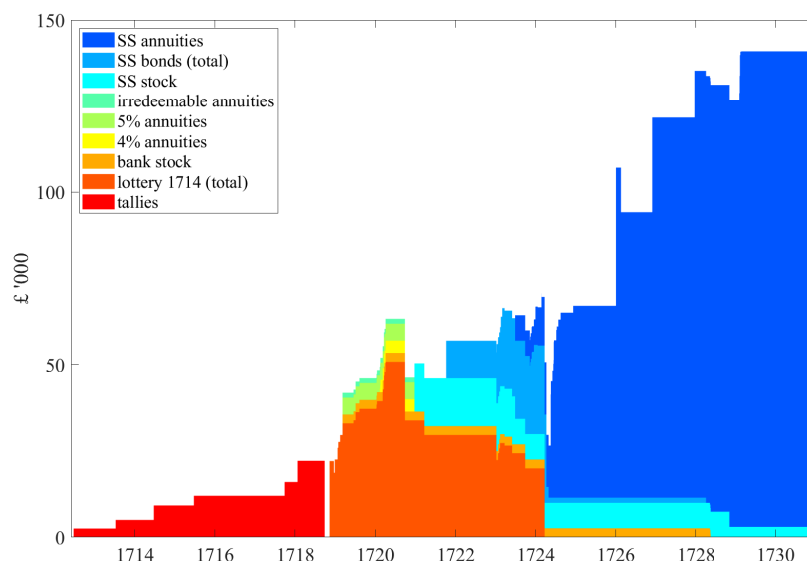


Figure 9: The Bounty's financial portfolio, daily, 1712–30.

Figure 8 shows the composition of the Bounty's portfolio from 1712 to 1793, and Figure 9 zooms in on the earlier period. The Bounty only held government-issued securities, except for South Sea stock and Bank of England stock in the early years.

3.3 First investments

The Bounty received funds from the Exchequer once or twice a year and needed to invest in relatively liquid securities so that it could make land purchases when the occasion arose, but yielding a good return so that it could pay interest to the livings.

For an investor in the early 18th century, the choices were limited.¹² There was an active financial market, but very few corporations were solid, liquid, and profitable. The Bank of England, founded in 1694 was one, the East India Company, formed in a merger in 1698, was another, both well-traded and high-yielding but perhaps of too recent origin. Long-term government debt, meanwhile, consisted of long-term annuities issued in the two recent wars, but they were not liquid. The only alternative was short-term debt, the so-called "tallies", were neither convenient for long-term investment nor very liquid, but they would have to do.

The governors on 14 June 1712 directed the Treasurer to invest the balance in hand "into the Exchequer upon the Land Tax or some other secure fund that bears a good interest."¹³ The first "improvement of monies held by the Treasurer" (investment income) appears in January 1713. The tallies in question yielded 5%. Only the total interest income is reported in the account books until 1717, after which amounts invested and duration of investment are also recorded. Using the same rate of interest for the earlier entries al-

¹²See Dickson (1967) for a classic and unsurpassed study.

¹³LPL, QAB/2/3/2/1, 14 Jun 1712, cited in Savidge (1955, 81).

lows to infer the average principal invested. For my portfolio reconstruction I have reconstructed the actual daily cash balance to choose plausible investment dates and quantities invested.

After Michaelmas¹⁴ 1718, the reported interest income always details the interest-bearing securities, so we have a clear picture of the portfolio at least every quarter.

3.4 The 1714 lottery investments

In the 1710s the options for investors grew. First, there were lottery loans, so called because a random draw soon after issue determined prizes, but after the draw a lottery ticket was just a bearer instrument yielding an annuity for a term of years. After a first experiment in 1694, lottery loans became a regular feature of British public finance until 1776 (Ewen 1932; Velde, n.d.). In 1715, the government issued £1m in 5% redeemable annuities transferable at the Bank of England's offices, hence their name of "Bank annuities." This was the first instance of the perpetual redeemable annuity (or consol) that would become the mainstay of British public finance. Other 4% redeemable annuities were issued in 1717 and 1718.

In January 1717 the Treasurer Barker made suggestions about investing the Bounty's growing cash pile. His proposal, to invest in the lotteries of 1711 and 1712, was debated and the governors opted instead to invest in "Bank annuity orders" and hold the purchased securities in an iron chest with three keys (one for the archbishop of Canterbury, one for the bishop of London, and one for the Treasurer). The occasion to do so arose later, when in July 1718 Barker reported that £12,000 was available in the Exchequer and the governors ordered him to withdraw it and "put it out to interest according to former orders made for the like purposes."¹⁵ The sum was collected on 21 October and quickly invested into the 1714 lottery; the first purchases were deposited in the iron chest on 22 Dec 1718.

The so-called Lottery of 1714 was a large loan (£1.4m) issued in the form of numbered tickets sold for £10 each. A lottery was held from January to April 1714: tickets that drew blanks (the vast majority) were entitled to 5% interest until repayment of the £10 principal. Tickets that drew prizes (so-called benefits) were entitled to a larger principal repayment, but only 4% interest. The repayment was scheduled to take place over a period of thirty-two years, and the course of payment for each ticket was determined by a second lottery. After these two draws, the tickets were exchanged for standing orders of payment at the Exchequer. Multiple tickets could be bundled into a single standing order (as long as they belonged to the same course of payment).

¹⁴Until 1752 the quarterly dates for payments of rents, annuities, interest, corporate dividends were Ladyday (March 25), Midsummer (June 25), Michaelmas (Sep 29), and Christmas. After the calendar reform, the dates were shifted by 11 days). The Bank of England, for example, paid dividends at Ladyday and Michaelmas while the South Sea Company paid at Midsummer and Christmas. The Crown's financial year started at Michaelmas, so annuity payments (if half-yearly) were usually due at Ladyday and Michaelmas. Until 1751 the calendar year started at Ladyday, I will use the notation 1 Jan 1717/18 to remove ambiguity. The Bounty's financial records started at Christmas.

¹⁵LPL, QAB/2/3/2/1, 9 Jan 1716/17, 7 Jul 1718.

The standing orders of the 1714 lottery were just two forms of small-denomination bonds, differing only by the interest they bore (5% for the blanks, 4% for the benefits). They were assignable and could therefore be bought and sold: their prices were recorded daily in the *Course of the Exchange* and in major newspapers.

Barker continued to make purchases at a steady rate and deposited another batch of orders in the iron chest in May 1719. He received the next Exchequer payment of £7,000 in June and invested it during the summer and in January 1720, likewise in 1714 lottery bonds.

3.5 The turbulent year 1720

The year 1720 was important because it marks the first diversification effort by the Bounty's Treasurer, and also the Bounty's investment into the South Sea Company. I first explain briefly what that Company was so that the Bounty's investment can be properly understood.

Corporate history of the South Sea Company (1)

The South Sea Company was founded in 1711 as a way for the government to pay unpaid bills accumulated by the Navy, the Army, and other branches of government during the War of Spanish Succession. The new Tory government decided to create a new company to deal with the problem rather than rely on the existing, presumably Whig, monied companies (the Bank of England and the East India Company). The scheme, however, was the same as the one used in the founding of those companies: to convert old debt or issue new debt in the form of an annuity to which some valuable commercial privilege was attached. This allowed the government to create revenues out of thin air (from the commercial privilege) and pay less interest by granting the privilege to those willing to lend. To exploit the privilege, the lenders were incorporated into a company. The South Sea Company's assets thus consisted of a government annuity paid to the Company, and the potential profits from the privilege. These two distinct assets must be kept in mind.

The South Sea Company's privilege was rather nebulous in 1711, as it consisted in a monopoly on trade with Spanish colonies in South America, at a time when Britain and Spain were at war. The treaty of Utrecht in 1713 made the privilege more concrete: the Company was allowed to sell up to 4,800 enslaved people per year for thirty years in Spanish South America (south of the Orinoco River on the Atlantic coast and anywhere up the Pacific coast), and send one 500-ton ship laden with goods free of taxes anywhere in Spanish America.

As events proved, the monopoly was unprofitable, largely because Britain and Spain were repeatedly at war: from 1718 to 1720, 1727 to 1729, and 1739 to 1748. Every war meant interrupted trade, confiscated ships, and long delays to settle claims. The South Sea Company was allowed to sell slaves in the British Caribbean as anyone else, but that was a highly competitive market in which it had no particular advantage.

Notwithstanding these weaknesses, the price of South Sea stock began to show a premium over the value of its first asset (the government annuity) from 1718. The premium became substantial enough that it seemed worthwhile to repeat the operation that founded the company, and convert outstanding debt into more South Sea shares. The premium might induce existing debtholders to accept an amount of shares that implied a lower annuity for the government. The details to work out were how to split the gains between the Company and the government.

The deal was sealed by a resolution of the House of Commons on 2 Feb 1720, although the bill only received royal assent on April 7. The basic principle was that holders of outstanding government debt would be offered a chance to turn their holdings into South Sea stock. At what rate? That was set neither by the Act nor by the subscription forms—amazingly, debtholders committed to exchange their debt for a price that would be decided later by the Company. The first subscription on April 28 admitted only holders of irredeemable debt, such as the long annuities issued before 1711; the second subscription on July 14 was open to redeemable annuities; the last on August 4 was open to irredeemables again and to the 1714 lottery standing orders. In addition, shares were also sold for cash at so-called “money subscriptions”: the fact that only a down-payment was required at time of issue incited much speculation and a booming secondary market, the famous South Sea Bubble.

The Bounty and the South Sea Company (2)

To be clear: all of the Bounty’s South Sea stock holdings originated in government debt held by the Bounty and exchanged for stock—none was bought at any of the money subscriptions or on the secondary market.

The debt that the Bounty’s Treasurer exchanged for South Sea stock had two origins. First, as explained above, the Treasurer followed a pattern of investing the payments from the Exchequer by steadily acquiring government debt and depositing large amounts once a year into the iron chest. By January 1720 he had £9,840 in 1714 lottery bonds in hand, and in the second week of February 1720 he purchased £3600 in 4% redeemable annuities. He received another £12,000 from the Exchequer in early March 1720 and immediately invested it between 11 March and 6 April in lottery 1714 annuities.

Second, the Bounty received in 1719 a generous legacy consisting of £2575 Bank of England stock, £3380 in Lottery 1714 annuities, £4900 in 5% lottery annuities, and two long-term irredeemables: a £45 annuity of 1710 (expiring in 1742) and a £30 annuity of 1706 (expiring in 1795).¹⁶ The 5% lottery annuities were redeemable annuities issued in 1717, so called because they were used to redeem the securities resulting from the 1711 and 1712 lottery loans. The Lottery 1714 annuity was the same one in which the Bounty

¹⁶Robert Osbolston, who owned the rights to collect tolls from the Foreland lighthouses, died in December 1715 and, by his will (NA, PROB 11/551/18) left the residue of his estate, net of some annuities to relatives, to the Greenwich Hospital and to the Bounty. It took a while to sort out matters, but the two institutions finally split the estate in April 1719. We know from the Bank of England’s ledger that the stock in his name was transferred on 11 March 1718/19 from Galfridus Walpole, Treasurer of Greenwich Hospital, to Edward Barker, Treasurer of the Bounty. The Treasurer’s accounts report interest income on the Osbolston securities from Michaelmas 1719.

was invested. All these securities, a rather typical portfolio, remained in the Treasurer's hands or name.

The rapid step-up in the Bounty's portfolio is visible in Figure 9, and certainly put the Bounty in a position to take advantage of the South Sea subscriptions.

The spring of 1720 was a heady period. From 1 February, the day before the resolution passed in the House of Commons, to 6 April, when the Bounty made its last purchase of government debt, the price of South Sea stock increased from 131 to 312. Which debts would be allowed when was not announced in advance, but one can easily imagine that the rising price led the Treasurer, like thousands of others, to expect further capital gains.

The 1723 Split between South Sea Stock and South Sea Annuities

From April to August 1720, various waves of subscribers were admitted to acquire South Sea stock, on different terms. In addition to the debt subscriptions mentioned above, which were the main objective of the operation, the Company also opened four money subscriptions, again at prices that tracked the market rate. As the bubble grew, the Company was able to acquire money or debt for fewer and fewer shares. Once the bubble burst in September 1720, subscribers bitterly regretted the terms they had accepted.

The terms were modified, first by a general court of the Company in September 1720, then by intervention of Parliament in August 1721 (7 Geo I st. 2). Both tended to rectify the grossest disparities, although not completely. The end result was that a very large part of the debt held by the public was now a debt owed to the South Sea Company, whose shareholders now included thousands of former shareholders. As before, the two assets of the Company were a government annuity and potential trade profits, but the size of the company was more than three times larger: the annuity had increased proportionately, but the trade profits had not, and were therefore severely diluted. Moreover the war of 1718–20 between Britain and Spain had suspended all trade and had already seriously dented prospects for future trade. As for the government annuity, part of the South Sea operation implied that it was now scheduled to fall from 5% to 4% in 1727.

The South Sea Company soon realized that a large part of its shareholders (the former debtholders) just wanted a bond-like security and nothing to do with its commercial ventures. Accordingly, at midsummer 1723 the stock was split in two (9 Geo 1 c. 6). Every shareholder who had £100 stock was henceforth owner of a £50 ("South Sea") annuity paying 5% until 1727 and 4% thereafter, redeemable at any time; and, in addition, owner of a £50 share in the South Sea Company. The government continued to owe a £100 annuity to the Company, but half was to be paid to the owners of South Sea Annuities and half to the owners of South Sea stock. Interest on the government annuity was received by the South Sea Company and paid out at South Sea House to both annuitants and shareholders. But only shareholders had any say in the management of the Company and any claim to its profits. Annuitants had nothing to do whatsoever with its commercial activities: the South Sea annuity was a government annuity paid at an office called "South Sea House." just as the Bank annuities (as all future consols) were not liabilities of the Bank of England, but government annuities paid at the Bank of England.

The South Sea annuity paid exactly the same interest rate as the government paid: 5% until 1727, 4% thereafter. The dividend on South Sea stock was decided by South Sea management. In practice, until 1727 the dividend paid out was 6%, higher than the annuity. Given that the trade activities remained unprofitable, the only way that the Company could pay out 1% more than the annuity it received was by issuing debt, something it could not do indefinitely while losing money on its trade.

South Sea bonds, mostly £100 one-year bearer bonds, became the way for the Company to finance the extra dividend, until it became clear that there were no future revenues to finance these high dividends. In 1732 the bond debt had reached £2m, and had to be paid down by paying dividends lower than the annuity. Again the stock was reduced, with “new South Sea annuities” replacing three quarters of the stock.

In 1740, with war against Spain resuming, the Company threw in the towel and admitted that it would never make any money off its trading business, aside from trying to force traders to pay for a license to trade with Spanish South America, an activity which never brought much income. The “trading stock,” much reduced by three fourths (the remainder constituting the “new” South Sea annuities of 1751), continued to exist but paid exactly the same as the annuities, until the Company was formally dissolved in 1853.

The Bounty and the South Sea Company (2)

What happened next for the Bounty is not perfectly clear because, as explained above, the securities that were turned into South Sea stock were part of the “cash balance” and the accounts are silent on the operations that were carried out with them. The minutes of the governors are also silent. We also know that the Treasurer’s accounts were not audited for several years. Hitherto a year’s account was audited within twelve months, and the year 1719 was audited on 2 Jan 1721. Then, no audits took place for more than two years. We only know that, in April 1723, the audit of the year 1721 listed the securities converted into South Sea stock, the resulting amount of the latter in the Bounty’s possession, and the resulting nominal loss.¹⁷

Nevertheless, knowing the securities involved and the terms on which they were converted into South Sea stock, it is possible to verify the loss stated in the accounts. The first two columns of Table 1 list the securities and amounts held in April 1720. The third computes the resulting amount of South Sea stock from the 1720 conversions and the Parliamentary additions of August 1721.¹⁸ The resulting losses, computed by the Treasurer as face value of original securities less face value of South Sea stock, is reported next.¹⁹ The final column reports the market values, taken from the *Course of the Exchange* for 11 Apr 1723.

¹⁷The years 1721–24 were not audited until after Barker was appointed to the position of Secretary, and it took a committee of governors several months and 14 meetings to go through the accounts (LPL, QAB/2/2/2/73). They signed off the 1721 account on 2 Nov 1724, the 1722 account on 7 Dec 1724, the 1723 account on 1 Mar 1724/25, and the 1724 account on 22 Mar 1724/25.

¹⁸The actual amount of South Sea stock reported in the Treasurer’s account is £13,907.

¹⁹Again, the numbers reported in the account are slightly different from my calculation: £9,513 and £5,306.

security	amount	South Sea stock	loss	market value (11 Apr 1723)
<i>Treasurer's purchases</i>				
1714 lottery	15,010			15,010
4% annuity	3,600			3,438
<i>total 1</i>	18,610	9,098	9,512	
<i>Osbolston's legacy</i>				
1714 lottery	3,380	1,652		3,380
5% annuity	4,900	2,396		4,925
1710 9% annuity	810	324		534
1706 annuity	1,020	433		600
<i>total 2</i>	10,110	4,806	5,304	
original portfolio				27,887
South Sea stock		13,904		14,321

Table 1: Securities converted into South Sea stock, nominal losses, and market values.

When the split into trading stock and pure annuities took place at midsummer 1723, the Bounty found itself with equal (nominal) amounts of both.²⁰

With respect to the stock, the Bounty remained completely passive, collecting the half-yearly dividends until it disposed of almost all its holding in November 1728, the remaining £180 was redeemed by Parliament in 1739 (3 Geo 2 c.16). The only other holding of South Sea stock came about through a legacy, made by Anne Weston in her will dated 6 May 1745. The stock, £2300 in value, was transferred to the Bounty in 1778 and sold on 19 Dec 1782.²¹

The Bounty held another South Sea security, namely bonds. The first purchase occurred right after the Exchequer's payment on October 3, 1721: the Treasurer invested bought £10,800 in 5% bonds, which were eventually deposited in the iron chest. The governors decided to make further investments in South Sea bonds, as they provided a convenient short-term investment yielding 5%.²² The peak investment was reached in January 1724, at £25,600. Then the bonds were repaid by the Company, and the governors decided to invest in South Sea Annuities.²³ Only £1500, which the governors had earlier decided to roll over at 4%, remained in the portfolio until it was sold on 14 April 1728.²⁴

After the 1723 split, the South Sea annuity became the Bounty's predominant and (once South Sea bonds were dropped) only form of active investment for 55 years. The reason, at least initially, is simple. There simply was no other form of liquid government debt available. The point of the South Sea conversion was to transform every publicly-held government debt into liabilities of the South Sea. As of 1723, the funded debt totalled 53.2m of which 12.6m was held by the Bank of England and the East India Company. The Bank annuities totalled 1.6m, and the rest was held by the South Sea Company for half. The remainder were the South Sea annuities. If the Bounty wished to invest in government funds, there was no choice.

²⁰The amount of stock £13,907, augmented by a 6.25% addition mandated by the statute, was split into £7,388 stock and £7,388.

²¹QAB/2/1/12, 112.

²²E.g., minutes of the governors, 3 Dec 1722 (LPL, QAB/2/1/2, 234).

²³Minutes of the governors, 6 Apr 1724 (LPL, QAB/2/1/2, 276).

²⁴Minutes of the governors, 3 Jun 1723 (LPL, QAB/2/1/2, 249).

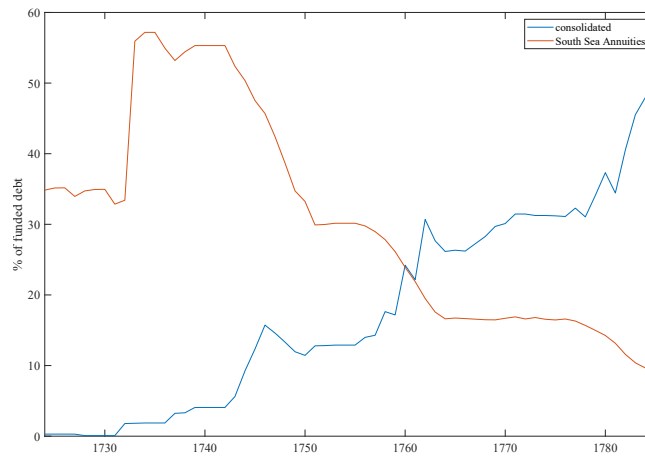


Figure 10: Share of South Sea annuities (old and new) and consolidated annuities in the total British debt, 1724–85. Source: *Return on National Debt 1857-58* (PP 443).

3.6 After the Bubble

As hinted earlier, the accounting procedures were rather informal until 1724, although from 1722 we see specific investment instructions in the minutes of the governors. Change really came with the change of Treasurer. When the secretary died in 1723 the governors nominated the Treasurer Edward Barker in his place. Although the audit of his books took months, the governors showed no dissatisfaction: indeed, they decided on a gratuity of £130 (in addition to his annual salary of £120) “for his extraordinary services.”²⁵

Nevertheless, with his successor the procedures became very tight. The treasurer announced that the Exchequer payment was available, and the directors ordered him to collect it and invest it in specific funds, for a long time in South Sea annuities.

With the War of Austrian succession new government funds became available, and while no new South Sea annuities were issued (the new South Sea annuities of 1751 not being a new issue), consolidated annuities at 3% (the famous “consols”) became the dominant form of government funds (Figure 10).

As Figure 8 shows, in 1778 the Bounty stopped investing in South Sea annuities and switched to the consols, progressively selling off its holdings of the former and increasing its holdings of the latter. The minutes of the governors in 1778 record a direction to the Treasurer to invest the annual Exchequer payment in consols, but there is no explanation for the decision.

4 The Bounty and the South Sea, assessed

Figure 11 shows the South Sea Company liabilities held by the Bounty, compared to its total portfolio, in levels and as percentages. During the year 1721 South Sea stock constituted 30% of the invested portfolio, and decreased in share thereafter. If we add the bonds, the total share of the portfolio reaches a peak of around 55% in mid-1723.

²⁵LPL, QAB/2/1/2, 312, 23 Mar 1724/25. Edward Barker stayed as secretary of the Bounty until 1730, then became receiver of the First Fruits and Tenth and in 1744 baron of the Exchequer. He died in 1753,

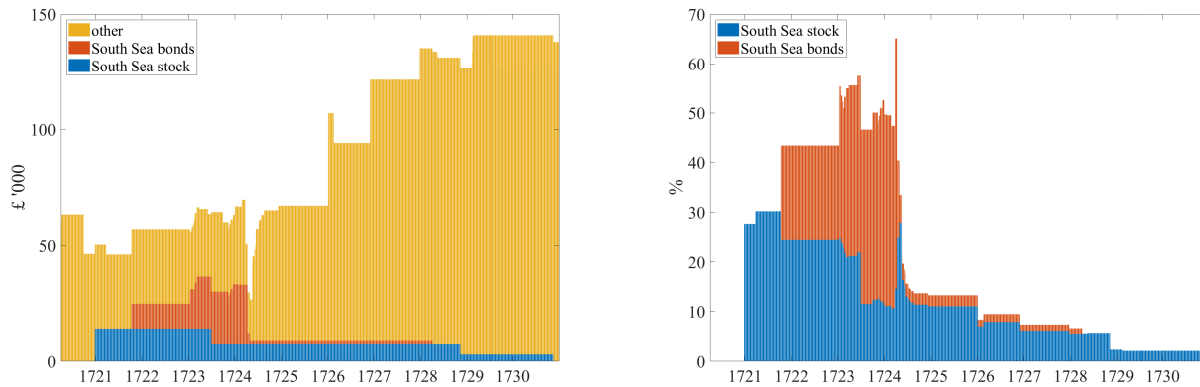


Figure 11: The Bounty's holdings of South Sea stock and South Sea bonds, compared with the total portfolio, in levels and percentages, 1720–30.

4.1 Did the Bounty gain from its South Sea holdings?

There are various ways to answer this question, depending on what one understands by “gain.”

One mechanical way is to trace out, or compute, the dividends and interest earned by the Bounty on South Sea stock and South Sea bonds. It bears repeating here that the “South Sea Annuities” were not liabilities of the South Sea Company, but government debt, hence they should not be and are not taken into consideration here.

From 1720 to 1728 the Bounty collected £4,200 in South Sea dividends and £2651 in South Sea bonds interest, for a total of £6,851: this was enough to make 34 grants, or about half a year's worth of grants. It is conceivably possible to find 34 grants made between 1720 and 1728, identify the corresponding parcels of land, and declare them to have been purchased with that money. It would not amount to a lot of real estate.

Did any of that money come from the slave trade? No, simply because the South Sea company never made any profits from the slave trade. Although we don't have the Company's books, we have a summary of the Company's income and expenditure flows from 1720 to 1732 (*Report of the Committee appointed to inspect and examine the Several Accounts of the South-Sea Company* 1733, 24–30) which show that the trade account had a negative balance. The dividends were paid by borrowing money in bonds, and the bonds were eventually repaid (in the 1730s) by reducing dividends on the stock, relative to the annuity that the government was paying to the Company.

There is an even simpler way of considering the question. Would the Bounty have been better off by keeping the government debt it held in April 1720 rather than exchanging it for South Sea stock? The answer is clear, from Table 1: the Bounty lost £13,500, or 14% of its portfolio of April 1720, a fact that the Treasurer stated plainly.

5 Conclusion

Queen Anne's Bounty was an institutional investor with a clear objective which dictated a specific investment policy. The Bounty started its investments in 1712, when British

capital markets were only beginning, and when government debt was still unsettled in many ways. Like many other investors, the Bounty appears to have been enticed into the South Sea conversion scheme, but after 1723, it followed a simple policy of investing all its income in the dominant form of government debt. Its involvement in the South Sea Company was financially costly, and within a few years it disposed of its equity and bond interests in the Company.

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Appendix

Time $t = 0, 1, \dots$ is discrete. A number N of livings can be augmented with 1 unit of income per period. The resources available are Y . Land providing a perpetual income of 1 can be purchased for a price x , the number of units purchased in each period is i_t and the stock of augmentations evolves as $B_{t+1} = B_t + i_t$, with B_0 given. The resources not used for land purchases $Y - xi_t$ are distributed to livings.

The corporation chooses a sequence $\{B_t\}_{t \geq 1}$ to maximize $\sum_{t=0}^{\infty} \beta^t (B_t + Y - x(B_{t+1} - B_t))$. The problem is linear so that the optimal policy is to set $i_t = 0$ (all pensions) if $\beta < x/(1+x)$ (if the corporation's time discount rate is higher than the return on land), $i_t = Y$ (all purchases) if $\beta > x/(1+x)$.