Personal finance in Jane Austen

Percents and sensibility

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What did early 19th-century literary characters live on?

“TEN thousand a year, and very likely more! 'Tis as good as a lord.” Mrs Bennet's reaction to her daughter Elizabeth's engagement to Mr Darcy is telling. “Pride and Prejudice”, like all of Jane Austen's books, is about sex and money. But Miss Austen's emphasis on each is different from that of today's chick-litterateurs. Her characters never touch, let alone kiss. And their wealth and income are at least as important in the calculus of courtship as personal tastes and sex appeal.

Miss Austen was neither mercenary nor a snob. She was a daughter of her times. At the turn of the 19th century, wealth merited much discussion. Landed wealth, which dominated the 18th century, was being supplanted by monied wealth, which came to dominate the 19th. Between 1796, when Miss Austen began “Pride and Prejudice”, and 1817, when she died while writing “Sanditon”, land and money (or “funds” as Miss Austen's peers called their investments) stood in rough and uncomfortable equality. In this shifting balance lay the foundations both of the Anglo-Saxon world's commercial prosperity and much of the drama and humour of Miss Austen's books.

Lady Denham, the doyenne of Sanditon, laid out the social order of the time:

> But heiresses are monstrous scarce! I don't think we have had an heiress here, or even a co-heiress, since Sanditon became a public place. Families come after families, but as far as I can learn, it is not one in an hundred of them that have any real property, landed or funded—an income perhaps, but

> no property. Clergymen maybe, or lawyers from town, or half-pay officers, or widows with only a jointure. And what good can such people do anybody?

There is bitter humour in Lady Denham's dismissal of her author's own class. As the daughter of a clergyman, who spent her later years living on the generosity of relatives, Miss Austen knew all too well that wealth was the only real source of security.

Where did that wealth come from? The answer lies in the combination of Britain's growing commercial riches and its government's continuing poverty. There was really only one kind of investment from the South Sea Bubble of 1720 to the railway boom of the 1840s: government debt. British government debt was the only security traded on the Stock Exchange at its foundation in 1801, and remained so until 1822. Thanks to luck and skill, the government managed to finance a century's worth of horrendously expensive wars in a way that not only did not cripple commerce but mobilised commercial resources for new challenges.

The key piece of skill was the mechanism of “funding” that secured interest payments. When William and Mary re-established the Protestant monarchy in 1688, Parliament wanted both to shore up the royal finances and establish its control over them. Funded borrowing did both. Parliament passed taxes sufficient to pay interest on a certain amount of debt—just over £1m in the first instance—then tacked on a bit more tax to pay down the principal gradually. The monarch could borrow against this “funded” amount fairly easily, but found it hard to borrow more, which gave British debt unparalleled stability. In 1715-70 France reneged on the terms of its debt five times; Britain never missed an interest payment.

The big piece of luck was the South Sea Bubble. In order to issue debt more cheaply, the government hit upon the wheeze of tying debt issues to the grant of trading privileges, which cost it nothing but persuaded investors to part with their money at a lower rate of interest. In 1693 the going rate on government debt was 14%. In 1698 the East India Company was prevailed upon to lend £2m at a rate of 8% in return for an extension of trading privileges. This understandably appealed to ministers. In 1711, the government raised a further £10m from the South Sea Company in return for exclusive trading rights to Spanish South America. Finally, in 1719, the South Sea Company proposed to take over the finance of the entire national debt. The government agreed.

Fortunately for posterity, the directors of the South Sea Company were greedy and incompetent. They promptly began talking up the price of their shares with inflated estimates of the value of their trading and financing rights, which helped to fuel a dotcom-style speculative bubble. After the bust, the government went off the idea of entrusting its finances to a single company. So it set about devising securities that could sell into a broader market.

Early flirtations with lotteries and annuities were generally disappointing. So were “tontines”, a sort of group annuity in which many paid into a general pot, and the last few survivors split the income. What did sell, hesitantly at first, were bonds—albeit ones which were often sweetened with “douceurs” like a lottery ticket or two.

The government consoles itself

In 1751 Henry Pelham's Whig government pulled together the lessons learnt on bonds to create the security of the century: the 3% consol. This took its name from the fact that it paid 3% on a £100 par value and consolidated the terms of a variety of previous issues. The consols had no maturity; in theory they would keep paying £3 a year forever.

Between 1751, when the funded national debt was only a tad over £70m, and 1801, when it climbed over £450m, the government issued £315m of consols. Lord North particularly liked them because they carried a low nominal interest rate. He argued that lower rates were better because "it was the interest that the people were burdened with the paying of and not the capital." That said, Lord North issued new consols at £60 or so, to create a 5% interest rate. Why he thought a discounted 3% bond was better value than a 5% bond sold at par is unclear.

William Pitt the Younger, however, discovered the downside of discounted bonds when he tried to reduce the national debt during the lull between the American war and the Napoleonic wars. In theory, the consols could be redeemed by the government at their par value of £100. In practice, doing so would have given a windfall to bondholders: nearly double their capital as well as interest payments. Pitt instead created a sinking fund, using tax revenue to buy back bonds in the market.

The sinking fund continued in operation through the Napoleonic wars, though in an increasingly bizarre fashion. By the end of the wars, the government was borrowing all of the money for the fund from the same markets that the fund bought from, in the deluded belief that reinvesting the interest on the bonds held by the fund would yield compound returns sufficient to pay off the whole of the national debt.

Clearly, the financial markets of Jane Austen's time were not sophisticated. But they were robust. There were no alternatives to easily tradeable, interest-bearing securities, and lots of people wanted them. Merchants put spare cash into the funds, which, as they would not otherwise have earned interest on the money, boosted their profits and competitiveness. Some landowners traded back and forth between funds and land in search of better returns. Others saw the funds as a new way to maintain their wealth without farming.

From a speculator's point of view, this was a lively market. The fact that early bonds had no fixed maturity date ensured that any change in interest rate was fully reflected in the capital value of the bond. Rates, in turn, fluctuated in response to foreign affairs in general and military ones in particular. When the British won a battle, investors anticipated the day that the government would stop issuing new bonds and turn to buying old ones via the sinking fund. Rates fell and values rose. When British forces lost, investors anticipated new issues coming to market, and the opposite happened. Compounding these movements were poor communications: nobody really knew what was going on in the wars.

One officer rushed from Portsmouth to London with forged dispatches proclaiming the fall of Paris and the rout of Napoleon, while at the coffee houses his confederates sold into the rising market and netted about £10,000. Even with full information, early markets did not always do what a modern trader would expect. In theory, the prices of various securities should have converged around a general market interest rate. Not so in fact. William Fairman of Royal Exchange Assurance noted that “the very great disparity between the current prices of different funds evidently shows that exact observers among the monied men are not numerous”. There was also a persistent fear that the government might have so over-extended itself with debt that a general failure of markets was inevitable.

The despairing and the hopeful, the greedy and those simply too lazy to farm all converged on coffee houses near the Royal Exchange to do business. Thomas Mortimer described the scene in “Every Man his own Broker, or, a Guide to Exchange Alley”:

> it consists of a medley of news, quarrels, prices of different funds, calling of names, adjusting of accounts, etc, etc continually circulating in an intermixed chaos of confusion.

While trading in the coffee houses was open to all, a booming industry of brokers and bankers arose to serve those who did not wish to brave the hubbub in person. Jane Austen's favourite brother, Henry, started his own bank, though after it failed he reverted to the family business and became a clergyman. In 1801, the Stock Exchange was founded as a members-only institution intended to bring some order to the markets—and in particular to ban from membership those who reneged on their deals.

By the end of the Napoleonic wars in 1815, the debts of the British government reached £745m. But instead of calamity and national bankruptcy, the rise in debt simply brought a hunger for more investments. As the government itself stopped issuing new bonds, and started retiring old ones through the sinking fund, investors turned first to foreign-government securities in the 1820s and then to shares in the new, capital-intensive companies, such as railroads, leading the industrialisation of the 19th century. Both markets were highly speculative, to say the least. Foreign-government debt included bonds from one entirely fictitious country, Poyais, and most of the new industrial ventures failed.

By then markets were big enough to absorb the bumps, and their growth has supported a cornucopia of prosperity ever since. Still, one shortage noted by Jane Austen in “Mansfield Park” arguably remains: “there certainly are not so many men of large fortune in the world, as there are pretty women to deserve them.”