Economics

The Tulip Mania

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Abby Wincey is interested in economics, analysing problems that our world faces on a day to day basis, such as poverty and homelessness. Economics strives to find solutions to such inequities.

When analysing times of great volatility in markets and economies, manias and their subsequent crashes are useful analogies for consideration. Conceptually, manias can be regarded as sparking speculative bubbles during periods of 'irrational exuberance', a term coined by Alan Greenspan who was Chairman of the USA Federal Reserve. This refers to widespread market optimism in asset prices, driving asset prices upwards and inflating them to a height that can only lead to the market bursting, hence the synonymous term to manias: 'economic bubbles'.

The Dutch tulip bulb market bubble, also known as 'tulipmania', was one of the most famous market bubbles and crashes of all time, and is instrumental in displaying similar characteristics to the UK and US economies in 19th century and 20th century, particularly in its origin. Tulipmania occurred in Holland during the mid 1600s, when speculation drove the value of tulip bulbs to extremes. Though it may seem difficult to draw parallels between recent manias, such as the 2008 Financial Crash and a 17th century mania caused by the sky-rocketing price of tulips in Western Europe, 'tulipmania' is generally regarded as the world's first recorded speculative bubble. By unravelling its history, 'tulipmania' provides a foundational understanding of 20th and 21st century manias.

It was during the Dutch Golden Age that Ogier de Busbecq, the ambassador of Ferdinand I, first distributed the tulip seeds that reached extraordinarily high price levels which would eventually collapse. The Dutch Republic's economic and financial system at this point were, at the time, the most advanced and sophisticated in history. It was responsible for many pioneering innovations in the economic, business and financial history of the world, hence acclaiming this era as the 'Golden Age'. Alongside other tradable goods entering the European market, such as potatoes, peppers and tomatoes, tulip bulbs were also becoming increasingly popular. One of the main reasons for this was their ability to tolerate harsher climate conditions that must be endured in the Netherlands. Their unique colour also contributed to their popularity: the intense, saturated petals were perceived as status symbols, coinciding with the rise of newly-independent Holland's trade fortunes, which had been unshackled from the rule of the Spanish.

Consequently, the tulips rapidly became a coveted luxury item. In particular, the rare 'Bizarden' tulips were sought after the most; their multi-color flame-like streaks on the petal made them appear strikingly vivid and exotic. Unsurprisingly, this particular bulb became a luxury item for the wealthy middle and upper classes of Dutch Society, where "it was deemed a proof of bad taste in any man of fortune to be without a collection of [tulips]". Its unique variation in colour was a catalyst for increased demand in rare, "broken-bulb" tulips, which was what ultimately led to the high market price. When supply is limited and demand is strong, prices are driven up; the same mechanism can be applied in the case of these tulips.

As the tulips grew in popularity, professional growers paid increasingly high prices for the Bizarden tulip bulbs. In 1634, as a result of demand from the French, tulipmania swept through the Dutch Economy with speculators beginning to enter the market. A single bulb was valued at 4,000-5,000 florins, which, by modern-day comparison, is equivalent to $750,000 and upwards. That same year, the Dutch created a variation of a formal futures market, where contracts to buy bulbs at the end of the season were bought and sold. By 1636, this expanded and relocated to the 'Stock Exchange of Amsterdam' in Rotterdam, Harlaem.

The economy was growing and flourishing: professional traders joined the bandwagon, and other speculators appeared to be making money simply by possessing these rare red and white striped bulbs. By 1936, the tulip bulb became the fourth leading export product of the Netherlands, after gin, herrings, and cheese, purely as a result of the speculation surrounding the future of tulips.

However, this triumph was short-lived. By the end of the year 1637, prices began to fall. The bubble had burst. Reportedly, bulb contracts were changing hands around ten times in a day, making deliveries to fulfil any of these contracts hardly possible. Like in many modern day manias, speculative buyers 'panic-sold' many of their tulips. The holders of the bulbs were forced to liquidate their former 'assets', selling at prices as low as a quarter of their initial investment. By 1638, tulip bulb prices had fallen, reflecting their true value and devoid of their aristocratic pretence.

The tulipmania is, therefore, often cited as a classic example of a financial bubble. When the price of something goes up, it continues to increase with a large group of people hoping to buy it and sell it again at a profit. In the case of the tulips, spending as much as $500,000 in 1634 would have been considered a rational investment. Since everyone had followed this trajectory, it had enacted the 'greater fool' theory. However, in February 1637, tulip traders could no longer find new buyers to willingly pay increasingly inflated prices for their bulbs. As this realization hit, the demand for tulips collapsed, causing prices to fall drastically, and bursting the bubble.

The tulip mania can now serve as a parable for the pitfalls of excessive greed and unfounded speculation. The historian Anne Goldgar argues that the Dutch economy has faced much trauma from the bursting of the tulip bubble, and its financial crisis was felt among a considerably large group of people. It is a story that has been incorporated into the public discourse as a moral lesson, where pursuing greed is unworthwhile and dangerous. In the context of previous and modern-day bubbles, such as the 2008 Financial Crisis and Dot Com Bubble, parallels can be drawn, where speculative buying and excessive optimism can lead to a damaging downfall.

For references, click here.