

## **CURRENT SCHOLARSHIP**

# **Bagehot's Giant Bubble Failure**

**Author: Andrew Odlyzko**

Walter Bagehot is remembered today primarily as a proponent of the doctrine of lender of last resort, in which central banks pump money into the economy to ameliorate the damage from a financial crisis. But none of the growing number of publications about him appear to investigate in depth whether, as the editor of "The Economist," he warned his readers about the bubble that collapsed in the famous Overend crash of 1866. This paper shows that while Bagehot did express serious misgivings about that bubble in its early stages, he did not understand just how large it was, and he did not succeed in penetrating the depths of "financial engineering" that concealed the ugly reality that led to the crisis. Since none of the other prominent observers of the time appear to have done better, this may not have been a giant failure, but it was a failure to identify a giant bubble. It suggests we should not expect regulators to be able to detect bubbles in the future.

Odlyzko, Andrew, Bagehot's Giant Bubble Failure (August 30, 2019). Available at SSRN: <https://ssrn.com/abstract=3445450> or <http://dx.doi.org/10.2139/ssrn.3445450>