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Have Financial Follies Changed since Walter Bagehot's Day?
Remarks at the American Enterprise Institute Conference
"The Life and Times of Walter Bagehot: A Discussion with James Grant"
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Among everything you might read in the realm of finance, there is nothing more enjoyable than reading Jim Grant, with his sparkling mixture of ideas, research and wit—except perhaps reading the great Walter Bagehot himself, with his wonderful Victorian rhetoric. Now we have Jim Grant writing on Walter Bagehot—a terrific combination. I have had the pleasure of reading several chapters from this new book in process.

Of course, Jim finds striking quotations from Bagehot, sometimes from surprising sources. For example, in a letter to his fiancée, Eliza Wilson, written during the financial panic of 1857, Jim has found what Bagehot observed about the "nature of financial faith."

> *All banking rests on credit and credit is rather a superstition. At any rate it is adopted not from distinct evidence but from habit, usage and local custom.*

That is why it is true that, as Bagehot later wrote in *Lombard Street*, "(e)very banker knows that if he has to prove he is worthy of credit … in fact his credit is gone."

When the 1857 panic was over, Bagehot wrote Eliza from London:

> *The last few times I have been here everybody was on their knees asking for money, now you have to go on your knees to ask people to take it.*

"Few better observations of the cycles of bankerly feast and famine have ever been written," says Jim, continuing: "Historians of economic thought may make of it what they will that the passages formed part of Bagehot's love letters" to Eliza!

I'm not sure what to make of that, either.

Credit expansion replaced panic, and proceeding to the 1860s, Jim relates, "Financiers reconsidered the field of opportunity. They found it to be bigger and more alluring than before," just as their successors did in the 1970s, 1980s, 1990s, 2000s and 2010s. Continuing Jim's text:

> *The British government borrowed at 3% with the assurance of absolute safety. The Turkish government, with no such assurance, willingly paid 12% to 15%; the Egyptian government, 8% to 9%; the government of the Confederate States of America [this is in the 1860s, remember] 7% along with an option on the price of cotton.*

This international credit expansion, like others, led ultimately to defaults and losses. Need we add that today we are once again experiencing stresses in emerging market debts?

The mention of the bonds of the Confederate States of America should remind us of Pollock's Law of War Finance, which is: Do not lend to the side that is going to lose. By 1865, it was clear that the holders of Confederate bonds were out of luck. The next year, 1866, brought the infamous collapse of the previously prestigious and unquestioned financial firm of Overend, Gurney & Co. in London. As Overend was going down, we learn from Jim's text:

> *Their only recourse was to the Bank of England. Would the Old Lady Bank extend a helping hand? The Bank dispatched a three-man team to inspect the supplicant's books. The verdict was negative—[Overend] was insolvent—and the Bank declined to assist. The heretofore unimaginable occurred. Overend, Gurney closed its doors. The ensuing panic exhausted the descriptive powers of the financial press.*

The formerly famous insolvent bank as supplicant to the central bank; this may sound too familiar.

"In the aftermath of the failure of Overend, Gurney," Jim writes, "investors in foreign bonds arrived in force … In the dull, post-panic British economy, savers strained to earn more than the 3 ¼% available on British government bonds. Risky borrowers, arm-in-arm with their opportunistic bankers, stepped forward to fill the void." But "Bagehot anticipated the consequences of the coming overseas bond bubble."

In the 1870s, Jim continues:

> *Egypt, then a semi-autonomous province of the Turkish, or Ottoman, Empire, was one such seeker of funds. In the case of Egypt, not even the Egyptian government had the [financial] figures.*

We may instructively note, much more recently, that neither did, nor does, the government of Puerto Rico, the largest municipal insolvency in history, have its financial figures straight. Nor did the biggest municipal insolvency of its time, the government of New York City, a generation ago and a century after Bagehot was writing on Egypt. But in none of these cases did it stop the investors from sending in their money on faith.

So Bagehot acutely described the financial adventures, mistakes, and foibles of his day, which were a lot like those of our day. Jim draws a further key conclusion about his subject's character:

> *Bagehot stood up for the ideal of personal responsibility in financial dealings.*

May we all.

We are certainly looking forward to reading the whole of Jim's new book on Bagehot's life, ideas, controversies and times.